

**Testimony of John Pelletier to the House Government Operations Committee
Wednesday March 17, 2021 at 9:00 AM**

Madame Chair

My name is John Pelletier, and I am the Director of the Center for Financial Literacy at Champlain College. I am here today in my capacity as a member of the Vermont Business Roundtable's Pension Reform Task Force and as one of the co-authors of this group's report on policy options available to the General Assembly that could help put Vermont's state employees' and teachers' pension and health care retirement systems on a sustainable path for the future.

I strongly agree with Treasurer Pearce that something must be done this year to address the issues created by the large and growing unfunded liabilities of these systems and to put these plans on a clear path toward long-term sustainability and affordability.

I have been asked by you to address two topics: (1) a periodic stress testing; and (2) cost sharing policies.

1. Stress Test

At least 10 states currently require periodic stress test of retirement systems. These stress tests are non-partisan early warning systems. They let you know the likely budgetary impact of market and economic downturns before they happen. It allows for an improvement in long-term budgetary planning. A regular and formal stress test given to the Treasurer, the General Assembly, the Governor and the public can go a long way toward making sure that Vermont's pension and health care funds will weather all cycles of the economy.

As previously described, many states have implemented regular stress tests by legislation, regulation or other policy. In 2019, a report from a center at Harvard's Kennedy School, lists its recommendations on how these stress tests should be conducted and they types of information that they should include.

2. Cost Sharing Policy

The Treasurer's pension recommendations are one time, ad hoc, changes to the pension system for existing employees and future retirees (these include the reduction of COLA, increases in existing employee contributions, modifying the method for calculating benefits, and increases in the waiting times for drawing benefits). As the Treasurer has clearly stated, a large portion of the anticipated savings to Vermont taxpayers will be borne by existing employees that are members of these plans. *But technically, what the Treasurer is recommending is not a cost sharing policy. A cost sharing policy would automatically lower benefits or increase*

employee contributions in response to all future market downturns. This is not what the Treasurer has recommended.

Hopefully, the Treasurers recommendations, when implemented, will fix all funding issues permanently. But what happens if there is a major stock market correction in the next few years? What if interest rates on bonds remain very low for many more years? What happens if life expectancy and other experience factors in the actuarial reports turn out to be as wrong in the future as they have been in the past? What happens if health care inflation continues to materially exceed the Consumer Price Index and the annual increase in Vermont tax revenues, as it has for many years? If any or all of these events happen, then new material funding issues for these plans will likely emerge again in the future. Under the Treasurer's proposal, future unexpected and unplanned costs are borne exclusively by Vermont's taxpayers.

A true cost sharing policy automatically distributes future unexpected cost increases—costs that result from short- or long-term deviations from plan expectations—between Vermont taxpayers and state employees and teachers. Cost sharing policies are often codified in state statute, are transparent, and are set in motion by low investment returns, low plan funding levels or higher than expected increases in medical costs.

For example, a cost sharing policy would exist when State and employee contribution rates changed automatically, annually, depending on investment performance and other assumptions that go into calculating pension costs.

The General Assembly created a pension study commission that issued a report that included a cost sharing policy recommendations in 2009. The initial source of this cost sharing policy recommendation was the Joint Fiscal Committee—not the commission members. Unfortunately, this cost sharing recommendation was never implemented. The 2009 study recommended that Vermont taxpayers would cover 100% of cost increases for the plans up to 3.5% per annum, and any annual pension cost increases over this amount would be shared equally by both the taxpayers and the plan members.

Many states have cost sharing policies. When unplanned events happen, the cost sharing policy automatically fixes the problem without the need for future legislation. AARP issued a report in 2019 that indicated that 10 states have cost sharing policies for pension plans and that 11 states have cost sharing policies for health care retirement plans. The National Association of State Retirement Administrators issued a report in 2018 that indicated that 12 states have variable employee contribution cost sharing policies and that 6 states have variable benefit cost sharing policies. The Pew Charitable Trust noted in a 2017 report that 17 states have some sort of formal cost sharing policy for pension plans.

I am happy to answer any questions that you may have with regard to these and other topics.

Reports referenced in the above testimony are listed below and included as exhibits to my testimony:

2020 Report from Vermont Business Roundtable: *Policy Options for Vermont State Employee and Teacher Pension and Health Care Retirement Systems.*

2019 Report from Harvard Kennedy School for Business and Government, Mossavar-Rahmani Center: *Better Measurements: Risk Reporting for Public Pension Plans.*

2009 Report with Recommendations to the Governor and the General Assembly: *Report of the Commission on the Design and Funding of Retirement and Retiree Health Benefits Plans for State Employees and Teachers.*

2019 Report from AARP Center for State & Local Government Excellence: *An Elected Official's Guide to Variable Benefit and Contribution Arrangements.*

2018 Report from the National Association of State Retirement Administrators (NASRA): *In-depth: Risk Sharing Retirement Plans in Public.*

2017 Report from The Pew Charitable Trusts: *Cost-Sharing Features of State Defined Benefit Pension Plans; Distributing risk can help preserve plans' fiscal health.*