STATE OF VERMONT
OFFICE OF THE STATE TREASURER

Vermont State Teachers' Retirement Marginal Contribution Rate Study

Submitted Pursuant to Act 114 of 2022

January 5th, 2023

Legislative Direction

Sec. 20. FISCAL YEAR 2025; VERMONT STATE TEACHERS' RETIREMENT SYSTEM; CONTRIBUTION RATES; STUDY

(a) The Secretary of Digital Services and the State Treasurer, in consultation with the Vermont Association of School Business Officers, the Vermont Superintendents Association, and the Vermont-NEA, shall study and make recommendations on the implementation of the marginal rates set forth in 16 V.S.A. § 1944(b)(2)(B)(iii) in FY 2025 and annually thereafter, including whether any adjustments need to be made to the marginal rate structure.

(b) On or before January 15, 2023, the Secretary of Digital Services and the State Treasurer shall submit a report on the study and recommendations described in subsection (a) of this section to the Joint Pension Oversight Committee and the House and Senate Committees on Appropriations and on Government Operations.

Background

Teacher Contribution Rate Structure

Act 114 changed the manner in which active teachers in VSTRS make employee contributions. Prior to Act 114, employee contributions were either 5 percent or 6 percent of earnable compensation. Employees who had less than 5 years of service credit as of June 30, 2014, paid 6 percent and all others paid 5 percent.

Beginning July 1, 2022, employee contributions are no longer differentiated based on when a member began working in a VSTRS-covered position. Instead, employee contributions are based on the member's annual base salary. Act 114 sets forth eight salary tiers, with different contribution rates based on the member tier, as follows:

- At or below $40,000.00 6.00%
- $40,000.01 to $50,000.00 6.05%
- $50,000.01 to $60,000.00 6.10%
- $60,000.01 to $70,000.00 6.20%
- $70,000.01 to $80,000.00 6.25%
- $80,000.01 to $90,000.00 6.35%
- $90,000.01 to $100,000.00 6.50%
- $100,000.01 or more 6.65%

This new tiered (or banded) structure has been implemented successfully, following significant time and expenditure by Retirement Division staff and school payroll officers. The Retirement Division has now closed the first quarter payroll reporting period for the VSTRS system, and while we are still working through some added complexities, we are pleased to see this substantial amount of time and effort result in a successful outcome.

Act 114 maintains this banded structure for FY24, while slightly increasing the contribution rates for each band. However, the law directs another substantial change beginning FY25. In that year, the tiered or banded structure will be replaced with a significantly more complex marginal rate structure. Act 114 provides the following for FY25:

A member's effective rate shall be calculated according to the following marginal rates and income brackets:

- if a member's base salary is at or below $40,000.00, the rate is 6.25 percent;
- if a member's base salary is $40,000.01 or more but not more than $60,000.00, the rate is the equivalent of $2,900.00 on $40,000.00 and 6.75 percent of the member's salary that is $40,000.01 or more;
- if a member's base salary is $60,000.01 or more but not more than $80,000.00, the rate is the equivalent of $3,850.00 on $60,000.00 and 7.5 percent of the member's salary that is $60,000.01 or more;
- if a member's base salary is $80,000.01 or more but not more than $100,000.00, the rate is the equivalent of $5,350.00 on $80,000.00 and 8.25 percent of the member's salary that is $80,000.01 or more; and
- if a member's base salary is $100,000.01 or more, the rate is the equivalent of $7,000.00 on $100,000.00 and 9.0 percent of the member's salary that is $100,000.01 or more.

Accordingly, whereas there were 2 contribution rates in FY22, and 8 contribution rates in FY23 and 24, FY25 will have potentially hundreds of individualized contribution rates, based on marginal differences in teacher income. For example, in FY25, rates will be as follows:

Income	Rate
65,000	6.5000%
66,000	6.5152%
67,000	6.5298%

A chart illustrating the FY23, 24, and 25 contribution rates by gross income is set forth in the Appendix. As the chart illustrates, both structures are progressive insofar as they generally result in greater contributions as salary increases.

However, please note that while Act 114 generally establishes a marginal rate structure that increases the contribution rate with income, the contribution rates for individuals making between $40,000 and $60,000 are higher than the rates for individuals making between $60,000 and $113,000. It is unclear whether this was an intentional rate structure or an error in the legislation.

School Payroll Systems

Vermont school districts and supervisory unions use a handful of different payroll systems, including the following, primarily the following four:

- New England Municipal Resource Center (NEMRC)
- PowerSchool eFinancePlus

- Tyler Profund System
- Tyler Infinite Visions

Some of these systems are older than others and have varying degrees of support. At present, the Agency of Education is under a statutory directive to move to a Shared School District Data Management System (SSDDMS), pursuant to Act 11 of 2018, the intent of which seems to be to complement the adoption of a standardized Uniform Chart of Accounts (UCOA) for all Vermont schools, with the goal of better tracking and understanding trends in education spending, including standardized payroll reporting. While the Treasurer's Office is not involved in this effort, we understand that implementations to this single system are currently on pause pending a report to the House and Senate Committees on Education pursuant to Act 185, Sec. E.500.5. This report was filed by the Vermont Agencies of Education and Digital Services and is awaiting review and potential action. Accordingly, schools will retain their existing payroll systems for the foreseeable future.

During the 2022 legislative session, the Vermont Association of School Business Officials (VASBO) cautioned that implementation of the marginal rate structure would be an expensive and time-consuming effort, posing significant challenges to the schools. In a February 2022 letter (appended here), VASBO explained:

> [D]eduction percentages are not generally calculated individually. Under this proposal, districts will need to run hundreds of individual calculations to determine each teacher's unique pension contribution percentage. Deductions which are calculated individually are time consuming and prone to error.
>
> It will be very challenging for districts and their accounting software vendors to develop systems that can automate this deduction. Eligible retirement wages vary for a variety of reasons including but not limited to post July 1 contract settlements, salary schedule placement adjustments, changes in the teacher's FTE, participation in school committees, summer school. As a result, teacher salaries are adjusted throughout the year.
>
> In order to create a deduction table similar to the state and federal tax tables (currently developed by software vendors, not districts), programmers would need to determine how to establish a separate table for the purposes of calculating retirement contributions, which will require extensive computer programming no matter which accounting/HR software system a district is using.

In anticipation of passage of the marginal rate structure, Treasurer's Office staff worked with school payroll officers over the course of multiple meetings to vet these concerns. We found them to be significant barriers to implementation, requiring substantial investments in programming and process changes.

Report

Act 114 directs that the Agency of Digital Services and the State Treasurer, in consultation with others, make recommendations on the implementation of this marginal rate structure. During the 2022 legislative session, the Treasurer's Office has taken the consistent position that in order to provide additional funding to the VSTRS system, some additional employee contributions would be appropriate. At the same time, the Treasurer's Office consistently urged the Legislature to be mindful of adding each degree of complexity, as increased complexity invariably leads to additional implementation costs and challenges, greater prevalence of error, and increased member confusion.

Both schools and the Treasurer's Office operate on a mix of current and dated information technology platforms. Moreover, school payroll systems vary significantly in their capabilities. Creating a marginal contribution rate structure analogous to the structure used for tax withholdings would tax both systems, and the Treasurer's Office has yet to see evidence that it is even possible given the current state of technology in use.

In order to vet these concerns, the Agency of Digital Services asked the vendors who provide these payroll systems about the feasibility of a marginal rate structure. The results are as follows.

- One vendor, which provides three of the six systems currently in use, indicated that a marginal rate structure would be available as of July 1, 2024, for one of its three systems at no additional cost. This system (System 1) is currently used by approximately 14 districts. The marginal rate structure would not be available for another system (currently in use by approximately 13 districts), although users of this second system are able to migrate to System 1 with a migration training cost. At the time of this report, the vendor had not provided the number of districts which do not have active migration plans. It is unclear whether the marginal rate structure would be available for the vendor's third system (currently in use by only 1 district).
- A second vendor that currently services approximately 21 districts indicates that a marginal rate structure would be possible with a total estimated expenditure of $35,000 - $50,000. This vendor indicated that it would take approximately 6 months to implement this functionality.
- The other vendors, which collectively service 6 districts, did not respond to the requests.

Importantly, while Act 114 was under consideration, all parties involved in implementation of the marginal rate structure cautioned against it in light of the additional complexity. As an example of this complexity, the development of the marginal rate structure appears to have resulted in a mathematical error resulting in excessive contribution requirements for teachers in the $40,000 - $60,000 salary band.

That said, system upgrades are on the horizon. The Treasurer's Office intends to update the most dated element of its teacher reporting system over the course of the next few years. At the same time, schools are in the process of creating a uniform payroll structure pursuant to Act 11 of 2018, a process that while on pause, seems to be still underway.

In light of these significant anticipated changes, and mindful of the just completed overhaul of the teachers' contribution rate structure, it is recommended that the Legislature remove language requiring a subsequent restructuring of the teacher contribution rate structure and maintain the tiered or banded structure just established. To the extent that the Legislature believes that more or less is needed in the way of employee contributions, the banded rates can be modified to increase the rates for all or some of the bands without a second overhaul of the system. Accordingly, while the Treasurer's Office makes no recommendation as to the specific contribution rates, it does believe that the existing structure retains the ability to be both flexible and progressive.

At minimum, any planned change should follow the successful completion of the SSDDMS project so that school payroll systems can (at least theoretically) accomplish the assigned task without jeopardizing the integrity of the reporting system.

VERMONT ASSOCIATION OF SCHOOL BUSINESS OFFICIALS

SERVING EDUCATION THROUGH SOUND BUSINESS PRACTICE

www.vasbo.net

To:	House Committee on Government Operations
From:	Michelle Baker, VASBO President
Subject:	Administrative Concerns Associated with the Legislative Pension Task Force Recommendations
Date:	February 22, 2022

I am writing to communicate the Vermont Association of School Business Officials' (VASBO) concerns regarding the costly administrative requirements that will be placed on local school district offices if the new pension calculations associated with the Legislative Pension Task Force proposal proceed.

As proposed, on an annual basis, VSTRS participants will have a unique contribution rate derived from their base contracted salary as of July 1st. The rate is a "blended" rate across several different salary categories, will be unique to each employee, and cannot be applied across groups of employees using a single deduction. This approach would require district offices to run a calculation for each teacher and to assign them an individualized deduction on an annual basis. Current accounting and payroll systems do not have a process for automating this, so payroll officials would need to assign unique deductions to each employee manually.

Generally, payroll deductions are limited in number and assigned to employees by group. Health insurance deductions, for example, are established based on whether an employee is enrolled in a single, two person, or family plan. For VSTRS deductions, there are two groups - employees contributing either 5% or 6%. The Treasurer's Office notifies school districts which group the employee should be assigned to; once a teacher is assigned to the deduction group, that deduction does not change on an annual basis. In the case of health insurance deductions, where effective contribution rates change on an annual basis, the deductions can be updated in a single location and the system applies them across employees so we don't have to update employee contributions on an individual basis.

In addition, deduction percentages are not generally calculated individually. Under this proposal, districts will need to run hundreds of individual calculations to determine each teacher's unique pension contribution percentage. Deductions which are calculated individually are time consuming and prone to error.

It will be very challenging for districts and their accounting software vendors to develop systems that can automate this deduction. Eligible retirement wages vary for a variety of reasons including but not limited to post July 1 contract settlements, salary schedule placement adjustments, changes in the teacher's FTE, participation in school committees, summer school. As a result, teacher salaries are adjusted throughout the year.

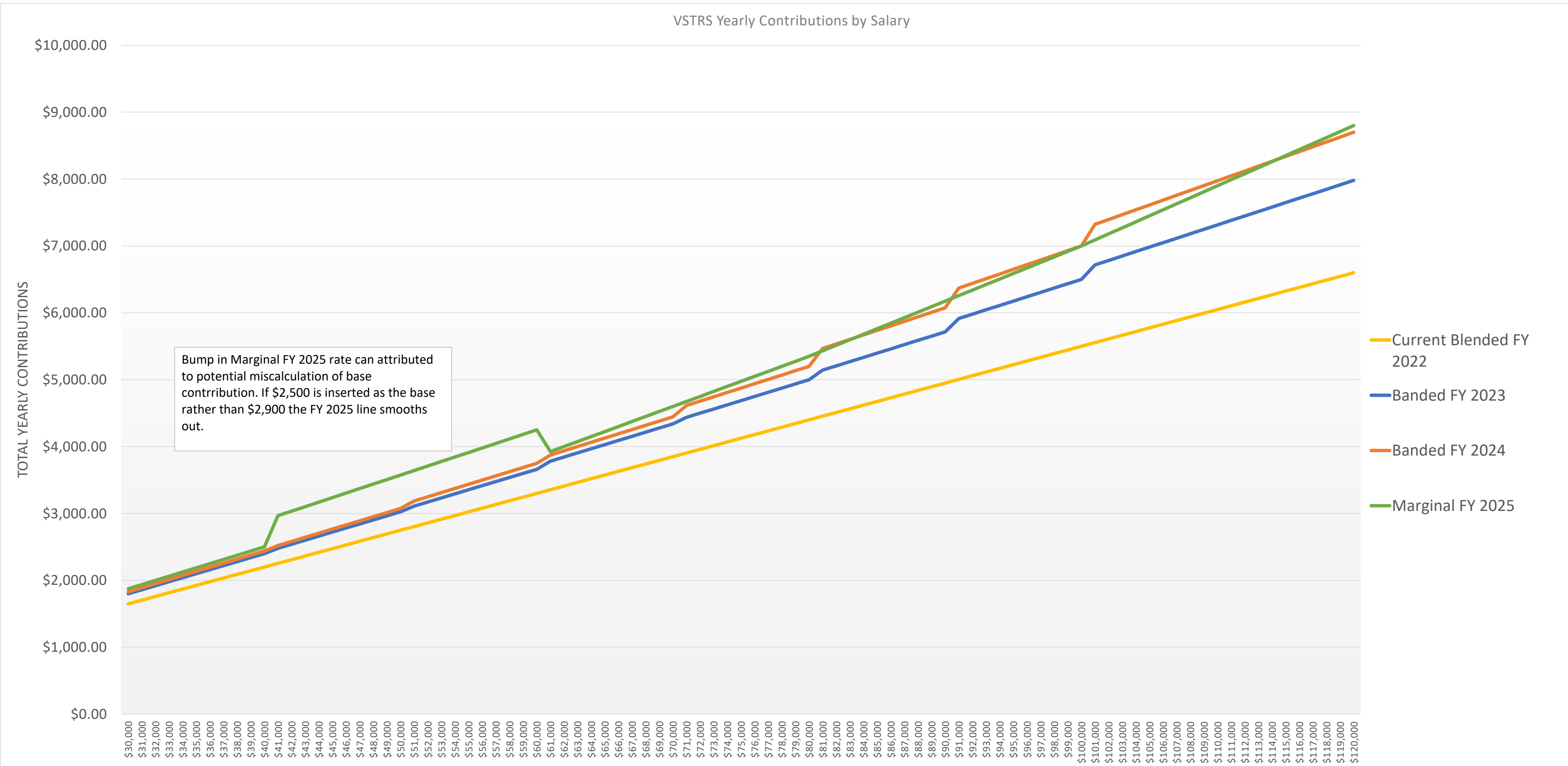
In order to create a deduction table similar to the state and federal tax tables (currently developed by software vendors, not districts), programmers would need to determine how to establish a separate table for the purposes of calculating retirement contributions, which will require extensive computer programming no matter which accounting/HR software system a district is using.

Another concern is that auditing costs will likely increase as it will take a lot more testing for both the Treasurer's office and contracted auditors to ensure rates are accurate.

We understand the importance of a pension system that is solvent and able to meet the commitments that Vermont has made to its teachers and administrators. However, the contribution structure as proposed is costly and administratively burdensome for school districts already short on administrative resources.

We request that consideration be given to a VSTRS contribution schedule that is more standardized, with rates based on levels of income, so that we have 4-5 separate deductions to administer, as opposed to a unique deduction for every employee participating in the system, which will change every year. We are happy to join the Committee at any time to review these concerns and answer any questions.

Cc: Representative Kate Webb, Chair, House Committee on Education



VSTRS Yearly Contributions by Salary
TOTAL YEARLY CONTRIBUTIONS
Bump in Marginal FY 2025 rate can attributed to potential miscalculation of base contrribution. If $2,500 is inserted as the base rather than $2,900 the FY 2025 line smooths out.
Current Blended FY 2022
Banded FY 2023
Banded FY 2024
Marginal FY 2025
$0.00
$1,000.00
$2,000.00
$3,000.00
$4,000.00
$5,000.00
$6,000.00
$7,000.00
$8,000.00
$9,000.00
$10,000.00
$30,000
$40,000
$50,000
$60,000
$70,000
$80,000
$90,000
$100,000
$110,000
$120,000