



State of New Jersey
DEPARTMENT OF THE TREASURY
DIVISION OF PENSIONS AND BENEFITS
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BRADLEY I. ABELOW
State Treasurer
FREDERICK J. BEAVER
Director

JON S. CORZINE
Governor

September 15, 2006

Ms. Pamela H. Espenshade
Mr. James F. Vari
Office of Legislative Services
State House Annex
P O Box 068
Trenton, New Jersey 08625-0068

Dear Ms. Espenshade & Mr. Vari:

Per the request of Senator Nicholas Scutari and Assemblywoman Nellie Pou, enclosed are the Division's written responses to questions that were raised before the Joint Legislative Committee on Public Employee Benefits Reform hearing on August 24, 2006

Should you have any questions I can be reached at (609) 292-3678.

Sincerely,

A handwritten signature in black ink, appearing to read "Frederick J. Beaver".

Frederick J. Beaver
Director

Enclosures



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Nicholas P. Scutari, Co-Chair
Nellie Pou, Co-Chair
Joint Legislative Committee on
Public Employee Benefits Reform
Office of Legislative Services
State House Annex
PO Box 068
Trenton, New Jersey 08625-0068

Dear Senator Scutari & Assemblywoman Pou:

This is in reply to your August 30, 2006 letter requesting a written response to the following questions raised by members of the Joint Committee on Public Employee Benefits Reform at the public hearing on August 24, 2006.

Assemblywoman Pou:

- The State currently does not charge members who purchase service credit for the cost of health benefits. For individuals who qualify for post-retirement medical benefits by reason of their purchase of service credit, what is the cost to the State?

Response: It is difficult to quantify what the exact cost is to the State for those who qualify for post-retirement medical (PRM) benefits by reason of their purchase of service credit. That is why we would recommend that any changes to the purchase rules include a provision that limits the purchase of non New Jersey service for use in the calculation of the retirement allowance only, but not for qualifying for employer-paid PRM.

However, in an attempt to quantify the cost, we developed a hypothetical example of an individual who is age 55 with 24 years of service who purchases one year of service credit and immediately retires. If that person then lives for 20 years while receiving state-paid member and spouse health coverage, the cost of that coverage, based on annual rate increases of 9% per year, would be approximately \$303,163. On a present value basis the PRM cost would be \$125,884. This cost would be in addition to any increased retirement allowance

benefits the retiree receives as a result of the purchase of the additional year of service.

This example demonstrates how costly PRM coverage can be for one retiree who qualifies for the benefit as a result of the purchase of a year of service credit. However, if the cost of PRM coverage were to added to the member's purchase cost, is likely that the individual would just work an additional year to qualify for State-paid PRM benefits.

- Please develop a list for the committee of the various scenarios under which members of a retirement system are eligible to purchase service credit.

Response: We have attached Fact Sheet #1, a publication of the Division of Pensions and Benefits, which details the various types of purchases available to members of the PERS, the TPAF and the PFRS. Fact Sheet #1 also explains the two types of purchase cost formulas – full cost (which requires the member to pay all costs associated with providing the additional retirement benefits, excluding future retirement COLA expenses and any additional PRM expense) and the less costly shared cost purchase (the member pays for half of the cost of the purchase and the remainder is absorbed by retirement system employers).

In fiscal year 2005-2006, the Division provided 12,330 purchase cost quotations as follows:

PURCHASE TYPES	SHARED / FULL COST	PURCHASES QUOTED FY 2005-2006
Temporary Service	Shared	2,342
Leave of Absence Service	Shared	2,775
Former Membership	Shared	3,021
Out-of-State Service	Shared	986
Uncredited Service	Shared	1,912
Optional	Shared	49
Local Retirement System Service	Shared-TPAF only	13
	Full-PERS & PFRS	0
U.S. Government Service	Full	369
Military Service	Full	<u>863</u>
TOTAL QUOTES PROCESSED		12,330

- Please provide the committee with recommendations to simplify this purchase system.

Response: The Division recommends the following changes to simplify the purchase system, make costs more appropriate, and establish equity across systems.

1. Make all purchases full cost purchases (employee pays all purchase costs except future COLA and PRM) to reduce liability to State, County and municipal employers.
2. Only allow the purchase of service rendered in New Jersey (former membership service, uncredited service, leave of absence and temporary service) to qualify towards establishing eligibility for employer-paid PRM benefits. Do not allow the purchase of out-of-state service (including leaves associated with such service), military service, U.S. Government Service, Local Retirement System service, layoff service, and employment with other out-of-state agencies to qualify for credit towards PRM.
3. Change PERS and TPAF statutes to allow the purchase of temporary or intermittent time that did not lead to a permanent appointment. There are many individuals that are denied the purchase of service due to breaks in employment or non-attainment of permanent appointments. Such breaks in service are often due to circumstances beyond the employees' control. For example, several years ago, certain employees in Civil Service locations sometimes worked for years before achieving a permanent Civil Service appointment (and thereby qualifying for PERS enrollment). If they were laid off, or if family circumstances forced the employee to leave a job before receiving a permanent appointment, there is no provision for them to purchase that service if they become a member of the retirement system at a later date. Currently, PERS and TPAF statutes require that temporary service result without interruption in permanent appointment in order to receive service credit through a purchase.
4. Change PFRS statutes to allow the purchase of pension credit for temporary service with a New Jersey public employer. Currently, the member cannot purchase temporary service that was not rendered in a PFRS-eligible title (examples of currently non-eligible temporary service would include time at the academy or firefighting training and special police service). This will bring PFRS statutes more in line with PERS and TPAF rules and regulations regarding the purchase of

temporary service that has not previously been available to PFRS members.

5. Charge an application fee for processing purchase quotations. This would eliminate requests from those individuals who are not seriously considering purchasing the service. Currently, only one third of purchase cost quotations are authorized for the purchase of service. This recommendation would decrease the number of purchases that must be researched by Division staff. The Department of Personnel currently charges an application fee for examination filings.

Assemblyman O'Toole:

- Please have the Division of Investments explain the reasons for the decline in the pension portfolio beginning in fiscal year 2001. Besides market conditions, what other factors contributed to the decline in market value?

Response: The market value of total pension fund assets was \$82.6 billion as of June 30, 2000. As of June 30, 2006, the market value was \$72.6 million, representing a decline of \$10.0 billion. The decline was attributable to net benefit payments from the pension fund (i.e., member and employer contributions offset by benefit payments and other expenses) of roughly \$17.9 billion. The net investment return averaged 2.3% per year during this period, which added about \$7.9 billion to total assets. By way of comparison, domestic equities (as measured by the S&P 500 index) averaged a return of -0.62% per year during this period, while international equities (as measured by the MSCI EAFE) returned 3.50% per year.

- Please explain the process of closing PERS or any of the retirement systems to new hires. If, hypothetically, the State moves all new employees into a defined contribution plan or some variation other than the current retirement systems, will the funding mechanism for PERS and the other systems be impacted? How would these defined benefit plans continue to be funded in future years without new enrollees?

Response: The total cost of a defined benefit plan is based on the benefits paid to its members and the expenses associated with administering the plan. The benefits paid to the members are based on the plan provisions (i.e., the benefit formula, eligibility provisions) and the experience of the plan (i.e., who will actually retire or terminate and be eligible for benefits, the life expectancy of the members receiving benefits).

Defined benefit plans are typically funded over the lifetime of its members. Plans are funded by employee contributions, employer contributions and investment income. The funding policy determines how much to contribute to the plan each year and is based on the actuarial assumptions and the actuarial cost method. The goal of any funding policy is to build-up sufficient assets over the working lifetime of its members to fully fund the expected value of future benefit payments upon their retirement. In addition, most funding policies are designed to fund the benefits for current members without considering benefit payments or contributions for future new members. Therefore, contributions from new members are not needed to fund the benefits for existing members.

Closing PERS or any of the other systems to new hires will have no effect on the funding mechanism for PERS or the other systems. Even though PERS or the other systems would be closed to new members, the systems would still need to be administered and funded for many years. The current members in PERS and the other systems would continue to make member contributions. In addition, the State and local employers would continue to make contributions each year consisting of the normal contribution (to fund the value of the benefits that accrue each year for the current active members) and the accrued liability contribution (to fund the unfunded accrued liability of the system).

Senator Gormley:

- Please provide the number of individuals who have multiple sources of income in each retirement system and within all the State-administered systems.

Response: Previously provided to both Co-Chairs.

- Please break-out by region of the State the number of individuals with multiple employers in the PERS and TPAF.

Response: Previously provided to both Co-Chairs.

- Please provide the names, salaries and job titles of the top 50 individuals with the highest multiple salaries in aggregate.

Response: Previously provided to both Co-Chairs.

Senator Scutari:

- Please provide the committee with a cost/benefit analysis to both the retirement systems and to individual members of legislation that would

limit dual account holders in the PERS, TPAF and other systems to one employment for pension purposes. What would be the impact to the system if legislation eliminated multiple PERS accounts for tax collectors, health officers and other public employees who serve various municipalities in part-time capacities.

Response: It is difficult to quantify the cost/benefit of limiting dual account holders in PERS, TPAF and other systems. Such individuals have separately qualified for participation in each retirement system, and the employee and the employers each contribute the required contributions to help fund any benefit that may be paid by each retirement system. Since the individuals cannot combine the salaries associated with such dual employment to increase the final average salary used in any one retirement calculation, thereby leveraging the advantages of a particular system, it would appear that the issue is not so much one of retirement system funding, but rather, from a public policy prospective, if it is appropriate for the public to provide a retiree with more than one pension based upon dual retirement system employment.

With regards to multiple enrollments within a single retirement system, in many instances, if the member maintains such multiple employment over the duration of their public career, there is no additional cost to the system, as the individual member is making their contributions based on the earnings from each employer and the employers are similarly contributing on behalf of the individual throughout the course of the career. However, because of the nature of the retirement system formula which bases the retirement calculation upon the three highest years of salary, or in some instances, upon the highest year, these individuals may have more opportunity than the average employee to add multiple employment in an effort to increase the final salary for retirement calculation purposes. The full-time employee with one employer who works overtime to increase their earnings will not have the overtime counted for retirement calculation purposes; unlike the multiple employee who works additional hours for a second (or third or fourth) public employer.

There are also instances, however, when the "employee/participant" has the opportunity to take advantage of the system by reason of the fact that they are contractors rather than employees. An example may be a municipal attorney who has the opportunity to participate but at the same time is retained under a contract which allows other members of his firm to actually do the work.

The key issue, we believe, is the provision of retirement benefits to true career service employees and not to those who do qualify due to loopholes in the existing system.

Letter to Senator Scutari & Assemblywoman Pou
September 15, 2006
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Please let me know if there is any additional information you require at this time.

Sincerely,

A handwritten signature in black ink, appearing to read "Frederick J. Beaver". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Frederick J. Beaver
Director

Enclosure