Joint Committee on Public Employee Benefits Reform

Office of Legislative Services
August 9, 2006

Joint Committee on Public Employee Benefits Reform
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Purpose of Committee

- Review recommendations from the December 2005 Benefits Review Task Force report as the basis for legislative proposals to:
  - End abuses of the public benefit system
  - Control benefits costs Statewide

The purpose of this Joint Committee is set forth in Assembly Concurrent Resolution 3 (Sponsored by Assemblymen Roberts and De Croce), which established the committee. A copy of the resolution can be found in the committee binder at the tab labeled "Concurrent Resolution / Overview."

Benefits Review Task Force

- Created by Governor Codey - May 25, 2005
- Eight members:
  - Six public members with special expertise
  - Commissioner of Labor and Workforce Development
  - State Treasurer
- Five public meetings held; 85 witnesses

The task force was created by Executive Order No. 39 of Governor Richard J. Codey, which stated that :

• a contributing factor to the recent budget shortfall has been a $1.4 billion increase in mandatory funding needs, including nearly a $1 billion increase in employee benefits.

• the total cost of health care benefits for current State employees has risen by 50 percent over the last four years; the total cost of health care benefits for retired State and college employees has more than doubled; and the total cost of health benefits provided free of charge to retired teachers and other school personnel has doubled.

• by the year 2010, it is projected that benefit costs will constitute 20 percent of the State budget.

The task force received extensive input during five public meetings held across the State. Those testifying included members of the public, two former State Treasurers, numerous advocacy groups, and over a dozen scholars and national experts. Over 245 members of the public attended task force meetings, and over 250 pieces of correspondence were received.

The full report is available in the committee binders at the tab labeled "Task Force Report." The executive summary can be found on page 3, and the list of task force members with brief biographies is on page 34.

Goals of Task Force

- Examine current laws, regulations, procedures and agreements governing the provision of employee benefits to State and local government workers
- Analyze the current and future costs of benefits
- Compare level of benefits provided to government employees to benefits provided to other workers
- Recommend changes designed to control benefit costs, while ensuring a fair and equitable benefit system

These goals were set by section two of the Executive Order that created the Task Force.

State-Administered Retirement Systems

Defined Benefit Systems:

- Public Employees' Retirement System (PERS)
- Teachers' Pension and Annuity Fund (TPAF)
- Police and Firemen's Retirement System (PFRS)
- State Police Retirement System (SPRS)
- Judicial Retirement System (JRS)

Defined Contribution System:

- Alternate Benefit Program (ABP)

New Jersey has six major State-administered retirement systems. Five of these systems are defined benefit pension plans. The Alternate Benefit Program (ABP) for faculty at New Jersey public institutions of higher education is a defined contribution pension plan.

In general, a **defined benefit plan** provides a certain benefit determined by a stated formula for the life of the beneficiary, often with cost-of-living increases. The formula is usually related to an employee's length of service and salary. A minimum number of years of service is usually required before employees are vested in their accrued benefit, that is, become eligible for certain benefits upon retirement. Public employee defined benefit plans usually require an employee contribution of a certain percentage of compensation through payroll deduction. The actuarial valuation, together with the plan's benefit provisions, determines the employer's periodic contribution.

Generally, in **defined contribution plans**, the employer's benefit promise is in the form of an actual periodic contribution placed into an employee's individual account. Unlike a defined benefit plan, a defined contribution plan does not guarantee a stated retirement allowance regardless of the employee's salary or years of service. The benefit is a function of the amounts of employee and employer contributions, wage history, and investment earnings. The participant usually is responsible for the investment choices.

See the tab labeled "Concurrent Resolution / Overview" for a comparison of the benefits of PERS, TPAF, PFRS, and SPRS. An overview of the plan types for retirement systems in other states is available at the tab labeled "Pensions: General Information."

Retirement Systems: FY 2007 Overview

- 564,311 total active members
- 1,710 participating employers
- 234,989 total retirees and beneficiaries received pensions in excess of $5.7 billion

This overview is for the five defined benefit plans only.

The 1,710 participating employers include the State, counties, municipalities, boards of education, and any authorities, commissions, boards and instrumentalities created by them.

Examples of beneficiaries may include surviving spouses or dependent children.

See the tab labeled "Division of Pensions and Benefits Annual Report" in the committee binders for a copy of the June 30, 2005 comprehensive annual financial report, which contains detailed information on the investment of fund assets and on each retirement system.

Public Employees' Retirement System

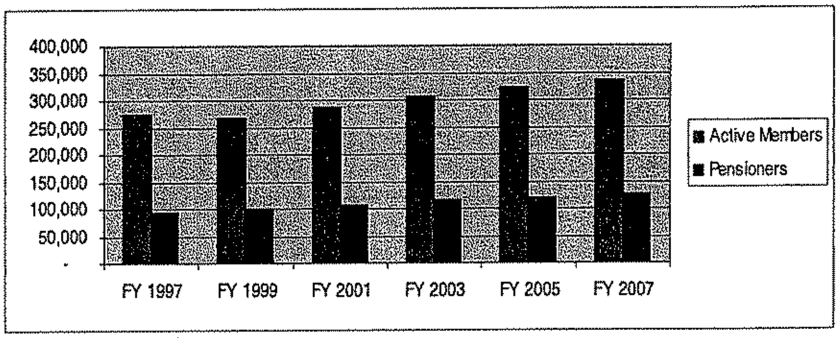
- Membership: State and local public employees
- 336,898 active members
- 127,028 retirees and beneficiaries
- Employee contribution rate is 5%
- Special Parts: Legislators, Law Enforcement Officers, Workers Compensation Judges, Prosecutors

The Public Employees' Retirement System (PERS) was created in 1954. Membership is mandatory for employees earning more than $1,500 per year. This threshold was set in 1986. Benefits in PERS are similar to those received in the Teachers' Pension and Annuity Fund (TPAF).

Several special parts in PERS provide unique sets of benefits for different groups. They are: Legislators (1972), Law Enforcement Officers (1955), Workers Compensation Judges (2001), and Prosecutors (2002). The benefits for Workers Compensation Judges are similar to those in the Judicial Retirement System (JRS). The benefits for Prosecutors are similar to those received in the Police and Firemen's Retirement System (PFRS).

See the tab labeled "Pensions" in the committee binders for an OLS paper on the Public Employees' Retirement System, and for fact sheets from the Division of Pensions and Benefits concerning various benefits in the system.

Public Employees' Retirement System



This chart shows an increase in PERS active membership at a rate of 2.3 percent each year, or by 23.4 percent over the past 10 years, from 272,966 to 336,898 active members. The number of pensioners rose by 36.2 percent over the same period, from 93,297 in 1997 to 127,028 in 2007.

Teachers' Pension and Annuity Fund

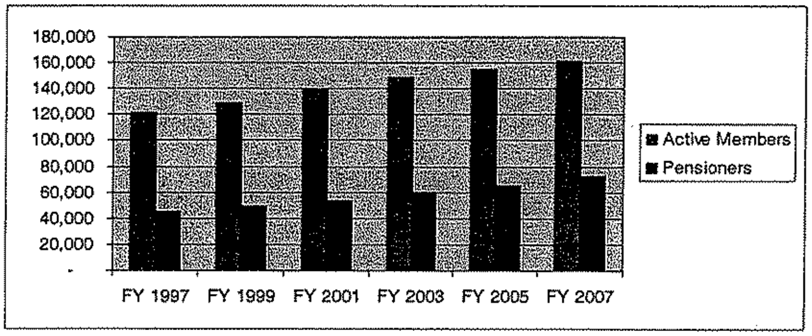
- Membership: Teachers, other education professionals, and certain DOE staff
- 161,226 active members
- 71,887 retirees and beneficiaries
- Employee contribution rate is 5%

The Teachers' Pension and Annuity Fund was created in 1955. Membership is mandatory for employees earning more than $500 per year. This threshold was set in 1955. Benefits in TPAF are similar to those received in the Public Employees' Retirement System (PERS).

Certain school staff who are not educators, but are board of education employees, are in PERS.

See the tab labeled "Pensions" in the committee binders for fact sheets from the Division of Pensions and Benefits concerning various benefits in TPAF. Details on TPAF in the division's annual report are on page 129 at the tab labeled "Division of Pensions and Benefits Annual Report".

Teachers' Pension and Annuity Fund



This chart shows that active TPAF membership rose at a rate of 3.3 percent each year, or by 32.7 percent since 1997, from 121,504 to 161,226. Over the same 10 year period, the number of pensioners rose by 59 percent, from 45,204 in 1997 to 71,887 in 2007.

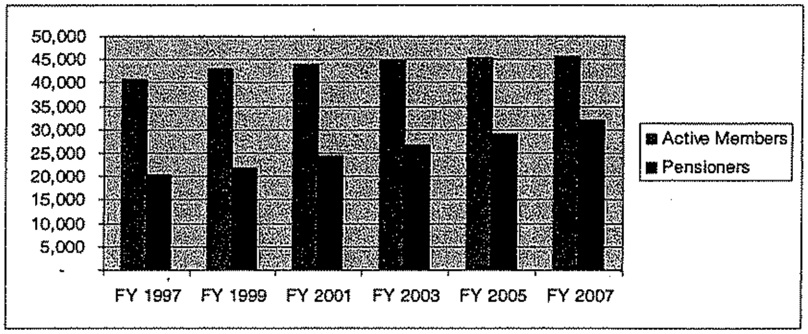
Police and Firemen's Retirement System

- Membership: State and local police and fire personnel
- 45,669 active members
- 31,931 retirees and beneficiaries
- Employee contribution rate is 8.5%

The Police and Firemen's Retirement System was created in 1944. Membership is mandatory for individuals who meet the definition of policeman and fireman in the statute, and are 35 years old or younger. Mandatory retirement is at age 65. Benefits in PFRS are similar to those received in the State Police Retirement System (SPRS).

See the tab labeled "Pensions: General Information" in the committee binders for a 2004 survey of key characteristics of public retirement systems in other states.

Police and Firemen's Retirement System



This chart shows that active PFRS membership has risen by 11.9 percent since 1997, from 40,804 to 45,069. The number of pensioners in that same period has increased by 56.2 percent, from 20,439 in 1997 to 31,931 in 2007.

State Police Retirement System

- Membership: Uniformed officers and troopers of State Police
- 2,913 active members
- 2,524 retirees and beneficiaries
- Employee contribution rate is 7.5%

The State Police Retirement System was created in 1965. Membership is mandatory for individuals who meet the definition in the statute, and are 35 years old or younger. Mandatory retirement is at age 55. Benefits in SPRS are similar to those received in the Police and Firemen's Retirement System (PFRS).

See the tab labeled "Pensions: General Information" in the committee binders for a summary of 2005 pension and retirement plan enactments in other states, prepared by NCSL.

Judicial Retirement System

- Membership: Members of judiciary
- 433 active members
- 469 retirees and beneficiaries
- Employee contribution rate is 3%

The Judicial Retirement System was created in 1973. Membership is mandatory for all members of the State judiciary. Mandatory retirement is at age 70. Judicial branch employees who are not judges are enrolled in PERS. Membership does not include administrative law judges, workers compensation judges, or municipal judges.

Funding of the Retirement Systems

- Task Force identified four major legislative changes in system funding since early 1990's
- Downturn in market conditions compounded the impact of legislative changes
- Problem exacerbated by legislation that provided pension benefit enhancements
- Result - $18 billion in unfunded accrued liability

Retirement systems are funded on an actuarially accrued basis based on assumptions and annual valuation of assets and liabilities to determine the unfunded liability and normal contributions. Actuaries also do experience studies every three years to test their assumptions. Losses and gains are realized on a five year basis.

The four major legislative changes affecting funding policy identified by the task force were:

•**The Pension Revaluation Act, P.L. 1992, c.41**, changed the methodology by which plan assets were measured, increasing the projected rate of return and thereby reducing State and local employer pension contributions.

•**The Pension Reform Act, P.L.1994, c.62**, revised the actuarial funding methodology for the State plans, thereby reducing State and local employer pension contributions.

•**The Pension Security Plan, P.L.1997, c.115**, allowed the issuance of pension obligation bonds to finance the plans' outstanding unfunded pension liabilities that had emerged due to the previous pension changes, and allowed the use of surplus pension assets to offset employers' annual normal contributions to the pension system. This change resulted in either complete or partial reductions in the State's and local employers' otherwise required normal contributions.

•**P.L. 2003, c. 108** enabled local employers to "phase-in" as of FY 2004 their total contributions due in increments of 20 percent a year. In 2007, the full estimated PERS payment due from local government is $379.2 million; at the 60 percent phased in level, the contribution is instead $227.5 million. The 2007 full estimated PFRS payment due is $528 million; at the 80 percent phased in level, the local contribution is instead $422.7 million.

The problem was exacerbated by the enactment of legislation that provided pension benefit enhancements, such as:

•**P.L.2001, c. 133** (known as n/55) increased PERS and TPAF pensions by 9.09 percent, increasing pension liabilities by over $4.2 billion

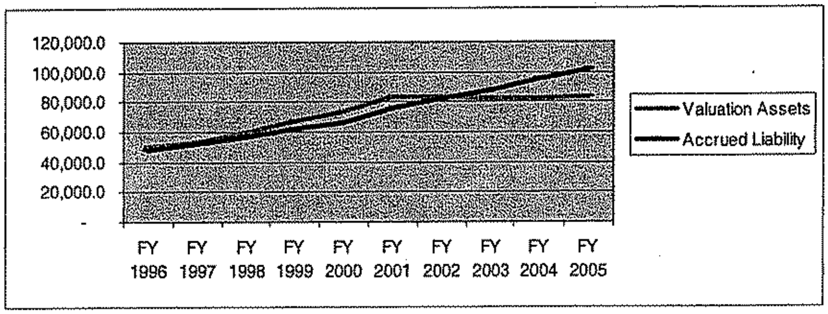
•**P.L. 1999, c. 428** provided enhanced pensions benefits including "20 and out" and "50 percent surviving spouse pensions" similar to the State Police for members of the PFRS, increasing pension liabilities by over $500 million.

Additional pension enhancements were given to prosecutors, workers compensation judges and others.

Since 1999, these enhancements have increased State and local pension liabilities by over $6.8 billion, according to the task force.

See the tab labeled "Pensions" in the committee binders for an OLS paper on the funding of retirement systems, and information on employer pension contributions and funded ratios for the various systems.

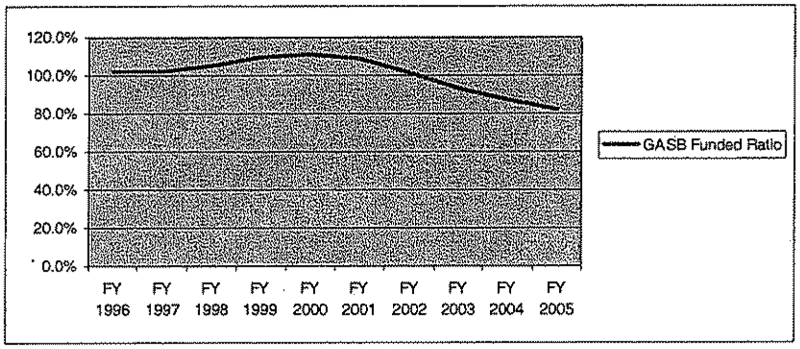
Retirement System Funding Levels



This chart shows the retirement system assets rising from $49.9 billion in 1996 to $83.5 billion in 2005. However, over the same period, the retirement system accrued liabilities rose from $48.7 billion to $101.5 billion.

Valuation Date	Valuation Assets	Accrued Liability	Unfunded Liability	GASB Funded Ratio
FY 1996	49,888.0	48,653.8	(1,234.2)	102.5%
FY 1997	53,324.7	52,063.0	(1,261.7)	102.4%
FY 1998	60,042.6	56,936.3	(3,106.3)	105.5%
FY 1999	67,570.5	61,732.7	(5,837.8)	109.5%
FY 2000	74,047.7	66,465.6	(7,582.1)	111.4%
FY 2001	83,440.8	76,427.3	(7,013.5)	109.2%
FY 2002	83,426.3	82,240.3	(1,186.0)	101.4%
FY 2003	82,527.9	88,265.3	5,737.4	93.5%
FY 2004	82,750.5	94,864.5	12,114.0	87.2%
FY 2005	83,508.5	101,486.3	17,977.8	82.3%

GASB Funded Ratio



This chart shows the retirement systems' GASB funded ratio peaked at 111.4 percent in FY 2000 and has since fallen to 82.3 percent in FY 2005.

GASB is the Governmental Standards Accounting Board. The mission of GASB is to establish and improve standards of state and local governmental accounting and financial reporting that will result in useful information for users of financial reports and guide and educate the public, including issuers, auditors, and users of those financial reports.

State Health Benefits Program

- 363,435 covered employees
  - 147,928 State employees
  - 216,137 local employees
- 968 participating local employers

The State Health Benefits Program (SHBP) was created in 1961. About 10 percent of the total population of the State, or over 800,000 individuals, are covered by SHBP.

Of the individuals covered by SHBP, about 390,000 are in the Traditional Plan, 240,000 are in HMO's, and 470,000 are in NJ Plus.

See the tab labeled "Health Benefits" in the committee binders for the 2005 SHBP report, which contains detailed information on membership and costs.

State Health Benefits Program

- Provides health benefits coverage to State and local employees, their dependents, and retirees with 25+ years of service
- Local employers elect to participate

The State Heath Benefits Program is self-funded, meaning that the State and other participating employers pay the actual expenses of the plan coverage, plus administrative fees – these employers assume the ultimate financial risk.

The current contract to administer the Traditional Plan, NJ Plus, and the prescription drug plan is with Horizon Blue Cross Blue Shield. The administrative service charges for FY 2005 were about $110 million, about 4.4 percent of total claims.

Prescription drug coverage is included in SHBP, and accounts for about 20 percent of the costs. Dental coverage with premium sharing is also available to State employees through other carriers.

State paid post-retirement medical benefits were extended to teachers in 1987 and certain police and firefighters in 1997.

See the tab labeled "Health Benefits" in the committee binders for an OLS paper on the basics of SHBP and for an SHBP program description by the Division of Pensions and Benefits.

State Health Benefits Program – FY 2007

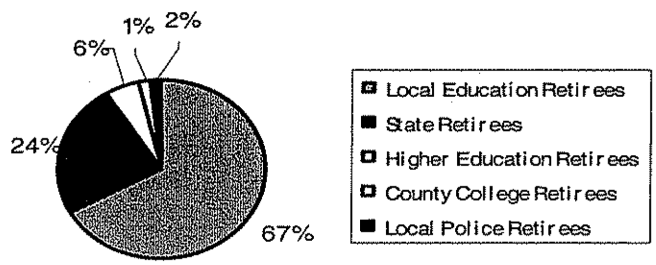
- Total appropriation for active State employees: $615.2 million
- Total appropriation for higher education employees: $362.4 million
- Total appropriation for active employees: $977.6 million

FY 2007 total cost information for local employees was not available. According to the Task Force report, the local employer's cost in FY 2005 was $1.724 billion.

See the tab labeled "Health Benefits" in the committee binders for a copy of a 2003 consultant's review of the SHBP, with an executive summary on page 5.

See also the tab labeled "Health Benefits: General Information" for health benefits plans and costs in the public and private sectors.

Post-Retirement Medical Benefits - FY 2007



The FY 2007 Budget appropriated $1.082 billion in funding for post-retirement medical benefits. Of this amount, 67% or $721.4 million, was appropriated for local school retirees. 24%, or almost $264 million, funds State retiree health care benefits. 6%, or $60 million, funds State higher education retirees. 1%, or $14.7 million, is for county college retirees and 2%, or $22 million, supports certain local police retirees.

Long Term Funding Implications

- In FY 2008, GASB will have new standards for reporting certain post-employment benefits, including health benefits
- State Benefits Review Task Force estimates State obligations at over $20 billion
- Mercer Consulting estimates liabilities at 40-60 times the annual cost of retiree health care, thus the State's unfunded liability may be in the $40-$60 billion range

Task Force Recommendations

- Meet financial obligations by funding the pension system
- Prevent abuses or "gaming" of the pension systems
- Implement Strategic Pension Reforms
- Implement Strategic Health Care Reforms
- Revamp Governance Process for Benefit Enhancements

Specifically, the task force recommended:

I. *The State (and by extension local government) must meet its financial obligation by fulfilling its duty to fund the pension system.*

•From the 1990's to the present, public employers at all levels of government have not fully adhered to their financial commitments to their employees. Before anything can be asked of employees in terms of a changed benefit structure, the State must first meet its existing obligations.

II. *Prevent Abuses or "gaming" of the pension systems.*

•The state pension system primarily exists to provide retirement security to public employees who dedicate their careers to public employment. It was never intended to be a means for a handful of politically connected individuals to enhance their own retirement benefits at public expense.

III. *Implement Strategic Pension Reform.*

•Public employee pension benefits are an integral part of the State's efforts to attract and retain a high quality workforce. The Task Force also recognizes and supports the policy goal and societal benefit of providing a secure retirement for its citizens. However, those goals must be consistent with a benefit structure that is affordable to the State and fair to the taxpayers who pay the pensions and the employees who contribute to their pensions.

IV. *Implement strategic health care reforms.*

•As a fundamental policy goal, the Task Force supports the efforts by the State to ensure affordable access to health care for its employees. However, the State must undertake efforts to manage the double digit increases in costs and encourage smarter health care utilization by consumers and lower costs for the State. As an overriding philosophy, the Task Force believes that participants, both active and future retired, should be contributing towards the cost of their health care.

V. *Revamp Governance Process for Benefit Enhancements.*

•The Task Force recommendations focus on bringing independence, integrity and informed debate to the benefit enhancement review process, specifically the overwhelmingly political process of benefit change via legislative enactment.

See the tab labeled "Workforce Profile" in the committee binders for information on public employees in New Jersey, and the binder also includes information on other States and articles of interest.