R·W·M

RICE, WALTHER & MOSLEY LLP

Attorneys and Counselors at Law

Brian F. Rice • Ann E. Walther* • Alana M. Mosley

*MSBA Certified Labor and Employment Law Specialist

Revised March 2, 2021
Via Email

Sen. Julie Rosen
Chair, Legislative Commission on Pensions and Retirement
2113 Minnesota Senate Bldg.
St. Paul, MN 55155

RE: Comments on the Report on the LCPR Study of Post-Retirement Adjustments (COLAs)

Dear Chair Rosen:

I represent the Minnesota Police Fraternal Association ("MPFA"). The MPFA is an organization that represents over 800 retired police officers and surviving spouses who are members of the PERA Police and Fire Plan ("PERA P/F").

The Legislative Commission on Pensions and Retirement's ("LCPR") Report on the Study on Post-retirement Adjustments ("COLA Study") provides considerable useful information to the LCPR on this very important issue. Your staff should be commended for the amount of time and effort they have put into this matter. I am writing to emphasize how very important the issue of COLAs is to the over 10,000 service retirees, disabilitants and surviving spouses who are members of the PERA P/F fund.

Retirees in PERA P/F are "basic plan" members. This means they do not receive Social Security. Their pensions are not coordinated with Social Security and they do not receive automatic COLA increases. This means their retirement income security is in your hands.

Over the next few years the LCPR may face no bigger issue than how to deal with COLAs for public pension retirees.

According to the Report, a retired, disabled, or surviving spouse member of the PERA P/F who was receiving a pension in 2011 would see a decline of 30% in the pension by 2041. Essentially, this cohort is falling behind to inflation 1% each year of retirement. (See, Page 32, Figure 16 in the Report.) That has enormous implications for those retirees and their families.

In the last decade there were major pension reform bills in 2010, 2013 and 2018. In each piece of legislation, PERA P/F plan members stepped up by reducing COLAs, increasing contributions or accepting benefit reductions. Throughout that decade retirees sacrificed the most to keep the pension well-funded.

10 Second Street Northeast • Suite 206 • Minneapolis, Minnesota 55413
Phone (612) 676-2300 • Fax (612) 676-2319 • www.ricewalther.com

The COLA Study notes at page 15 that the savings due to the reduction post-retirement COLAs in the 2018 Pension Reform Act amounted to a $3.6 billion reduction from all public service retirees. While the 2018 legislation was a "shared sacrifice" effort the largest sacrifice was made by the retirees.

In December 2020, the National Association of State Retirement Administrators ("NASRA") issued an update on state and local government spending on public employee retirement systems. Nationwide, state and local government spending on pensions amounted to 5.2% of direct general spending in Fiscal Year 2018. (See Attached NASRA Report.) https://www.nasra.org/content.asp?admin=Y&contentid=116

In Minnesota, we spent 2.3% based in Fiscal Year 2018 expenditures on pensions. In the NASRA report Minnesota ranks 47th of the 50 states in spending under this metric. Only the states of Wisconsin, South Dakota, and Wyoming spent less as a percent of their state and local government spending than Minnesota on pensions. This is quite shocking. (Note: NASRA's most recent report does not account for the significant new funding the state authorized in the 2018 pension legislation. Undoubtedly, Minnesota's spending percentage will increase, whether it will change our ranking remains to be seen.)

Last September, NASRA also updated its report on employee contributions to public employee pension plans. (See Attached NASRA Issue Brief, Employee Contribution to Public Pension Plans.) https://www.nasra.org/content.asp?contentid=122

Nationwide, for employees that are coordinated with social security, employees on average contribute 6% of salaries in Fiscal Year 2019 according to the report. Every employee group in Minnesota contributes at least 6% of their salary to pensions with MSRS employees contributing the lowest at 6%, PERA General employees' contributions are at 6.5% and Teachers contribute at 7.5%. So, Minnesota employees are contributing at least as much and in most cases more than the national average to their pension.

We have been fortunate, as indicated in testimony two weeks ago, that the State Board of Investment ("SBI") has been a top performer in the country on investment rates of return. The SBI regularly ranks in the top quarter and even top tenth of their investment returns compared to their peers. The SBI has done its share in terms of earning its investment return. What is clear is that who has not been making their fair share of contributions is state and local units of government. Unfortunately, it appears that the retired cohort that have been most affected by this lack of funding.

With the public employees contributing above average amounts and the SBI earning above average rates of returns, this logically explains why the state and local government employers rank 47th in pension costs. The predicament retirees find themselves in is found in the email from Kurt Winkelmann to the LCPR staff dated November 26, 2020. Mr. Winkelmann's comment on his third substantive point found on Appendix A, Page 2 of the LCPR COLA Study notes that:

> Failing to make regular contributions at the required rate only locks in persistent underfunding. According to our quick analysis, the SBI has done a good job in reaching their investment return targets. By contrast, contributions seem to be persistently below the ARC. Consequently, the only other lever to pull for budget relief is the COLA. So, it isn't really a surprise that:
>
> A. There are cost savings from the COLA policy, and
> B. Real retiree income decreases.
>
> I know that this point seems to be outside the area that this report is meant to look at, but it is nevertheless an important one.

While we may disagree on a path forward, Mr. Winkelmann accurately assesses the situation. There are options other than cutting COLAs; increasing employer contributions should be on the table.

There is one other point in the report that my client takes exception to. This relates to the core policy of the LCPR and COLAs. The current LCPR Principles, Section II(B)(8)(a) states the following:

> Retirement benefits should be increased during the period of retirement to offset the impact of economic inflation over time in order to maintain a retirement benefit that was adequate at the time of retirement.

At page 17 of the COLA Study the report says "… this statement's precise meaning is ambiguous. Should the postretirement-increase partially or completely" offset the impact of economic inflation at the time? How much value can a benefit lose and still be one that "was adequate at the time of retirement?"

I do not find any "ambiguity" in the principle and I submit on behalf of my client that they do not either. Section II(B)(8)(a) of the Principles does not contain any modification or qualification with regard to impact of inflation. I have appeared before the LCPR for 39 years. I have long understood that the LCPR sought to protect retirees from inflation and I believe this principle has been part of the LCPR policies for decades. The Policy does not say that the benefits should "partially" protect the benefits. I have sat through at least three LCPR meetings where the principles have been considered and at no time has there been any question that the LCPR should not try to provide an inflationary increase to its retirees to make up for the effect of inflation on their benefits.

The reason this policy issue is so important is how the legislature has been able to address pension funding over the last decade. The mantra of the 2018 Pension Reform Bill was "shared sacrifice" from the employer, the employee, and the retirees. At that time the legislation required "contributions" from all these groups. Under the 2018 legislation the state itself stepped forward with significant new funding to address funding issues. But the largest single source of balancing the pension deficit fell on the retirees.

I would respectfully submit that what the COLA Study shows is that careful attention needs to be paid to what COLAs will be paid to retired persons going forward. For decades the state has either paid too little in COLAs (the 1970's, 2000's, and 2010's) or too much (the 1980's and 1990's.) The COLA Study suggests that at the current 1% COLA the retirees will fall behind in meeting their income security needs. On behalf of my client I would urge the LCPR to receive and file this report. I would ask that you reject any suggestions that the LCPR is not committed to seeking to maintain a retirement benefit that is consistent with inflation.

Lastly, I would ask that this Commission begin to look at how to avoid having 200,000 public service retirees see their pensions eroded by inflation.

Very Truly Yours,

Signature redacted

Brian F. Rice

cc: Susan Lenczewski
Chad Burkett
LCPR Members

A

NASRA Issue Brief:
State and Local Government Spending on Public Employee Retirement Systems

Updated December 2020

State and local government pension benefits are paid not from general operating revenues, but from trust funds to which state and local government retirees and their employers contribute during retirees' working years. These trusts pay over $300 billion annually to retirees and their beneficiaries, benefits that reach virtually every city and town in the nation.[i] On a nationwide basis, contributions made by state and local governments to pension trust funds account for 5.2 percent of direct general spending (see Figure 1).[ii] Pension spending levels, however, vary widely among states, depending on various factors, and are actuarially sufficient for some pension plans and insufficient for others.

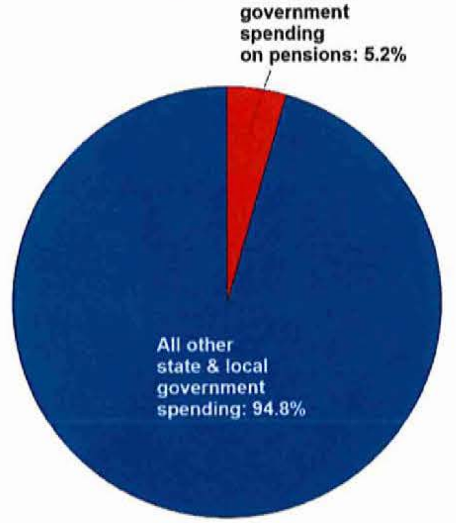
In the wake of the 2008-09 market decline, nearly every state and many cities have taken steps to improve the financial condition of their retirement plans and to reduce costs.[iii] States and cities changed their pension plans by adjusting employee and employer contribution levels, reducing benefits, or both. This update provides figures for public pension contributions as a percentage of state and local government direct general spending for FY 2018, and projects a rate of spending on pensions on an aggregate basis for FY 2019.

Nationwide Spending on Public Pensions

Based on the most recent information provided by the U.S. Census Bureau, 5.2 percent of all state and local government spending is used to fund pension benefits for employees of state and local government. As shown in Figure 2, pension costs rose sharply following FY 02 after falling equally sharply in the preceding years. These costs declined from 3.9 percent, in FY 90, to a low point of 2.3 percent in FY 02, and reached 5.2 percent in FY 18. The increased rate of spending in FY 18 was driven by the largest annual increase in employer pension contributions since FY 06, which includes a $6 billion one time appropriation from the California Legislature and an additional $538 million from political subdivisions in California to reduce their respective shares of unfunded liabilities of the California Public Employees' Retirement System (CalPERS). Excluding this amount reduces the projected spending figure for 2018 to 5.0 percent.

State and local governments contributed, in aggregate, approximately $168 billion to pension funds in FY 19, an amount that represents the smallest annual increase in employer pension contributions since a decline in FY 05. As displayed in Figure 2, this change is projected to reduce the percentage of state and local direct general spending on public pensions, from 5.16 percent to 5.05 percent.[iv]

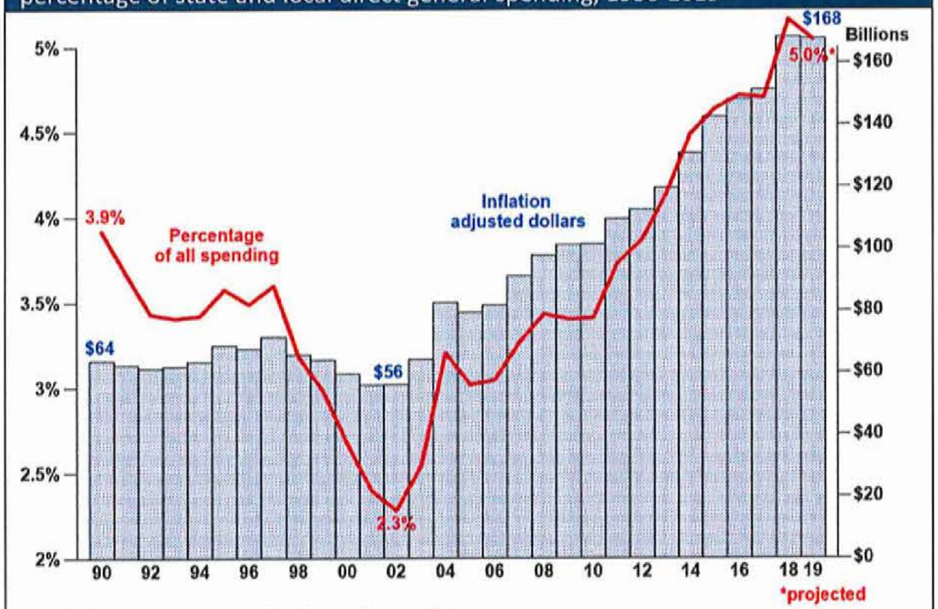
Figure 1. State and local spending on public pensions as a percentage of total government direct general spending, FY 18



Compiled by NASRA based on U.S. Census Bureau data

Although pensions in most states do not comprise a significant portion of aggregate state and local spending, (as shown in Table 1 on page 5), spending on pensions by states and political subdivisions varies widely among states, from just over 2.0 percent to more than 10.0 percent. Some municipalities have reported higher pension costs as a percentage of their budget.

Figure 2. State and local pension contributions, in 2019 dollars, and as a percentage of state and local direct general spending, 1990-2019*



Compiled by NASRA based on U.S. Census Bureau data

*Projected, based on estimated state and local government spending from National Association of State Budget Officers (NASBO) and U.S. Census Bureau data

Differences in Pension Cost Levels

The variation in pension spending levels among states is attributable to such factors as differences in pension benefit levels; variations in the size of unfunded pension liabilities; the level of commitment by the state and its local government plan sponsors to make required pension contributions; the portion of the state's population that lives in an urban area; and the fiscal condition of government plan sponsors. Most employees of state and local government participate in statewide retirement systems. In FY 19, state and local government contributions to statewide retirement systems accounted for 78 percent of total pension contributions, with the remaining 22 percent belonging to locally administered systems. As a percentage of total spending, cities spent approximately 31 percent more than states on pensions over the 30-year period spanning 1988-2017.[v] This higher level of spending is largely attributable to the types of services delivered at the local level (i.e., more labor-intensive, such as public safety personnel) and the resulting larger portion of local government spending that goes toward salaries and related benefits compared to spending by states.

Differences in Benefit Levels

Pension benefit levels, and therefore required costs, vary among public pension plans. As described below, this difference is particularly pronounced for the 25 percent to 30 percent of state and local government employees who do not participate in Social Security, as their pension benefit levels—and costs—generally are higher to compensate for all or part of the absence of Social Security benefits. In addition to pension benefit accrual rates, variations in benefit levels may manifest themselves also via differences in required employee contribution rates and other features of the plan design, such as vesting periods, age of retirement benefit eligibility, etc.

Size of Unfunded Liabilities

An unfunded pension liability is the projected difference between the pension benefits that have been accrued and the assets that have been set aside to pay for them. For a plan with a relatively large unfunded liability, the annual cost of paying down that liability can exceed the cost of benefits accrued each year. By contrast, the cost for a plan with no unfunded liability is simply the cost of benefits accrued each year, i.e., the normal cost. States with pension plans that have a relatively large unfunded liability will have higher pension plan spending levels, assuming the employer is making a good faith effort to pay its required contributions.

Social Security Coverage

Twenty-five to thirty percent of state and local governments and their employees make contributions to their retirement plan instead of to Social Security. This is the case for most to substantially all of the state and local government workforce in seven states, 40 percent of the nation's public school teachers, and a majority of firefighters and police officers.[vi] Pension benefits—and costs—for those who do not participate in Social Security are usually higher than for those who do participate, in order to compensate for the absence of Social Security benefits. This higher cost should be considered in the context of the 12.4 percent of payroll, or an estimated $29 billion annually,[vii] these employers and employees would otherwise be paying into Social Security.

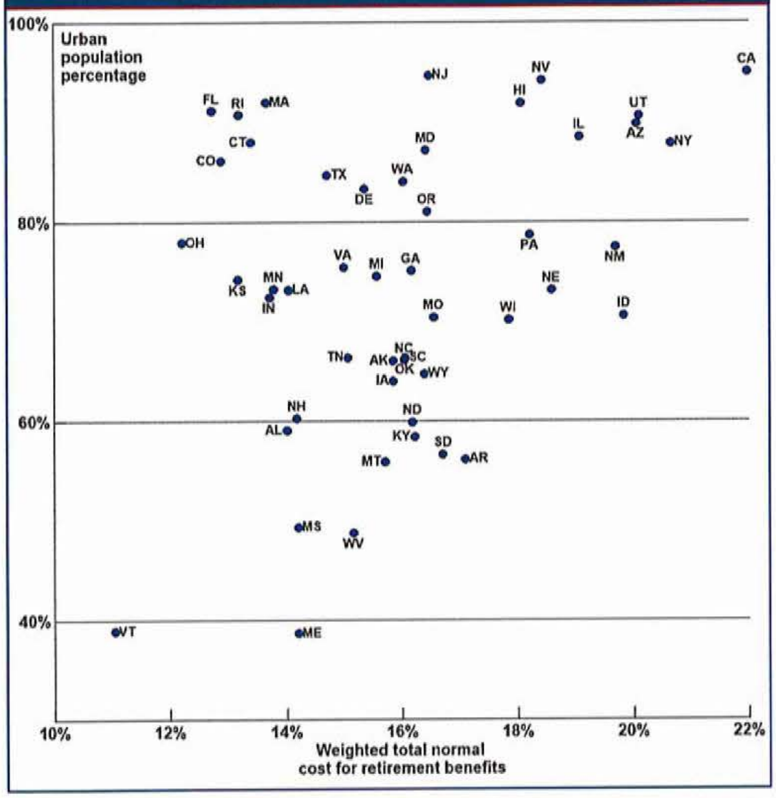
Level of Commitment to Pay Required Contributions

State and local government efforts to pay required contributions vary widely: some employers consistently pay the full Actuarially Determined Contribution, and others pay less.[viii] Whatever the cost of the pension plan, actual spending on pensions as a percentage of all spending is affected by employers' effort to actuarially fund the plan.[ix]

Urbanization

Another factor that appears to contribute to differences among states in pension costs is the extent to which the state's population resides in urban areas, or cities. Figure 3, which reflects analysis of state and local spending on pensions and the percentage of population residing in metropolitan areas within each state, suggests that, although not true in every case, states characterized by greater urban populations are more likely to experience higher costs for public pension benefits than states with lower urban populations.[x] Tighter labor markets and higher cost of living – factors that may characterize densely populated cities – may lead employers to offer higher retirement benefits in order to meet their workforce management objectives. Pension benefits are just one component of total compensation, and other factors, such as salaries and health benefits for active and/or retired workers, may also be correlated with a state's degree of urbanization, and may also affect the difference in pension costs. Further research into the relationship of these factors may clarify these differences.

Figure 3. FY 17 State Retirement Benefit Costs and Urban Population Percentage



Fiscal Resources of the Plan Sponsor

The fiscal status of governments that sponsor public pension plans is an important factor to consider when measuring the percentage of state spending dedicated to pensions in each state. The national aggregate rate of increase in state expenditures from FY 17 to FY 18 was 4.2 percent, which is consistent with recent recovery in state and local finances. FY 18 represents the fourth consecutive year of state and local spending growth above 4 percent following five straight years of growth below 3 percent[xi] However, the individual state experience is mixed: compared to FY 17, FY 18 individual state expenditures ranged from an increase of nearly 14 percent to a nearly 5 percent rate of decline. States with greater increased spending – may be better able to absorb higher pension contributions than states with weaker or negative spending.

In addition to these causes of variation in pension costs among states, consistent comparisons of pension spending by local governments can be difficult to make because the fiscal relationship between each state and its political subdivisions is unique with respect to revenue, spending structure and taxing authority, and varies widely. For example, funding responsibility for K-12 education budgets ranges from primarily a state duty to one that is primarily a local responsibility.[xii] Likewise, revenue-sharing arrangements and the authority of local governments to tax and raise revenue also run a wide range. As with states, pension costs for municipalities also can vary widely.

Cost and Financing Factors

Public pensions are financed through a combination of contributions from public employers (state and local agencies) and public employees, and the investment earnings on those contributions. Since 1990, investment earnings have accounted for 61 percent of all public pension revenue; employer contributions, 27 percent; and employee contributions, 12 percent.[xiii]

Employee Contributions

Because nearly all public employees are required both to participate in their employer-sponsored retirement plan and to contribute toward the cost of their pension benefit—typically four to eight percent of pay—most state and local government retirement plans are, in fact, mandatory savings programs. In recent years, many states increased rates of required employee contributions. On a national basis, in fiscal year 2019, employee contributions accounted for nearly 26 percent of all public pension plan contributions, with employer contributions making up the remaining 74 percent.[xiv]

Employer Contributions

A variety of state and local laws and policies guide governmental pension funding practices. Most require employers to contribute what is known as the Actuarially Determined Employer Contribution (ADEC), which is the amount needed to finance benefits accrued each year, plus the annual cost to amortize unfunded liabilities from past years, less required employee contributions. On a weighted basis, the average ADEC paid in recent years has been over 90 percent. Beneath this average contribution experience lies diversity: approximately 75 percent of plans in the Public Fund Survey[xv] consistently receive 90 percent or more of their ADC.[xvi] This means that although a majority of plans have been receiving their actuarial required funding, some plans have not been adequately funded, which will result in higher future costs. Leading national public sector associations established a Pension Funding Task Force, which in 2013 released its report *Pension Funding: A Guide for Elected Officials* urging policymakers to follow recommended guidelines for an actuarially determined contribution to government retirement systems.

Investments and Other Parts of the Financing Equation

The largest portion of public pension funding – over 60 percent for the 30-year period 1990-2019 – comes from investment earnings, which illustrates the major role this revenue source plays in determining pension costs (see *NASRA Issue Brief: Public Pension Plan Investment Return Assumptions*, February 2020).

In addition to the performance of pension fund investments, actuarial expectations regarding macro-economic and demographic events also affect the cost of the plan. These events include the rate of inflation, retirement rates, attrition and rates of hiring, and wage growth, which can be affected by salary cuts and layoffs. Additionally, legislatures in nearly every state made changes to pension benefits and/or financing structures, in some cases reducing plan costs and long-term obligations.

Conclusion

Pension costs paid by state and local government employers vary widely and reflect multiple factors, including differing levels of public services, benefits, pension funding levels, employer effort to pay required contributions, and the fiscal condition of states and their political subdivisions, among others. Employers in FY 19 contributed a total of $168 billion to pension benefits for employees, an amount that, in total, is a relatively small—but growing—part of state and local government spending.

Table 1: State and local government contributions to pensions as a percentage of all state and local government direct general spending, by state, FY 09 to FY 18

	FY 09 %	FY 09 to FY 18 %	FY 18 %
Alabama	3.61		3.15
Alaska	7.01		4.21
Arizona	2.93		4.34
Arkansas	3.57		3.66
California	4.46		7.98[1]
Colorado	3.82		4.08
Connecticut	4.47		10.27
Delaware	2.52		2.88
District of Columbia	1.82		2.61
Florida	3.05		2.86
Georgia	2.55		4.90
Hawaii	4.07		5.70
Idaho	2.78		3.12
Illinois	5.82		10.38
Indiana	3.17		3.86
Iowa	1.90		2.83
Kansas	2.22		3.43
Kentucky	3.09		6.14
Louisiana	4.14		6.85
Maine	3.06		3.33
Maryland	3.13		4.77
Massachusetts	4.04		4.23
Michigan	2.93		5.49
Minnesota	1.87		2.30
Mississippi	3.19		4.06
Missouri	3.71		5.25
Montana	2.69		3.66
Nebraska	1.86		2.91
Nevada[2]	6.46		7.36
New Hampshire	2.61		3.91
New Jersey	2.88		4.76
New Mexico	3.39		3.38
New York	5.02		5.96
North Carolina	1.23		2.68
North Dakota	1.58		2.46
Ohio	3.47		4.01
Oklahoma	3.89		4.21
Oregon	2.49		3.56
Pennsylvania	1.99		6.15
Rhode Island	5.82		6.34
South Carolina	2.78		3.49
South Dakota	1.87		2.04
Tennessee	2.54		3.97
Texas	2.33		3.64
Utah	3.29		4.06
Vermont	1.00		2.82
Virginia	4.11		4.26
Washington	2.41		3.65
West Virginia	4.15		4.68
Wisconsin	1.49		2.13
Wyoming	1.32		2.13
US Average	**3.45**		**5.16**

Compiled by NASRA based on U.S. Census Bureau data

Table Notes

Charts in the FY 09 to FY 18 % column reflect the percentage spending for each of the 10 years within the timeframe.

Percent-of-spending is as of publication date; figures are subject to periodic revisions by the U.S. Census Bureau.

States where more than one-half of public employee payrolls are estimated to be outside of Social Security are italicized.

[1]Figure reflects an additional $6 billion contribution above the actuarially determined contribution from the State of California, and an additional $538 million from local governments, made to reduce the state's unfunded pension liabilities.

[2]In addition to being a non-Social Security state, one-half of Nevada PERS employers' contribution is attributable to a non-refundable pre-tax salary reduction to fund the employees' portion of the contribution.

See also

National Governors Association, National Conference of State Legislatures, The Council of State Governments, National Association of Counties, National League of Cities, The U.S. Conference of Mayors, International City/County Management Association, National Council on Teacher Retirement, National Association of State Auditors, Comptrollers and Treasurers, Government Finance Officers Association, and National Association of State Retirement Administrators, "Pension Funding: A Guide for Elected Officials," 2013, https://www.nasra.org//Files/JointPublications/PensionFundingGuide(1).pdf

National Association of State Retirement Administrators, Issue Brief: Public Pension Plan Investment Return Assumptions, Updated February 2020, http://www.nasra.org/returnassumptionsbrief

National Association of State Retirement Administrators, Issue Brief: Employee Contributions to Public Pension Funds, September 2020, https://www.nasra.org/contributionsbrief

Contact

Keith Brainard, Research Director, keith@nasra.org
Alex Brown, Research Manager, alex@nasra.org
National Association of State Retirement Administrators

---

[i] U.S. Census Bureau, Annual Survey of Public Pensions, https://www.census.gov/programs-surveys/aspp.html, 2019; see also "Economic Effects of Public Pensions," http://www.nasra.org/economiceffects

[ii] The U.S. Census Bureau defines direct general expenditures as all payments to employees, suppliers, contractors, beneficiaries, and other final recipients of governmental payments. Excluded from this category are expenditures for utilities, publicly owned liquor stores, employee retirement benefits paid from trust funds, and intergovernmental payments. Some state and local government spending is non-discretionary, and therefore not in competition for funds with other programs and services. Including non-discretionary spending would make the effect of pension spending appear smaller. In addition, some states and cities do not contribute the amount determined actuarially to adequately fund the plan.

[iii] NASRA, Significant Reforms to State Retirement Systems, https://www.nasra.org/reforms & Selected Approved Changes to State Public Pensions, https://www.nasra.org/files/Compiled%20Resources/nasrapensionchanges.pdf

[iv] Projected spending for 2019 derived from actual state expenditures as reported by the National Association of State Budget Officers in the 2017-2019 State Expenditure Report (https://www.nasbo.org/mainsite/reports-data/state-expenditure-report p. 8 and projected increase in local government direct general spending, as provided by the U.S. Census Bureau https://www.census.gov/programs-surveys/gov-finances.html

[v] Author's calculations using public pension and state and local government finance data provided by the U.S. Census Bureau

[vi] Social Security Coverage @NASRA.org, http://www.nasra.org/socialsecurity

[vii] Author's calculation based on 25 percent of state and local government employees not participating in Social Security, using US Census, 2016 Annual Survey of Public Employment & Payroll, https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk

[viii] NASRA, The Annual Required Contribution Experience of State Retirement Plans, FY 01 to FY 13, https://www.nasra.org/arcspotlight and State and Local Government Contributions to Statewide Pension Plans: FY 18, http://www.nasra.org/adcbrief

[ix] NASRA, State and Local Government Contributions to Statewide Pension Plans, FY 18

[x] A moderate positive relationship is observed to exist between each state's weighted cost for pension benefits, with an adjustment for Social Security costs, and the percentage of residents in each state residing in Census-designated urban areas. Pension costs are sourced from Public Plans Data (https://publicplansdata.org/) , and are weighted for plans in each state and adjusted between 0-500 basis points depending on the percentage of public employees covered by Social Security in each state, based on expected present values of lifetime Social Security benefits and taxes paid as published in "Social Security and Medicare Lifetime Benefits and Taxes: 2018 Update," Urban Institute (October 2018). Urban density data are published by the U.S. Census Bureau and may be accessed at https://www.census.gov/geo/reference/ua/urban-rural-2010.html.

[xi] State and Local Revenue @NASRA.org, http://www.nasra.org/revenue

[xii] U.S. Census Bureau, Table 5. Percentage Distribution of Public Elementary-Secondary School System Revenue by Source and State: Fiscal Year 2018, https://www.census.gov/programs-surveys/school-finances.html

[xiii] U.S. Census Bureau, Annual Survey of Public Pensions, https://www.census.gov/programs-surveys/aspp.html, 1990-2019

[xiv] U.S. Census Bureau, Annual Survey of Public Pensions, https://www.census.gov/programs-surveys/aspp.html, 2019

[xv] NASRA Public Fund Survey, http://www.nasra.org/publicfundsurvey

[xvi] NASRA, The Annual Required Contribution Experience of State Retirement Plans, FY 01 to FY 13, https://www.nasra.org/arcspotlight

ꞧ3

NASRA Issue Brief:
Employee Contributions to Public Pension Plans

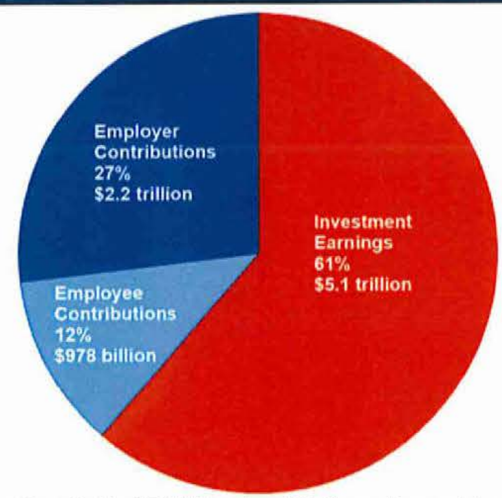
September 2020

Unlike in the private sector, nearly all employees of state and local government are required to share in the cost of their retirement benefit. Employee contributions typically are set as a percentage of salary by statute or by the board that oversees the retirement system. Although investment earnings and employer contributions account for a larger portion of total public pension fund revenues (see Figure 1), by providing a consistent and predictable stream of revenue to public pension funds, contributions from employees fill a vital role in financing pension benefits.[i] Reforms made in the wake of the 2008-09 market decline included higher employee contribution rates for many public pension plans. This issue brief examines employee contribution plan designs, policies and recent trends.

Mandatory Participation & Shared Financing

For the vast majority of employees of state and local government, both participation in a public pension plan and contributing toward the cost of the pension are mandatory terms of employment. Requiring employees to contribute distributes some of the risk of the plan between employers and employees. The primary types of risk in a pension plan pertain to investment, longevity, and inflation. Employees who are required to contribute toward the cost of their pension assume a portion of one or more of these risks, depending on the design of the plan.[ii]

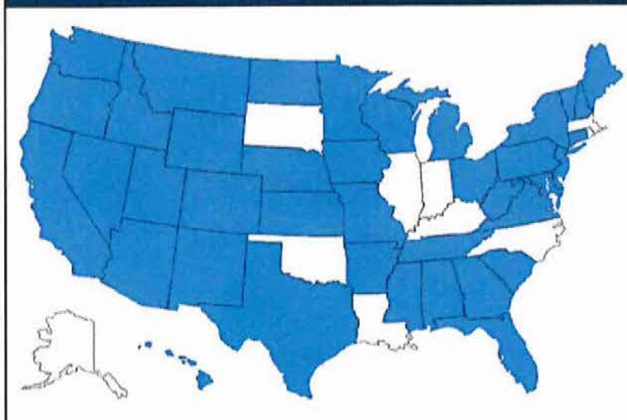
Figure 1: Public pension sources of revenue, 1990-2019



Source: Compiled by NASRA based on U.S. Census Bureau data

The prevailing model for employees to contribute to their pension plan is for state and local governments to collect contributions as a deduction from employee pay. This amount usually is established as a percentage of an employee's salary and is collected each pay period. As shown in Appendix A, employee contribution rates to pension benefits typically are between four and eight percent of pay, and are outside these levels for some plans. In some cases, required employee contributions are subject to change depending on the condition of the plan, the fund's investment performance, or another factor. In some plans, the employee contribution is actually paid by the employer in lieu of a negotiated salary increase or other fiscal offset.

Figure 2: States that increased employee contributions in at least one public pension plan since 2009

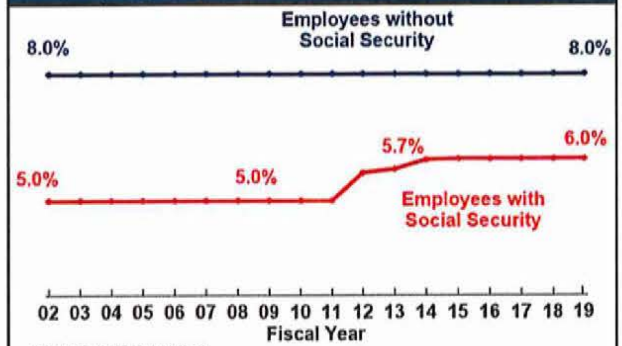


Some 25 to 30 percent of employees of state and local government do not participate in Social Security. In most cases for those outside of Social Security, the pension benefit and required contribution are greater than the typical benefit and required contribution than for those who do participate in Social Security.[iii]. Appendix A identifies whether or not most plan members participate in Social Security.

Trends in Employee Contributions

Many states in recent years made changes requiring employees to contribute more toward their retirement benefits: since 2009, 40 states increased required employee contribution rates (see Figure 2). Higher rates in some cases applies only to new hires, and in other cases, the higher rates apply to all active plan participants. As a result of these changes, the median contribution rate paid by employees has increased. Figure 3 shows that the median contribution rate has risen, to 6.0 percent of pay, for employees who also participate in Social Security, and has remained steady at 8.0 percent for those who do not participate in Social Security.

Figure 3: Median employee contribution rate by Social Security eligibility, FY 02 to FY 19 (non-public safety)



Public Fund Survey

New Contributions

Contribution requirements for certain employee groups in some states, such as **Missouri** and **Florida,** which previously did not require some employees to make pension contributions, were established in recent years for newly hired employees, existing workers, or both. Employees hired in **Utah** before July 1, 2011 are not required to contribute to the cost of their pension benefit. Those hired since must contribute if that cost exceeds 10 percent of pay (12 percent for public safety workers). Because the cost of the plan remains below those thresholds, the Utah Retirement System remains non-contributory for most plan participants.

Variable Contributions

A growing number of states maintain plans in which the employee contribution rate may change, depending on the pension plan's actuarial condition or other factors. NASRA's report, *In-Depth: Risk-Sharing in Public Retirement Plans*, describes a range of variable employee contribution rate arrangements, including those based on the plan's actuarial funding level, the plan's normal cost, and a rate that is tied to a percentage of the employer rate. Changes approved in recent years in **Arizona, California,** and **Connecticut** require some workers to pay at least one-half of the normal cost of the benefit, which can result in a variable contribution rate. Similarly, recent reforms in **Michigan** require newly hired school teachers to pay one-half of the full cost of the plan. And, as described previously, the **Utah** plan affecting new hires since July 2011 could become variable, depending on the plan's required cost.

Increased Contributions for Current Plan Participants

Most employee contribution rate increases approved in recent years affected all workers-current and future. In some states, such as **Virginia** and **Wisconsin**, new and existing employees are now required to pay the contributions that previously were made by employers in lieu of a salary increase.

Hybrid Plans

A growing number of public employees now participate in hybrid retirement plans, which combine elements of defined benefit and defined contribution plans, and that transfer some risk from the employer to the employee. In one type of hybrid plan, known as a combination defined benefit-defined contribution plan, employees in most cases are responsible for contributing all or most of the cost of the defined contribution portion of the plan.

Contribution requirements to the DB component of combination plans vary: some are funded solely by employer contributions, while others require contributions from both employees and employers. As described in NASRA's issue brief, *State Hybrid Retirement Plans*, in most of these cases, employees are also required to contribute toward the cost of the defined contribution portion of their hybrid plan benefit.[iv]

Collective Bargaining

Employee contributions in some cases are set by collective bargaining, and can be changed when labor agreements are negotiated. For example, required employee contribution rates for employee groups in **California** and **Connecticut** increased in recent years as a result of labor agreements in those states.

Legal Landscape

The legality of increasing contributions for current plan participants varies. Some states prohibit an increase in contributions for existing plan participants. For example, a 2012 ruling in **Arizona** found that legislative efforts to increase contributions for existing workers violated a state constitutional protection against impairment of benefits. In other states, however, such as in **Minnesota** and **Mississippi**, higher employee contributions either did not produce a legal challenge, or withstood legal challenges (such as in **New Hampshire, New Mexico,** and **Oregon**).

Governance Changes

Traditionally, state legislatures have been responsible for determining employee (and employer) contribution rates for public pensions. A few states in recent years have granted authority, limited in most cases, to retirement system boards to adjust contribution rates for employers and employees. For example, the Arkansas Legislature in 2017 approved legislation authorizing the board of the state Teachers Retirement System to adjust employer and employee contribution rates as necessary "to maintain the actuarial soundness of the plan." Similarly, in 2020, the Colorado Legislature enacted a bill authorizing the board of the Fire and Police Pension Association to increase the member contribution rate if the rate increase is equal for the member and employer; and the increase is approved by 65 percent of the active members and 50 percent of plan employers. Some boards in other states, including Montana and Ohio, have been granted similar authority in recent years, while in other states, such as Idaho and Iowa, boards have had longstanding authority to modify contribution rates.

Conclusion

Employee contributions are a key component of public pension funding policies. Nearly all employees of state and local government are required to contribute to the cost of their pension benefit, and this number has grown in recent years as most states that previously administered non-contributory plans now require worker contributions.

Many employees also are being required to contribute more toward the cost of their retirement benefit. In some cases, this requirement applies to both current and new workers; in other cases, only to new hires.

A growing number of states are exposing employee contributions to risk – either by tying the rate to such factors as the plan's funding condition or cost, or by requiring participation in hybrid or 401k-type plans as a larger component of the employee's retirement benefit.

See Also

Information is available on public pension contributions at

- Contributions @NASRA.org
- Selected Approved Changes to State Public Pensions, 2019-Present, NASRA
- Significant Reforms to State Retirement Systems, NASRA, December 2018
- Public Fund Survey Summary of Findings, NASRA

Contact

Keith Brainard, Research Director, keith@nasra.org
Alex Brown, Research Manager, alex@nasra.org
National Association of State Retirement Administrators, www.nasra.org

---

[i] NASRA Issue Brief: Public Pension Plan Investment Return Assumptions
http://www.nasra.org/returnassumptionsbrief
[ii] In-depth: Risk Sharing in Public Retirement Plans
http://www.nasra.org/sharedriskpaper
[iii] Social Security@NASRA.org
[iv] NASRA Issue Brief: State Hybrid Retirement Plans
http://www.nasra.org/hybridbrief