Pension Reform Task Force Memo **10/13/21**

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I have followed some of the discussions by the Task Force and reviewed some of the documents provided. I have the following recommendations based on this review and my past analysis of the situation. I summarize them below, and then discuss each at greater length.

Recommendation Summary:

****** Condition adding significant additional taxpayer resources to pay down unfunded liabilities on system reforms that reduce benefits and increase beneficiary contributions.**

****** Include "insurance" risk sharing provisions that would be implemented if unfunded liabilities increase again over time, or if they decrease.**

****** In the task force report I was very pleased to see an account of the causes of this situation that emphasized the low investment rate of return and the changing demographics as primary causes. However, I wonder if a relevant factor has been omitted in terms of the Teachers' systems: twice in the early 2000s the benefits were made more generous without any increase in contributions.**

****** Use caution about adding the additional teacher retirement costs to the Education Fund without removing non-education state costs that have been imposed on it.**

****** Add charts that provide inflation-adjusted figures along with the numbers that have not been adjusted for inflation to offer a more accurate view of the changes in values across time.**

Recommendation Brief Discussion:

(1) Condition adding resources to pay down unfunded liabilities on system reforms that reduce benefits and increase beneficiary contributions.

I believe that the costs of paying for the unfunded liabilities has to be shared between the beneficiaries and the taxpayers. The taxpayers cannot be contributing more resources without more contributions or reductions in benefits from the beneficiaries.

(2) Include "insurance" risk sharing provisions in both directions – if unfunded retirement liabilities increase over time or if they decrease.

The major factors that have led to the repeated increases of the unfunded retirement liabilities have been low investment returns, increasing longevity of beneficiaries, and rising compensation at retirement. Since these factors may continue to influence the estimated funded levels in the future, it is important to not only make adjustments to address the current situation, but also put in place mechanisms that could be implemented if the same pattern plays out again.

(3) A complete account of the causes of this situation should be in the Task Force Report.

The public discussion of this problem has often centered on the state's failure to make the actuarially determined contributions during the 1990s. While this is true, at that time the systems were rated as almost fully funded. Clearly if the state had made larger contributions then the liabilities now would be lower, but that factor did not cause the current problems. These problems are due to the fact that in estimating the funding level and thereby determining the necessary contributions, assumptions were used that turned out to be wrong. The assumptions about rates of return on investment, about beneficiary longevity, and about beneficiary compensation at retirement that were used in the calculations were not borne out by reality. Two of these factors are not controlled by the state at all – investments are determined by the pension board and longevity (which is a good thing!) by a multitude of forces. The state does have some influence on compensation levels for state employees. I was very pleased to see a good account of these factors in the draft report.

But in addition, it is important to note that back when the systems were still estimated as well funded the teachers were twice granted larger benefits without any increase in state or beneficiary contributions. Such changes may be an added factor in why those systems are now in worse shape than the state employee systems. (In 2000 the vesting period for early retirement and disability retirement was cut from 10 years to 5 years and in 2002 the state's share of OPEB costs increased to 80% from 50%.) I have no way of estimated the significance of these particular changes in the increases in ADEC or unfunded liabilities, but the OPEB contribution increase seems especially important. I believe that this was back when that cost was paid from the Pension Fund, and here it was increased! Perhaps the Committee might consider whether these two changes should be reversed going forward, if the provisions are in fact still in place.

Here are the references for these changes:

- With respect to the change in vesting period in 2000 Acts and Resolves No. 158, there is this change for the Teachers' Retirement System (see highlighted language):

"Sec. 8. 16 V.S.A. § 1937 is amended to read:

§ 1937. SERVICE RETIREMENT

* * *

(f) Upon written application to the board, any group C member who has not attained age 62 but who has attained age 55 and has completed *[~~ten~~]* five years, but less than 30 years, of membership service may retire on an early retirement allowance on the first day of the calendar month next following the filing of the application or the member's separation from service, whichever date is later, provided that the applicant has notified the superintendent of schools in writing 30 calendar days prior to the effective date of the application.

* * *

Sec. 9. 16 V.S.A. § 1938(a) is amended to read:

(a) Upon notice not later than *[~~ninety~~]* 90 days subsequent to the date the member may have separated from service, any member who has had *[~~ten~~]* five or more years of creditable service and has served as a teacher in the state during the five years immediately preceding the date of such separation from service, may be retired by the board of trustees on a disability retirement allowance on the first day of the calendar month next following receipt of application, provided such application is filed not less than *[~~thirty~~]* 30 nor more than one *[~~hundred and eighty~~]* 180 days subsequent to the filing of such notice, or on the first day of the calendar month next following *[~~his~~]* the member's separation from service provided such application is filed prior to such separation, and further provided that the medical board, after a medical examination of such member, shall certify that the member is mentally or physically incapacitated for ordinary service; and, if previously separated from service, that such incapacity has existed since the time of the member's separation from such service; and that such incapacity is likely to be permanent."

- With respect to 2002 Acts and Resolves No. 63, Sec. 175, this increased the State's burden of funding OPEB for the Teachers' Retirement System (see highlighted language):

"Sec. 175. 16 V.S.A. § 1944(c)(12) is amended to read:

(12) Payment of a portion of the cost of health and medical benefits provided by section 1942(p) of this title for retired members shall be made from the pension accumulation fund. The board *[~~may~~]* shall pay up to the amount determined by the board to be equal to *[~~fifty percent (50%)~~]* eighty percent (80%) of the cost of the applicable standard plan for retired members. The board shall pay an equal dollar amount for eligible retirees regardless of the plan selected. All eligible retirees may select health plan coverage from a range of plans approved by the board. Retired members may authorize deductions to be made from their monthly retirement allowance for the balance of the cost of such benefits *[~~and the full cost of such benefits for dependents.~~]* for the retired members and their dependents. The board shall determine annually that part of the cost of the applicable standard plan in excess of fifty percent (50 percent) of the cost for retirees, allocate forty-one and one-half percent (41.5 percent) of that amount to active members, and adjust the members' contribution rate accordingly. Periodically, the board shall approve the following:"

(4) Caution about adding the EF burden new costs without removing other costs.

I note that one possibility listed in the committee's work is to shift more of the costs of teachers' retirement into the Education Fund. Clearly these systems are related to education, but their structure and operation has been entirely outside of the process through which school district education costs are approved voters. It seems inequitable to impose costs on education property taxpayers that they did not approve. In addition, the "normal" cost of pensions that was put into the Education Fund several years ago has increased from $6 million to $36 million from 2020 to 2021. This kind of cost increase will make it harder to provide quality education to students and in the future such an increase could completely swamp the effects of any change in per pupil weights that emerges from that task force.

The state has had control of these systems, and it should take responsibility for the problems resulting from state management. The financial burdens of this situation should not be imposed on school districts and education property taxpayers that never voted to approve of the programs. Resources should not be taken from school children to fix problems wholly created by adults.

If additional retirement costs are in fact to be imposed on the Education Fund, it would make sense to fully re-imburse that fund for certain non education state costs that are paid within it to offset the effect on property tax liabilities and educational quality. These non-education costs are the Current Use Program, the Property Tax Credit, and the Tax Increment Financing Program. I believe that the General Fund should be re-imbursing the Ed Fund for these costs since they are not education.

(5) Lack of Inflation Adjustment.

In the Interim Report there are a number of charts in which dollar figures are provided for periods over 10 years, without mentioning that the figures are not adjusted for inflation, and without providing a version of the numbers that IS adjusted for inflation. At the very least any numerical chart showing dollar figures over time should note that the figures are not adjusted for inflation, and ideally there would be versions of the chart that ARE adjusted for inflation. Even though inflation has been relatively low, across 20 years it makes a difference to the real changes in costs.