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REPORT OF THE COMMISSION TO STUDY THE INTEGRATION OF THE MAINE STATE RETIREMENT SYSTEM WITH SOCIAL SECURITY

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EXECUTIVE SUMMARY

REPORT OF THE COMMISSION TO STUDY THE INTEGRATION OF THE MAINE STATE RETIREMENT SYSTEM AND SOCIAL SECURITY

The Commission reviewed the eligibility and benefit structures of the Social Security System and the Maine State Retirement System. It had its staff prepare a model to compare and contrast Maine State Retirement and Social Security System benefits received by employees at different income levels and with different career patterns. It also reviewed the Tillinghast proposal for an integrated plan and found that it was inadvisable to accept that recommendation given the recent revisions in the Social Security System and federal tax codes.

ELIGIBILITY, BENEFITS AND COST

The eligibility and benefit structures of the Maine State Retirement System and the Social Security System clearly reflect different basic principles upon which they were developed. The Maine State Retirement System has a clear pension system structure with retirement pensions based on salary level and length of service. Social Security is a form of social insurance. It weights its pensions toward the basic needs of the recipients and therefore provides a higher percentage of income protection to low income earners than high income earners and includes additional benefits for dependents. A more detailed examination of the eligibility and benefits are provided in the main report.

Of importance, however, are the 1983 amendments to the Social Security Act which institute a Windfall Elimination Provision and a Government Pension Offset. Prior to these two amendments it was advantageous for a couple to have one spouse covered by Social Security and the other covered by Maine State Retirement or to work the first part of ones career on Social Security and the second part under Maine State Retirement. The 1983 amendments reduce this advantage as compared to the coverage of all career employment under Social Security. The provisions do not apply to employment covered simultaneously by both pension plans as in the case of many Maine municipalities.

Comparing the costs of the two systems was not as straight forward as it first appeared. The State's contributions to the Maine State Retirement System include expenditures to cover the funding of expanded benefits which were enacted in the past but which are funded on an ongoing basis. Under present actuarial assumptions and contribution rates, these expanded benefits will be fully funded by the year 2000. These are referred to as the systems unfunded liability as differentiated from the cost of the system for current employees. Secondly, since employees who leave state service before they have worked 10 years or reached retirement age are not eligible for retirement benefits, the State's contributions to fund current employees' pensions are lower than if the pension rights were portable to most other private and public employment as is the case with Social Security. Employees who leave before they are vested in the system can have their contributions returned. Indirectly, the State's employer contributions are also returned in the form of an actuarial adjustment of the State's contributions, calculated as a percent of salary of current employees.

When the adjustments are made, the Social Security System appears to be funded at a lower contribution rate than the Maine State Retirement System. The disability pensions under Social Security are funded at 1% of salary divided equally between employers and employees. Disability pensions under Maine State Retirement costs 1.48% of salary and are usually attributable entirely to the employer's costs. It should be noted that the eligibility requirements of the Maine State Retirement System disability program are more liberal than those of Social Security.

The combined retirement and survivors benefits are funded under Social Security at 10.4% of salary, again equally divided between employers and employees. Under Maine State Retirement, the costs differ between the state employee plan and teacher plan and among the various municipal plans. The total cost is estimated at 12.12% for the state employees and 12.7% for teachers. Of that amount, the employees share is 6.5%. The higher cost of the Maine State Retirement System is probably the result of the higher percent of coverage of middle and upper level salaries under that system. It should be noted that while the employees' contribution is 6.5%, the State contribution is actually only 4.04% for state employees and 4.42% for teachers because those individuals who leave covered employment before becoming vested (or reaching retirement age) are not eligible for a pension.

BENEFITS ASSOCIATED WITH COMPUTER SIMULATED CAREER PATTERNS

A review of the benefits of the two pension systems does not necessarily describe what an individual will receive in a pension. The actual work career of an individual determines the size of the pension derived from the benefit structure. In order to compare the actual size of the pensions earned, the main report analyzed the out come for four different hypothetical salary levels for each of eight career patterns. (See the main report for a more in-depth description of the computer simulated career model.)

The general finding for a career totally within one system or the other was that the retirement and disability pensions of the Maine State Retirement System generally protected a higher percent of salary than Social Security. Because the benefits are weighted toward the first dollars earned, the percent of salary coverage is lower in the higher income brackets under Social Security. They remain constant under Maine State Retirement. The major exception to this general pattern is for low income earners with dependents. Social Security provides additional benefits for a spouse and dependent children if these individuals do not have their own earned income. For low income families, and to a lesser extent average income families, the added benefits for dependents produces a larger total benefit under Social Security than Maine State Retirement.

For careers divided between Social Security and Maine State Retirement covered employment, it is clearly advantageous to work under Maine State Retirement at the end of ones career rather than at the beginning. The retirement pension for a career which is first covered under Maine State Retirement System does not produce a pension as large as would have been earned if the individual had been covered by Social Security for his or her entire career. For low and average income earners, an individual with a dependent spouse would have earned a larger pension under continuous Social Security coverage than having Social Security followed by Maine State Retirement. The reason that Maine State Retirement provides a lower pension if coverage is early in an individual's career is because the final average compensation upon which the pension is calculated is not adjusted for inflation. If there is a substantial number of years from the end of Maine State Retirement covered employment to retirement, even moderate rates of inflation reduces the purchasing value of the individual's calculated final average compensation. The disparity does not occur under Social Security because prior earnings are adjusted for inflation before they are included in the formula to calculate an individual's pension.

Disability pensions are also negatively affected by having Maine State Retirement System coverage early in one's career. First, the years under non-Social Security covered employment are included as zero earning years in calculating average Social Security earnings. Lower average earnings result in a lower disability pension. For any given salary level, the longer the period of employment not covered by Social Security the longer the period needed to produce an average Social Security earnings high enough to produce a minimal pension. It is also true that for any given employment period, individuals with higher level salaries accumulate a minimal Social Security pension faster than those with lower salaries.

Second, Social Security requires a period of recent covered employment, referred to as a current connection, before an individual is eligible for a disability pension under the system. This current connection is not required of younger individuals who are not old enough to have a work history. The requirement does negatively affect individuals who have worked outside the Social Security System for a number of years and later enter Social Security covered employment.

Survivors benefits were generally higher under Social Security than under Maine State Retirement. The only exceptions is when a spouse of an upper income individual receives a pension under the early retirement/survivors benefit option of the Maine State Retirement System.

As a general conclusion, the Maine State Retirement System provides a better pension coverage for employees who work their entire career under the State Retirement System. For other individuals, past employment history and future career plans have to be considered on a case by case basis to determine whether it is advantageous, from a pension perspective, for an individual to enter Maine State Retirement covered employment or to look for employment covered by Social Security. It should be noted that the disadvantages for some employees are largely a new phenomena resulting from the Windfall Elimination Provision and Government Pension Offset which were enacted as part of the 1983 amendments to the Social Security Act. These new provisions also do not apply to employees in participating municipal districts which offer both Maine State Retirement and Social Security.

TILLINGHAST REPORT

The Commission reviewed the Tillinghast proposal for a new Maine State Retirement System plan which would be integrated with the Social Security System. Tillinghast proposed an offset formula whereby 50% percent of the pension earned from Social Security coverage would be subtracted from an individual's pension from Maine State Retirement. Two arguments were raised by Commission members against an offset mechanism. First, using a proportion of Social Security as an offset means that the actual size of the Maine State Retirement pension paid out to recipients varies according to the size of the Social Security pension for which a retiree is eligible. Because Congress can amend the Social Security benefit levels at any time, the Maine State Retirement System's obligations would increase if Congress ever decided to lower Social Security benefits in the future. To avoid creating an unfunded liability problem in the future, pensions under the Maine State Retirement System should be calculated independently of the size of a retiree's Social Security pension.

A second problem raised in the Commission's discussions was that of equity to lower income employees. The initial calculation of the Maine State Retirement portion of the proposed offset plan followed the same pattern of the present retirement pension and protected the same percentage of salary (final average compensation) for all income levels of employees. Social Security pensions protect a higher percentage of a one earner family's salary than of an individual's income, reflecting the added pension from spousal benefit. It also protects a higher percentage of a low income earner's salary than that of a higher earner. With an offset mechanism, the higher the Social Security pension the higher the offset and the smaller the final Maine State Retirement pension. Under the assumption that families and low income individuals have a more difficult time in meeting basic needs than those with higher incomes, it appears to be inequitable to have a higher offset for families than for individuals and for low income earners than for those with higher incomes.

The Commission concluded that an offset plan was not a desirable option for a new Maine State Retirement System plan designed to supplement Social Security. They felt that any new State Retirement System plan should be calculated independently of a recipients Social Security pension. They also felt that all employees should be treated equally.

CONCLUSIONS

The Commission feels that the analysis provided in the preceding report will provide a sound basis for future policy and actuarial decisions which are necessary for the development of an integrated plan. However, the Commission felt that final recommendations for a proposal needed to wait until the federal government had promulgated its regulations governing the effect of the new tax law on the relationship of private and state operated pension plans with Social Security. The question of whether the benefits under Maine State Retirement are issues for mandatory collective bargaining is also presently under litigation and a ruling is expected early this year.

Once these two issues have been decided, several important policy questions must be addressed. These are:

1. Should a supplemental plan option apply to:
All new employees?
Current employees who choose to join the new plan?
All Current employees?

2. Should the supplemental plan provide the same levels of benefits for retirement, disability and survivor's benefits or different levels of benefits?

3. Should the supplemental plan provide equal percent of salary protection for all income groups or (partially) reverse Social Security's emphasis on low income workers and families by providing higher benefits to higher income earners?

4. Should the supplemental plan be a plan which offsets a portion of an individual's Social Security pension or be calculated by a formula independent of an individual's eventual Social Security pension?

5. Should the supplemental plan help higher income workers protect their income level by providing a State match to the State's present deferred income plan?

6. Should the supplemental plan be paid for entirely by the employer or shared between employees and employer?

The Commission discussed these issues and has reached tentative recommendations on some. The Commission decided that what ever plan is adopted it should not be an "offset" plan. This is because an "offset" plan would reduce the added support Social Security provides lower income workers and because of the potential of creating an unfunded liability if Maine State Retirement System benefits were dependent on future changes in Social Security regulations. The members also felt that any new plan should apply primarily to new employees but that current employees should have the option of joining if they wished.

RECOMMENDATION

The remaining questions, the Commission believed, are partly dependent on actuarial determinations of the cost of different options. It is the recommendation of the Commission, therefore, that the study of the Integration of the Maine State Retirement System and Social Security be extended for one year and that the funds be provided for the Commission to contract with the Maine State Retirement System to provide actuarial services to the Commission.

INTRODUCTION

Faced with the possibility of future initiatives on the part of the Federal Government to incorporate state and local government employees into the Social Security System, the 112th Legislature established a Commission to Study the Integration of the Maine State Retirement System with the Social Security System. The imposition of Federally mandated participation in Social Security would not necessarily require an alteration of the Maine State Retirement System benefit plans as the two systems would operate independently of each other. However, the provision of Social Security concurrently with the present benefits available under the Maine State Retirement System would impose financial burdens on both employees and state and local government employers which neither group may be willing to support. The Maine Legislature considered it advisable to compare the purpose, structure, benefits, and costs of the two pension plans in order to assess the policy questions which must be addressed before an alternative State Retirement System plan can be developed which is better coordinated with the Social Security System than the existing Maine State Retirement System plans.

The specific charge of the commission included, but was not limited to:

1. A review of the public policy under which the United States Social Security System was established and the conditions under which the State Government and local government may establish independent systems;

2. A comparison of the benefits available under the Maine State Retirement System with those available under the United States Social Security System. The comparison shall include an assessment of the actual benefits received by various categories of recipients based on their length of service, level of earnings and their memberships or their spouses' membership in other retirement systems;

3. An analysis of the contribution of employers and employees under both systems. Based upon the actuarial assumptions of the 2 systems, assess the cost of the various components of each system and where possible relate the differences in the premium rates of both systems to the exclusion or inclusion of different categories of individuals from coverage;

4. A review of the January 14, 1986, Tillinghast Report to the Maine State Retirement System, "Proposal for Designing a Program to Coordinate with the Federal Social Security System" and discuss its policy recommendations with the Board of Directors of the Maine State Retirement System; and

5. A public hearing to allow interested employer and employee groups to express their opinions of the advantages or disadvantages of both systems and of the possibility of coordinating the benefits available under the 2 systems.

The following report compares the policies and purposes of the Social Security and Maine State Retirement Systems, the benefit structures of each, and the employer and employee contributions for the various components of each. It presents a model comparing the final pensions received by individuals with various career patterns in order to estimate the benefits actually available to recipients. The legal position of Maine State Retirement System benefit plans in relation to individual employees' contractual and vested rights and in relation to the bargaining rights of unions representing state and local employees is also reviewed. Finally, the policy issues which underlie any decision to develop a new Maine State Retirement System plan are outlined.

PUBLIC PENSION POLICIES

The Social Security System (FICA) was enacted by the federal government to provide a basic pension for all employed workers in the country. It was later expanded to include self employed individuals and to allow state and local governmental agencies to participate. When the Social Security System was first established the question was raised whether the federal government could require state and municipal employers and employees to participate in the system. The consensus of opinion in 1935 was that the division of responsibilties between the federal government and state and local governments precluded federal government taxation of state or local governments.

In 1950, the US Congress amended the Social Security Act to allow states to pass enabling legislation to permit municipalities and states to include public employees if these employees were not already covered by by a public plan. Since a plan for state employees in Maine was established in 1942 and Teachers had their own separate plan starting in 1913 and joined the Maine state Retirement System plan in 1947, Maine's enabling legislation only covered municipal employees. Additional amendments to the Social Security Act in 1955 allowed states and municipalities to expand their enabling legislation to include public employees even if they were already covered by other public retirement plans. However, to include these employee groups, there would also have to be a favorable referendum vote among the membership of the employee group to be covered before Social Security coverage could take effect.

The 1983 amendments to the Social Security Act prohibited state and local government units from withdrawing from Social Security. A 1986 US Supreme Court case on the state of California's attempt to withdraw from participating in the Social Security System upheld the 1983 amendment. Last year the US Congress expended the coverage of the Medicare portion of Social Security to include all new state and municipal employees. This expansion appears to be at odds with the original concern about federal taxation of state and local governments and may open the way for mandatory coverage of all public employees under Social Security.

Maine state government provides a separate pension plan for its employees and public elementary and secondary school teachers. Municipalities and other local governmental agencies had the choice of participating in Social Security, the Maine State Retirement System (MSRS), both systems, or neither system. Local governmental units which joined the Maine State Retirement System have not been required to adopt all of the changes or improvements in benefit structures which the state has adopted in the intervening years. In the following discussion the variations in the plans for local governmental units will not be discussed in detail. It should be remembered, however, that individual local plans may provide lower benefits or have more restrictive requirements than the general provisions outlined in this report.

The Maine State Retirement System and the federal Social Security System are both comprehensive insurance and retirement packages. They provide a retirement benefit; a survivor's benefit to a surviving spouse, dependent children or dependent parents; and disability insurance. Health insurance is also provided to recipients of benefits under FICA and to a portion of the state employee group under MSRS. (State paid health insurance is not provided to retired teachers or to retirees from municipalities who participate in MSRS.) In addition to the pension benefits, the state also provides state employees with group life insurance coverage.

The philosophies upon which the two systems are built differ in significant ways and as a result so do the benefit structures of the two systems. The basic goal of Social Security is to insure individuals and their dependent family members a minimum income if the major wage earner retires or is unable to support the family because of a disability or death. The formula for calculating a pension includes the earnings level of the individual but is heavily weighted toward low income earners. It also provides additional support to cover the needs of dependent family members. While there is a trust fund connected with the system, it is not intended that enough money will be deposited on behalf of current employees to take care of their future retirement and other pensions. The system relies on current funding for current benefit expenditures. The trust fund is intended to even out variations in economic activity and to modulate the impact of expected demographic changes.

The Maine State Retirement System, in contrast, has different principles for each of the three pensions provided. The retirement pension for state employees and teachers rewards individual employees for their length of service. Its pension is computed as 2% of the average final compensation (average of the three highest earning years) for each year of employment. The pension would equal 100% of an employee's final average compensation for an individual who has worked for 50 years. The disability pension protects a fixed 2/3ds of salary for all employees regardless of length of service. Survivor's benefits depend on whether the death is from a job related injury or non-occupationally related. Job related deaths are covered under what is labeled accidental death benefits and equals a fixed percentage of salary. The benefit is 2/3ds of salary if it is a spouse with out dependent children and 100% of salary if it is a spouse with dependent children or dependent children with no living parent. Non-occupationally related deaths are covered under ordinary survivor's benefits and offer three options. The survivor can receive return of the deceased employees contributions, a reduced retirement if the deceased employees was eligible for retirement, or a guaranteed minimum pension based on family size which is the same for all employees regardless of income level or length of service.

The intended goal is for the system to be a fully funded plan, with respect to accrued benefits, where current employer and employee contributions, prudently invested, should be sufficient to cover the future pension costs of those employees. This has been the intended goal of the system, and under the present funding plan all accrued benefits will be fully funded in the year 2000. The employer contribution rates recognize the need to provide for the future benefits of current workers and the accrued pension rights for previous service which were not fully funded at the time they were given. The benefits which were not fully funded are basically those for employees who were given pension credits for service rendered prior to their joining the Maine State Retirement System and those for certain previous increases in benefits.

Social Security was designed to provide a minimum benefit for the broad spectrum of wage earners and thereby reduce the reliance of disabled individuals, widows and their dependent children, and the elderly on state and local welfare programs. To some extent, therefore, Social Security is a needs based program and recognizes the increased demands placed on an individual wage earner by dependent family members. As a result, low income earners with dependents have a substantial proportion of their earnings protected. It was intended that individuals with higher earnings would use private pension plans and personal savings to make up the difference between Social Security and their current or desired standard of living.

At the same time, the Social Security system takes into consideration the work career of recipients. It is clear that the system is designed to reward work. Those with continuous work careers under Social Security covered employment are eligible for higher benefits.

Only in the case of survivor's benefits does the Maine State Retirement System focus on the protection of a basic minimum income. The disability and retirement pensions are intended to reward individuals for working for state or local government and to protect current level of earnings. The pensions do not vary based on the needs of the family unit. In fact, if an employee on retirement wishes to provide for the future needs of a spouse when the retired employee dies, the individual's pension is reduced to provide for the continued coverage. This clearly shows the difference between the pension system structure of the Maine State Retirement System as opposed to the social insurance structure of the Social Security System.

ELIGIBILITY REQUIREMENTS

RETIREMENT

The eligibility requirements for Social Security and for state employees, teachers and participating (municipal) districts are outlined in Chart 1. The major difference in eligibility for retirement is that under Maine State Retirement employees are eligible when they reach age 60, while under Social Security retirement is at age 65. In addition, Maine State Retirement makes an exception for individuals with long service and allows individuals with 25 years of service to retire early with reduced benefits. Social security provides for early retirement with reduced benefits at age 62.

The two systems also differ in their determination of the number of years an individual has to have been employed in order to be eligible for benefits. Under the Maine State Retirement System an individual who is currently employed by the state or as a public school teacher is eligible if he or she has been employed for at least one year prior to retirement. If an individual had left state service or public school teaching prior to retirement age, he or she must have 10 years of service to be eligible for a pension on reaching retirement age. The Social Security System requires an individual to have worked one quarter for every year between the age of 21 (or 1951 which ever comes later) and retirement or a maximum of 40 quarters (equivalent of 10 years). For computational purposes a quarter is defined by Social Security as $440 rather than a period of time ($1760 per year equals 4 quarters regardless of the length of time taken to earn it). The 10 year or 40 quarter requirement is commonly referred to as "vesting." It should be noted that all workers must vest under the Social Security System in order to receive a pension while only those who leave employment prior to attaining retirement age must vest under the Maine State Retirement System.

Social Security is planning to raise the retirement age in the future. This is in response to the demographic trends toward increased life expectancy of older individuals and increased proportion of older individuals in the population. Both trends make the cost of providing benefits greater relative to the number of current contributors. If the benefits under the Maine State Retirement System are adequately funded during the working life of employees, the increased proportion of older, retired, people should not affect the system's finances. Similarly, as long as the actuarial assumptions upon which the contribution rates for current employees are based adequately account for their future increased life expectancy, there should be no financial crisis.

DISABILITY:

Under the Maine State Retirement System individuals are eligible for disability pensions from the first day of employment. (Participating districts who have not adopted this amendment may still require 10 years of service.) Preexisting conditions require a 5 year employment period. For social

CHART 1: ELIGIBILITY REQUIREMENTS

	MAINE STATE RETIREMENT STATE (REG.)	TEACHER	PART. DIST.*	SOCIAL SECURITY
RETIREMENT	Age 60 (25 years) Vesting: 10 years	Age 60 (25 years) Vesting: 10 years	Age 60 (25 years) Vesting 10 years	Age 65 (Age 62) Vesting 40 quarters
NON OCCUPAT. DISABILITY	First day (5 yrs. pre exist. cond.)	First day (5 yrs. pre exist. cond.)	First day (5 yrs. pre exist. cond.)	1 quart. per yr. from age 21 Current connection of a min. of 20 quart. in past 10 years, except no min.under 31
ORDINARY SURVIVORS FOR SPOUSE	First day if children or spouse age 60 or disabled All others at age 60 with 10 years vest.	First day if children or spouse age 60 or disabled All others at age 60 with 10 years vest.	First day if children or spouse age 60 or disabled All others at age 60 with 10 years vest.	Same as disability above except no min. last 10 yrs. no current connect If vested, from: First day if child Age 50 if disabled All others age 65 or early at 60
HEALTH	At retirement if employed for one year Disab.: From disab. approve. New hire: Medicare	None New hire: Medicare	None New hire: Medicare	Ret.: Medic. (emp. & spouse) Disab. Medic. .. after 24 mo.

Definitions: Quarter = $440 or four quarters (one year) = $1760 for Social Security.
Child = age 16 or under for Social Security and 18 or under (under 21 if full time student) for Maine State Retirement

* Benefits for participating districts may be more restrictive if the district has not adopted all the changes in benefits.

security, there are two criteria that have to be met. The first is the criterion of an average of one quarter of coverage for every year between an individuals 21st birth day and age at disability. The second is the requirement of a current connection for those over 31 to have 20 quarters of coverage during the past 10 years.

SURVIVORS

A spouse is eligible for ordinary survivor's benefits from the date of death if the spouse has children age 18 or under (age 22 or under if the children are unmarried and full time students), is disabled, or is age 60. All other spouses are eligible for ordinary survivor's pensions when they reach age 60 if the deceased employee had 10 years of service. Beneficiaries are eligible for accidental (job related death) survivor's benefits from the day of death. Under Social Security the the deceased wage earner had to be employed for one quarter out of every year from age 21. The surviving spouse has to be age 65 with an early retirement option from age 60 (age 50 if disabled), or have children under age 16. Children were eligible until age 18.

HEALTH INSURANCE

Current employees with the state have their state health insurance plan continued if they are in state employment when they become eligible for retirement or disability. They must have been employed for at least one year immediately prior to retirement. New hires are also covered by Medicare. Teachers and participating district employees have health insurance coverage if it is provided by their employer. Under Social Security, an individual has Medicare upon retirement(at age 62 or 65) or after 24 months under a disability pension.

BENEFIT FORMULAS

RETIREMENT

An over view of retirement benefits is presented in Chart 2. The Maine State Retirement System pensions for all groups are calculated under the formula of 2% of the average salary of the three highest years times the number of years of service. This is called the regular or 1/50th plan. (Participating districts may have different formulas and may be on 1/60th or 1/70th plans.) Using the 3 highest years has the effect of controlling for inflation for those pension recipients who were in covered employment for the three years prior to retirement. No inflation adjustment is made for the years between when an employee left covered employment and the time he or she reached retirement age. There are no additional benefits for a dependent spouse or children. If an individual wishes a spouse to continue to receive a pension after the pension earners death, the initial pension is reduced at the time of retirement.

Under social security the calculations are based on the total average earnings, indexed for inflation. The formula includes total earnings indexed for inflation for the years from 1951 through 1986 (or retirement), subtracts the 5 lowest earning years and averages the sum over 31 years (the number of years from 1951 to 1986 minus 5). The period used for computation will be increased one year for each subsequent year until a maximum of 40 years. This establishes the average indexed monthly earnings (AIME) indexed to the value of the dollar at time of retirement. The pension for an individual retiring in 1986 is calculated as 90% of the first $297 of AIME, 32% of the next $1493, and 15% of the average monthly earnings over $1790. These dollar amounts, or bend points, are increased for inflation each year. This individual pension is called the primary insurance amount (PIA) and is used to calculate additional pension amounts for dependents.

The computational formula for Social Security reflects its primary interest in providing a benefit designed to meet basic needs. Maine State Retirement's formula, on the other hand, is designed to protect the same percentage of salary for all employees. This different emphasis is also reflected in the treatment of dependent spouses and children. Under Maine State Retirement, in order to make sure a dependent spouse has a pension when the pension earner dies, the pension recipient has to take a reduced pension at retirement. Under Social Security the increased need created by a spouse, or dependent children, is taken into account by increasing the primary insurance amount by 50% for each dependent up to a family maximum. Under both systems pensions are reduced for early retirement.

The two plans also treat increases in the cost of living differently once individuals are retired. Under the Maine State Retirement System, cost of living increases are capped at 4% per year. Under present Social Security Laws, adjustments

Chart 2: BENEFIT FORMULAS

	MAINE STATE RETIREMENT STATE (REG.)	TEACHER	PART. DIST.*	SOCIAL SECURITY
RETIREMENT				
Worker	(AFC) X (Yrs) X (2%)	(AFC) X (Yrs) X (2%)	(AFC) X (Yrs) X (2%)	PIA = AIME (90% 1st $297 mo. • 32% next $1493 • 15% over $1790)
Spouse	None, reduced to cover any surviving beneficiary	None, reduced to cover any surviving beneficiary	None, reduced to cover any surviving beneficiary	50% of PIA for spouse and each child (Family maximum)
Cost of Living Adjust.	Pension: up to 4% Earnings: Not indexed	Pension: up to 4% Earnings: Not indexed	Pension: up to 4% Earnings: Not indexed	Pension: none if below 3% infla. Earnings: Year prior to retire
Reductions	Early ret. Cover surv. beneficiary	Early ret. Cover surv. beneficiary	Early ret. Cover surv. beneficiary	Early ret. Spouse under age 65
DISABILITY				
Worker	2/3ds AFC	2/3ds AFC	2/3ds AFC	Same as retirement with AIME over years age 21 to disab. minus 5 lowest years.
Spouse	None	None	None	Same as retire
ORDINARY SURVIVORS	Spouse and 1st child $150 mo. each $75 each addit. child (max.= $450 mo.) Reduced retirement if age 60 Return contribution	Spouse and 1st child $150 mo. each $75 each addit. child (max.= $450 mo.) Reduced retirement if age 60 Return contribution	Spouse and 1st child $150 mo. each $75 each addit. child (max.= $450 mo.) Reduced retirement if age 60 Return contribution	75% of PIA for spouse and each child (Family maximum)

Definitions
AFC = Average of three highest earning years
PIA = Primary insurance amount
AIME = Average indexed monthly earnings from 1951 minus 5 lowest earning years from age 21 to retirement with maximum of 35 years.

* Some participating districts have different plans.

in pensions are made if the cost of living increase exceeds 3%. In periods of high inflation, like those experienced in the 1970's, the Social Security increases exceeded general wage increases while the increases for the Maine State Retirement pensions trailed well behind inflation and salary increases.

DISABILITY

Disability pension computations under Maine State Retirement are a flat 2/3ds of average final compensation. There is no allowance for dependents. The cost of living factor is the same as that for retirement benefits. The individual is transferred to a retirement pension on the 10th anniversary of normal retirement (usually at age 70), or as soon as the retirement pension equals or exceeds the disability pension. Service time for retirement accumulates under disability so the cross over point for combined service time is 33 years and 4 months if they are age 60 under the regular plan.

Social Security computes disability pensions on the same formula as retirement benefits. The total earnings, indexed for inflation, are divided by the number of years from age 21 until disability. The 5 lowest earning years are eliminated from the calculation. Assuming that an individual remains in the same economic group throughout his/her work career, the disability pension equals what the retirement benefit would have been if the individual had worked until retirement age.

SURVIVORS' BENEFITS

Under Social Security, the primary insurance amount is calculated on the same formula as the disability pension. The spouse and each dependent child receive 75% of this amount up to the family maximum. For a spouse with one child this equals the same amount (150% of the PIA) as the wage earner and spouse would have received under retirement or disability pension.

The Maine State Retirement calculates ordinary survivors' benefits on a totally different basis than the other pensions. Ordinary survivor's benefits are not computed as a percent of salary but as a fixed dollar amount regardless of income. This amount is set at $150 each for the spouse and first child and $75 for each additional child up to a family maximum of $450 per month. This basic amount is not increased each year for inflation, but once awarded, a survivor's pension is increased by the same cost of living percentage as retirement and disability pensions are. Surviving spouses (or other beneficiaries) can also choose to have the deceased employees contributions returned or, if the employee was eligible for retirement, to receive a reduced retirement pension. If the death results from a work related injury, a beneficiary would receive an accidental survivor's benefit equal to 2/3ds of the deceased employees average final compensation for a spouse alone and 100% of the average final compensation for a spouse with children or children alone.

WINDFALL ELIMINATION AND GOVERNMENT PENSION OFFSET PROVISIONS

Prior to the 1983 amendments to the the Social Security Act, Social security pensions were not adjusted by the amount an individual or spouse received from another governmental pension from employment not covered by Social Security. This created two situations where Social Security paid larger pensions than they would have paid if all governmental emloyer's were covered by Social Security. In one case, a spouse of a Social Security recipient received a full spousal benefit (50% of the recipient's PIA) even if that spouse received a pensions from another governmental pension earned at a job not covered by Social Security. In the second case, it meant that an individual received a full Social Security pension, with its higher percentage of income protection to the first dollars earned, even though the individual may be receiving another governmental pension earned from working on a job not covered by Social Security.

In the first case, if the spouse's earnings had been covered by Social Security, the spousal benefit on one Social Security pension would have been offset by the individual pension on the other. A spouse who received another governmental pension on a job not also covered by Social Security, therefore, received a bonus from Social Security because his or her spousal benefit was not offset by his or her own governmental pension. In order to treat families where both spouses who work at Social Security covered employment equal with those couples where one spouse works on a job covered by another governmental pension but not Social Security, a Government Pension Offset was added to the Social Security Act in 1983. This Offset provision means that 2/3ds of a spouses non-Social Security pension is offset against his or her spousal benefit. As an example, if a Social Security recipient received a monthly pension of $400, his or her spouse would be eligible for a spousal benefit of $200. If the spouse received a governmental pension of $150 from a job not covered by Social Security, 2/3ds of that pension would be offset against the spousal benefit. Two-thirds of the $150, or $100, would be offset against the $200 leaving a Social Security spousal benefit of $100.

In the second case, if the individual had always been covered by Social Security, the earnings from all of his or her jobs would have been added together increasing the individual's life time average earnings under Social Security. However, having some of the earnings not covered by Social Security lowers the calculation of average life time earnings. Since a Social Security pension includes 90% of the first $297 in average monthly earnings and 32% or 15% of higher earnings, if the individual's government pension replaced income at a higher percent than 32% or 15%, then the individual receives a windfall from having earnings split between two pension systems. To correct this differential treatment, the 1983 amendments also enacted a "Windfall Elimination Provision." This provision reduces the computation of the pension from 90% of the first $297 of average monthly earnings to 40% of the first $297. This reduction is phased in over five years and does not become fully effective until 1990. The reduction produced by calculating the pension at 40% of the first $297 instead of 90% also cannot exceed 50% of the pension received from the other governmental pension.

It should be remembered that these offsets only apply to governmental pensions earned from employment not covered by Social Security. If on the date of retirement, the individual, or spouse, is employed on a job covered by both Social Security and another governmental pension, then the offset and windfall provisions do not apply to his or her own or spousal Social Security benefits. Thus, municipal government employees who are covered by both Social Security and Maine State Retirement would not be affected by either the windfall or offset provisions.

COST OF BENEFITS

The costs of benefits are presented as a percent of the last year's salary in Charts 3 and 4. The charts only present information for state employees and teachers. The rates for participating districts vary considerably from district to district and hence are not presented here.

In the first chart the actual contribution rates are used. It clearly shows that the retirement and survivors' benefits for current employees are less costly for the state under the State Retirement System than under Social Security for both state employees and teachers. When the unfunded liability is added, however, the cost to the state for state employees and teachers triples.

As would be expected the more liberal disability provisions and benefits under the Maine State Retirement System result in 50% higher costs than those experienced by the Social Security System. These are paid entirely by the employer under the Maine State Retirement System and divided equally between employers and employees under social security.

When retirement, survivors, and disability are combined, the state's share is slightly lower than the employer's share would have been under social security and slightly higher then social security would have been for teachers. The employees share is almost one percent higher under Maine State Retirement than under social security.

Figures for health insurance are included for Social Security. Health insurance for retirees is not part of the Maine State Retirement System and is funded under a separate account. The state only provides health insurance for state employees and not for teachers. In addition, within the state employee group, it only provides health insurance for those individuals who were employed by the state for at least one year prior to retirement or at the time of disability.

It does not provide health insurance for those who are eligible for retirement pensions who had left state service before reaching retirement age.

The administrative costs are included for comparison purposes. These are included in the percentage figures for the various pensions. The Social Security System indicates that administration is 1.3% of contributions or 0.19% of salary. This is identical to the cost indicated by the Maine State Retirement System.

The cost to the state in the above discussion have been actuarially adjusted to account for those individuals who leave state service before attaining vesting rights in the system. Those individuals who leave the system can withdraw their own contributions but the employer's share is taken into consideration in the actuarial assumptions which determine the

Chart 3. COST AS A PERCENT OF 1985-86 SALARY

	MAINE STATE RETIREMENT STATE (REG.)	TEACHER	SOCIAL SECURITY
RETIREMENT			
Fut. Serv.			
Emp'er	3.69%	4.16%	
Emp'ee	6.5%	6.5%	
Accrued			
Emp'er	9.66%	10.82%	
SURVIVORS			
Emp'er			
Ordinary	0.30%	0.21%	
Accident	0.05%	0.05%	
Emp'ee	0%	0%	
TOTAL RETIREMENT AND SURVIVORS (Excluding accrued)			
Emp'er	4.04%	4.42	5.2%
Emp'ee	6.5%	6.5%	5.2%
DISABILITY			
Emp'er	1.48%	1.58%	0.5%
Emp'ee	0%	0%	0.5%
TOTAL RETIREMENT, SURVIVORS AND DISABILITY (Excluding accrued)			
Emp'er	5.52%	6.0%	5.7%
Emp'ee	6.5%	6.5%	5.7%
HEALTH			
Emp'er	NA	NA	1.45%
Emp'ee	NA	NA	1.45%
ADMINISTRATION	0.19%	0.19%	0.19% (1.3% of 2(7.15%))

employer's rate. Based on estimates from the Tillinghast report on the percent of employees who leave public employment by years of service between 60% to 70% of the individuals who enter public employment in any given year leave before they have completed their 10 year vesting period. It should be noted that the current actuary employed by the Maine State Retirement System does not feel the leaving rate is that high.

This sizable exodus from public employment is also reflected in the reduced cost of the employees contribution when the state assumed the cost of the employees contribution under the stipulation that the state paid "employee's" share were not refundable on termination. Under the state paid system the "employee's" contribution was reduced from 6.5% to 4.55% of salary. This is a ratio of 1.429 to 1. Assuming that the employee's share applies only to retirement and survivor's portion of the Maine State Retirement benefit package, this means that the actual cost of retirement and survivors' benefits for those employees who will become vested is substantially higher than that listed in Chart 3. The adjusted figures for the future benefits for current employees is presented in Chart 4. Caution should be taken in interpreting the figures from this chart. They represent rough adjustments of the costs and have not been developed by a precise actuarial calculation.

Chart 4. COST AS A PERCENT OF 1985-86 SALARY ROUGHLY ADJUSTED FOR THE EFFECT OF EMPLOYEES LEAVING BEFORE VESTING

	MAINE STATE RETIREMENT		SOCIAL
	STATE (REG.)	TEACHER	SECURITY
Fut. Serv.			
Emp'er	5.27%	5.94%	
Emp'ee	6.5%	6.5%	
SURVIVORS			
Emp'er			
Ordinary	0.30%	0.21%	
Accident	0.05%	0.05%	
Emp'ee	0%	0%	
TOTAL RETIREMENT AND SURVIVORS (Excluding accrued)			
Emp'er	5.62%	6.2%	5.2%
Emp'ee	6.5%	6.5%	5.2%

The adjusted figures allows for a truer comparison of the costs of the pensions per covered employee. The comparison indicates that the future costs for current employees exceeds that of Social Security for each of the categories in the Maine State Retirement System. It is 4/10th of a percent higher for state employees, one percent higher for teachers. The difference between the employer's actual and adjusted costs under the State Retirement System represents the additional amount the system would cost the state or participating districts if the benefits were completely portable similar to Social Security. Conversely, given the lack of portability, the difference indicates the amount those leaving the system contribute to holding the employer's costs down.

COMPARISON OF MAINE STATE RETIREMENT SYSTEM WITH SELECTED OTHER STATES

Maine is one of 6 states which does not participate in the Social Security System for its employees. In examining Maine's system relative to a potential integration with social security it is of interest to examine the benefit packages of these states. It is also potentially useful to examine the packages of selected other states which do provide Social Security. The following 6 charts present a condensed overview of the retirement, disability, and survivors' pensions for Maine and the 5 other states which do not offer social security plus Maine and 6 states recommended as having relatively good supplemental state plans to Social Security.

The 5 other states which do not provide social security have similar retirement provisions as Maine. Three of the 5 have vesting periods of 5 rather than 10 years and 1 has a pension based on 40 years (2.5% of salary for each year worked) as compared to Maine's 50 years (2% of salary). The states which offered Social Security generally had 10 year vesting periods. The pensions were computed as a straight supplement to social security with 4 of the 6 computing the pension as 1.5% (or less) of salary times the number of years worked.

The disability provisions of both groups of states followed their retirement benefit computations. A clear difference appeared in their definition of disability. The states which were integrated with social Security tended use the Social Security definition of too disabled to perform any suitable work. The 5 states which did not offer social security tended to provide a disability pension, at least in the first years, if an individual was too disabled to perform his or her present job.

Only one of the other five states without Social Security was similar to Maine and had a fixed dollar amount for survivors benefits. The other states computed Survivors' benefits as a percent of final salary for spouse and children. Vesting periods ranged from one to five years. Those which offered Social Security tended to have longer vesting periods and typically followed the retirement benefits or a percent of salary.

The 6 states providing Social Security included in this survey all had "straight" supplemental state plans. The supplemental benefits were calculated independently of any Social Security benefit. None of them had an "offset" plan whereby a proportion of the amount from Social Security was offset against the state pension. An offset reduces the amount of state pension and also tends to reduce the higher percentage of salary coverage for lower income earners. The Social Security Pensions of low income workers are higher and, therefore so is their pension offset.

Chart 5. RETIREMENT PROVISIONS OF STATES WITH SOCIAL SECURITY

STATE	VESTING PERIOD	RETIREMENT AGE	BENEFIT	DEPENDENT PROVISIONS	RESTRICTIONS ON EARNINGS	COST-OF-LIVING ESCALATOR
Florida	10 yrs.	62-or 30 yrs. service	1.6%xFAS(5)*x yrs	elective options	no restrictions outside system 12 mo. post ret. restriction within system	3% year max.
Vermont	10 yrs.	62	1 1/4% x FAS(5) x yrs.-max 50%- Designed to provide slightly more than full salary when combined with FICA	elective options	no restrictions outside system	after 12 mo.-1/2 of C.P.I., capped at 5%
Connecticut	10 yrs.	Tier 1 - 55 w/25 yrs. (contributory) Tier 2 (non-cont.)-65	Tier 1-dependent on cont. level (5% or 2%) Tier 2-1 1/3% x FAS (3) x yrs.	elective options	90 days/yr within the system No restrictions outside the system	AD HOC adjustment**
Kentucky	5 yrs.	30 yrs service or age 65	1.85% x FAS(5) x yrs.	elective options	under age 65 - $5,750 65-70-$7,800 over 70-no restrictions	4% year
Tennessee	5 yrs.	55 w/red. benefits 60 or 30 yrs. service	1 1/2% x FAS(5) + 1/4% of salary over $15,000 x yrs	elective options	No earnings within system	3% yearly
Texas	10 yrs.	60	1.5% x FAS(3) x 10 yrs + 2% FAS x add. yrs.	elective options	1/2 of salary	AD HOC

* FAS - Final Average Salary (5) or (3) - indicates average highest 5 or 3 yrs. compensation
** AD HOC indicates Legislature decides when and how much to adjust

Chart 6. RETIREMENT PROVISIONS FOR STATES WITHOUT SOCIAL SECURITY

STATE	VESTING PERIOD	RETIREMENT AGE	BENEFIT	DEPENDENT PROVISIONS	RESTRICTIONS ON EARNINGS	COST-OF-LIVING ESCALATOR
Colorado	5 yrs.	65-full Benefits Reduced Benefits 55/20 yrs. service 60/10 yrs. service 65/5 yrs. service	2.5% x FAS(5)* x yrs. up to 20, plus 1% ea. yr. over 20-max 70% plus post retirement heath care benefit	elective options	Some limits within system. No restrictions outside system	3% of base ret. amt. per yr., plus AD HOC every other year
Ohio	5 yrs.	60 with 5 yrs. service	2.1% x FAS(3) x yrs. up to 90%	elective options	No restrictions out- side system. 59 days per yr. if within retirement system	3% yr.
Louisana	10 yrs.	30 yrs. service 60 - 10 yrs. service 55 - 25 yrs. service	2.5% x FAS (3) x yrs.	elective options	1/2 of salary	all AD HOC**
Massachusetts	10 yrs.	age 65	2.5% x FAS x years Drops .1% for ea. yr. under 65	elective options	Difference between FAS and pension, plus $5,000 allowed	AD HOC after 2 yrs.
Alaska	5 yrs.		2% x FAS (3)xyrs.			1/2 or 3/4 of cost of living index yearly
Maine	10 yrs. 25 yrs. service	age 60	2% x FAS (3) x years	elective options	No limitation on earnings outside system, earnings in system limited	Cost of living index up to 4% per year

* FAS - Final Average Salary (3) or (5) indicates average of highest 3 or 5 yrs. compensation
** AD HOC indicates Legislature decides when and how much to adjust

Chart 7. DISABILITY PROVISIONS FOR STATES WITH SOCIAL SECURITY

STATE	VESTING PERIOD	DEFINED	BENEFIT	DEPENDENT PROVISIONS	RESTRICTIONS ON EARNINGS	TRANSITION
Florida	10 yrs, or 5 yrs. if not fully insured by FICA	any suitable work	In addition to FICA. May elect same options as retirement or 25% of FAS.	elective options	no earnings allowed w/o termination of benefit	some leeway in vesting period
Vermont	10 yrs.	same work - re-exam possible but not routine	1 1/4% xFAS(5)* - based in 40 yr employment min-25%. max-50% In addition to FICA	elective options	outside system coverage - no restrictions	no provision - state cont. remains intact for additional # of yrs. equal to # of yrs. employed
Connecticut	10 yrs. or 5 yrs for contributory system occ.-immediate	1st 2 yrs.- same job any suitable work thereafter	1 2/3% x FAS(3) x yrs. projected to age 60. In addition to FICA (if qualified for FICA), up to 100% of salary (salary adj. yearly)	elective options	1st 2 yrs -20% of earnings offset Thereafter, earnings, comp., FICA, + disability may not exceed 100% of base salary, which is recomputed yearly as if worker was still employed.	employee contribution refundable
Kentucky	5 yrs.	any suitable work	1.85% x FAS(5) x yrs.(proj 25 yrs or to 65) In addition to FICA, not to exceed 100% of salary.	elective options	no earnings allowed w/o termination of benefit	employee cont. refundable - no interest
Tennessee	occ.-immediate non-occ. -5 yrs.	any suitable work	1 1/2% x FAS(5) x yrs (proj to 20) not to exceed 90% of salary when combined w/FICA	elective options	$3,600 allowable	can withdraw pre-1981 contributions + 5% of post 1981 state contributions
Texas	occ-immediate non-occ. -10 yrs.	any suitable work re-exam every 2 yrs	1.78% x FAS(5) x actual yrs of service	elective options	no earnings allowed unless non-work income	employee cont. refundable + 5% int

* FAS (5) or (3) indicates final average salary - average of highest 3 or 5 years compensation

Chart 8. DISABILITY PROVISIONS FOR STATES WITHOUT SOCIAL SECURITY

STATE	VESTING PERIOD	DEFINED	BENEFIT	DEPENDENT PROVISIONS	RESTRICTIONS ON EARNINGS	TRANSITION
Colorado	5 yrs.	same job - re-exam on individual basis	50% of FAS (3yr)* More if greater than 20 yrs. service	elective options	No earnings allowed w/o termination of benefit	No provisions 8% employee cont. refunded(no interest)
Ohio	occ. immediate non-occ. - 5 yrs.	same job - re-exam after 1 or 2 years	2.1% x years (proj) x FAS (3) min. 30% max 75%	elective options	no earnings allowed w/o termination of benefit	No provisions 8 1/2% employee cont. refunded(no interest)
Louisiana	10 yrs.	same employer - yearly exam until age 60	2.5% x FAS(3) x yrs. (projected)	elective options	yes-specifics N/A	No provisions 7% employee cont. refunded(no interest)
Massachusetts	occ - immediate non-occ - 10 yrs.	same job - but trying to change it to any suitable work. Re-exam every 3 yrs.	2.5% x FAS x yrs. (proj. to 55)	elective options	difference between benefit & FAS	No provisions Employee con-tributions refundable & interest
Alaska	occ. immediate non-occ. 5 yrs	occ.- same job non-occ. same employer. Yearly statement of continued eligibility (based on FICA standards)	2% x FAS(3) x yrs			Supplemental benefits elective for less than 5 yrs employment Employee cont. refundable
Maine	occ. immediate non-occ. immediate except 5 years for preesisting condition	same job first 5 years any suitable work after 5 years	2]3 x FAS	elective options	none upt to $10,000 then dollar for dollar offset	No provisions, employee cont. refundable with interest

*FAS - Final Average Salary, highest 3 yrs.

Chart 9. SURVIVOR'S BENEFIT PROVISIONS FOR STATES WITH SOCIAL SECUIRTY

STATE	VESTING PERIOD	BENEFIT	RESTRICTIONS ON EARNINGS
Florida	occ-immediate non-occ. -10yrs	1/2 monthly salary at death until remarriage <u>or</u> an early retirement type pension which would not be terminated	none
Vermont	20 yrs. or age 55	as if retired at age of death	none
Connecticut		only for hazardous duty, otherwise whatever disability option chosen	
Kentucky	4 yrs 5 yrs.	$2,500 death benefit elective minor children benefit 66% - 50% - 25%	none
Tennessee	occ.-immediate non-occ.-5 yrs.	elective options	none
Texas	10 yrs.	If less than 20 yrs. service, amt. in acct. plus 5% for ea. yr. service(interest) Over 20 yrs, 10 yr. or lifetime annuity based on retirement at age of death.	none

Chart. 10 SURVIVOR'S BENEFIT PROVISIONS FOR STATES WITHOUT SOCIAL SECURITY

STATE	VESTING PERIOD	BENEFIT	RESTRICTIONS ON EARNINGS OR REMARRIAGE
Colorado	1 yr.	40% of salary for 1 child 50% two or more 25% dep. spouse, starting at 60 if greater than 10 yrs. employment, 55 if 10-15 yrs., & 50 of over 15 yrs.	None on earnings, but terminates if spouse remarries.
Ohio	5 yrs.	40% with 1 child 50% with 2, 60% 3 or more children 25% F.A.S.* for dep. spouse at age 62 if less than 10 yrs. employment, age 50 if greater than 10 yrs.	None on earnings, but terminates if spouse remarries.
Louisana	3 yrs.	75% of F.A.S. for minor child 50% for dep. spouse, payable form time of death.	No restrictions
Massachusetts	2 yrs. employment, 1 yr. marriage	$250 a month spouse, $120 add. for 1 child $90 add. 2 or more children; payable at death of employee	No restrictions on earnings. May be reduced or eliminated upon remarriage.
Alaska		Occ. death-40% of monthly wage at death Less than 1 yr. employed contributions refunded.	
Maine	none except 10 years for spouse without dependent children	$150 a month for spouse, $150 for 1st child, $75 for 2nd and 3d child for a $450 maximum	None on earnings

* FAS - Final Average Salary

Chart 11. CONTRIBUTIONS TO STATE RETIREMENT SYSTEMS

States without FICA	Employee	Employer
Alaska	4.25% rising to 6.75% Jan '87 (4% int)	N]A
Colorado	8% (tax deferred no interest)	12.2-12.5%
Ohio	8.5% no interest	13.75%
Massachusetts	5%, 7%, or 8% depending on benefit (& interest)	13.5%
Louisiana	7% (no interest) agency remittances	10.2% plus
Maine	6.5%	5.5% - 6% for future service
State with FICA		
Connecticut	5%, 2%, or 0 12.56% depending on employee cont & type of duty. 19% - includes unfunded liability	6.28% to
Florida	non-cont. since 1975	12 1]4%
Kentucky	5% (no int. tax def.)	7 1]4%
Tennessee	non-cont. since 1981 Biennially	Fluctuates
Texas	6% (5% int.)	7.4%
Vermont	95% non-contributory yearly	9%-fluctuates

A COMPARISON OF COVERAGE UNDER SOCIAL SECURITY AND THE MAINE STATE RETIREMENT SYSTEM

COMPUTER SIMULATED MODEL CAREER PATTERS

In order to analyze how the Social Security and the Maine State Retirement System plans compare in practice, several example compensation and career patterns were created. These example careers are necessarily simplifications of the variety of actual career possibilities. They do, however, give a general picture of the differences and similarities of the two systems. By using a computer simulation model, pension benefits for each of the example careers were calculated as if the individuals were retiring in 1986.

Because Social Security starts its calculations from the year 1951, the model is based on the average salary earned under FICA for the years 1951 to 1986 (a total of 36 years). Four salary groups were created. A LOW group was computed at 1/2 the average FICA salary. A MIDDLE/LOW group was set at the average salary, and MIDDLE/HIGH and HIGH groups were set at 2 and 3 times the average salary respectively. The 1986 salaries for each of these four groups are $8,725; $17,451; $34,903; and $52,355. For each of these income groups, income tax rates were estimated using the new federal tax code and the state income tax rate. The overall average rate on gross earnings for each of the groups are calculated as 0%, 7.47%, 13.39%, and 17.48% respectively. This makes the net (after tax) income for each group $8725, $16,148, $30,230, and $43,204 respectively.

Within these salary groups eight coverage career patterns were analyzed. Five assume that individuals have remained in the same income group through out their entire careers. The remaining three provide salary increases beyond that of the average wage increases during the period.

Of the first five, two were single coverage patterns where an individual worked his or her whole career under FICA or MSRS. A third was a double coverage career where an individual was simultaneously covered by both FICA and MSRS. Double coverage is provided by certain participating districts or municipalities.

The next two are based on individuals working part of their career under FICA coverage and part under MSRS. The careers are split with 20 to 21 years under FICA and 15 to 16 years under MSRS. They differ as to whether the FICA coverage is at the beginning or end of the career.

The final three model careers which show advancement from one salary category to another. The salary progression is 5 years in the LOW group and then 15 years in each of the two MIDDLE groups. Two of the patterns represent careers exclusively within FICA or MSRS and the third a dual coverage career.

For each of these 8 career types comparisons are made for individual coverage and for family coverage. A simplifying assumption behind the model is that in all cases the family coverages are based on the "traditional" family where there has been one earner(i.e. not a family where both spouses have been contributing to retirement programs). (See Appendix A forma list of assumptions used in model.)

RETIREMENT BENEFITS

MSRS FORMULA

The MSRS uses a relatively straight forward formula of an individual's average final compensation (AFC) times the number of years in covered service divided by 50 (2% of average final compensation for every year of covered service). Some participating districts use the old 1/60th or 1/70th calculation formula. This computation determines the pension for an individual.

A recipient may select an option to insure that a spouse will continue to receive a partial pension after the provider who earned the pension dies. However, this results in a reduced pension during the life of the pension earner compared to a recipient not selecting that option. To provide a 50% pension for a spouse the same age as the recipient, the pension would be reduced to 91% of the individual pension.

The three highest years of compensation used to determine an individuals AFC are also not adjusted for inflation before the pension is computed. This means that between two individuals with the same number of years of service in the same job classification, the person who held the job late in his/her career receives a much larger pension than the individual who held the job early in his or her career.

The normal retirement age is set at age 60. Individuals can retire early if they have 25 years of service. The pension amount is reduced based on the number of years until the individual reaches 60.

FICA FORMULA

FICA computations start from a different point. They assume that all individuals have the same length of work career -- from 1951 or age 21 to eligibility for benefit. What varies is only the amount of covered earnings over an individual's career. After adjusting the covered earnings (before tax earnings up to the FICA maximum) for wage inflation to bring previous earnings up to current salary levels, the five lowest earning years are subtracted. The sum of the remaining earnings are divided by the number of months from 1951 (or age 21) to retirement minus the 5 lowest earning years to determine the average indexed monthly earnings (AIME).

The basic pension amount under FICA is called the primary insurance amount (PIA). For 1986, the PIA was computed at 90%

of the first $297 of AIME, 32% of the next $1493, and 15% of AIME above $1790. These break points for determining the percent of AIME used to calculate the PIA are called bend points and are increased each year to adjust for inflation. As indicated previously, these bend points provide a higher percentage of salary coverage for low income earners than high income earners.

The percent of income protected below the first bend point is reduced from 90% to 40% for individuals who were employed by a FICA covered employer at one part of their career and a MSRS participating employer under another part of their career but were not under an employer with dual coverage. This is a recently enacted provision to remove the windfall resulting from FICA's weighting of benefits to individuals with lower average FICA covered earnings but who receive a pension from another source. This reduction is modified when necessary so that an individual never has their FICA pension reduced by more than 1/2 of the size of their second pension.

The retirement age for computing pensions is 65. An individual may retire at anytime after reaching age 62. A person who retires early receives a reduced pension. At age 62, this amounts to a reduction of 20% from what the pension would have been at age 65.

If the individual has dependents, the primary insurance amount for the individual is increased by 50% for each dependent up to a family maximum. This increase is meant to reflect the greater economic needs of an individual with dependents over a single individual. At the death of the pension earner, the spouse receives 75% of the individual pension amount (50% of the pension the couple had been receiving.)

RESULTS

Table 1 presents the percentage of 1985-86 salary protected under each of the first five alternative career coverage patterns. These patterns assume that individuals remained in the same income group through out their careers. The percentages are based on the final, after tax, 1986 salary. The MSRS pensions in each group are also reduced by the tax rate applied to each income group.

Computations are presented for both single recipients and one earner couples. In addition, Social Security (FICA) coverage is calculated for retirement at age 65 and 62. As indicated above, individuals can retire under Maine State Retirement at age 60 and receive full benefits.

Those employees with dual coverage under both FICA and MSRS throughout their whole working career, as expected, get the largest pensions. For all income groups, pensions are close to or over 100% of estimated final after tax salary. For the lowest income group, the pension is actually as high as 143% of final salary for a couple and 123% for an individual.

For all single recipient and for couples in the MIDDLE/HIGH or HIGH income groups, the next highest pension is provided by straight MSRS coverage. The coverage under MSRS is 69% of salary for individuals and 63% of salary for a couple. For a couple in the LOW or MIDDLE/LOW income group, however, FICA provides equal or higher coverage than MSRS. The FICA family maximum for both the lower two income groups protects almost 20% more of an individual's income than MSRS.
A comparison of the two split coverage career patterns shows the impact of adjusting FICA and not adjusting MSRS for inflation before computing pensions. Those who have MSRS covered employment early in their career receive a smaller MSRS pension than those who had MSRS coverage at the end of their career. FICA applies an inflation adjustment before computing the pension so it makes virtually no difference if the FICA coverage came early or late in a person's career. When the two are added together, the percent of income covered is always greatest when MSRS covered employment occurred second.

Table 1: Retirement comparison of coverage under FICA and MSRS for single earners and one earner couples for individuals who remain in the same income group though out their career.

	LOW	MIDDLE/LOW	MIDDLE/HIGH	HIGH
SINGLE:				
1986 NET SALARY	$8725	$16,148	$30,230	$43,204
FICA only --65	53%	45%	31%	22%
--62	43%	36%	25%	18%
MSRS then FICA --65	43%	33%	26%	20%
--62	36%	28%	22%	18%
FICA then MSRS --65	53%	48%	42%	38%
--62	49%	45%	39%	37%
MSRS only	69%	69%	69%	69%
Both FICA & MSRS --65	123%	114%	100%	91%
--62	112%	105%	94%	87%
MARRIED:				
FICA only --65	80%	67%	46%	33%
--62	63%	53%	36%	26%
family maximum	82%	82%	54%	39%
MSRS then FICA --65	60%	45%	34%	26%
--62	48%	37%	28%	22%
FICA then MSRS --65	62%	54%	44%	39%
--62	55%	48%	41%	37%
MSRS only	63%	63%	63%	63%
Both FICA & MSRS --65	143%	130%	109%	96%
--62	126%	116%	99%	89%
--family maximum	145%	144%	117%	102%

Straight FICA coverage provides consistently a higher pension than the split pattern where MSRS covered employment was early in the career. This is true for both individuals and couples, but the difference is particularly significant for couples. The difference is larger in the lowest two groups. For couples in these two income groups, the straight FICA coverage protects 15% to 20% more of final salary than the split career pattern. For an individual, FICA coverage protects 7% to 12% more of final earnings.

Among couples, FICA also provides a higher pension than the the split career pattern where MSRS employment came second for the LOW and MIDDLE/LOW income groups. The range here is from 5% to 20% more income protected under straight FICA coverage.

Though there are several interrelated trends here which overlap, two general trends appear. First, single individuals and higher income earners are advantaged under the MSRS system. Lower income couples receive higher pensions under FICA. The weighting of pension coverage to the initial dollars earned and providing additional support for dependents means that low income earners and those with dependents would have larger pensions under social security. Second, under both of the two split career patterns, couples receive lower pensions than if they had FICA coverage during their entire career. Single recipients would have had higher pension coverage under FICA only under the split career pattern where MSRS covered employment occurred early in their career.

The final three career patterns examined were those representing advancement from one salary group to another. (See Table 2.) This career advancement pattern was based on 5 years in the LOW income group, 15 years in the MIDDLE/LOW group, and 15 years in the MIDDLE/HIGH group. The percent of salary protected is computed for straight FICA and straight MSRS coverage and dual coverage. These percents are compared with the percent of salary coverage for a recipient who had always been in the MIDDLE/HIGH group.

The basic conclusion to be drawn from the table is that both FICA and MSRS are heavily weighted to the highest earning years in determining the size of an individual's pension. The percent of final salary covered is in the career advancement pattern is virtually identical to that in the pattern where the individual has always been in the MIDDLE/HIGH income group.

This means that within the career advancement pattern, the double coverage career provides the largest pension, protecting about 100% of salary for individuals and couples. MSRS protects 63% and 69% respectively of the final salary for individuals and couples. Straight FICA coverage protects 24% to 53% of income.

Table 2: Retirement coverage under FICA and MSRS for single earners and one earner couples with increased earnings during the individuals career.

	THREE LEVEL CAREER	MIDDLE/HIGH
SINGLE:		
1986 NET SALARY	$30,229	$30,229
FICA only --65	30%	31%
--62	24%	25%
MSRS only	69%	69%
Both FICA & MSRS --65	99%	100%
--62	93%	94$
MARRIED:		
FICA only --65	45%	46%
--62	35%	36%
family maximum	53%	54%
MSRS only	63%	63%
Both FICA & MSRS --65	108%	109%
--62	98%	99%
--family maximum	116%	117%

DISABILITY PAYMENTS

MSRS FORMULA

The MSRS formula for determining a disability pension is calculated at 2/3 of an individual's average final compensation. If an individual has not worked long enough to compute a three year average, the average of the years the individual has worked is used. The formula is not based on the individual's length of service. It is also not reduced to provide future payments for a spouse. This formula results in a pension equivalent to the pension an individual would have received if they had worked for under MSRS coverage for 33 1/3 years.

The disability pension is converted to a retirement pension on the 10th anniversary of his/her normal retirement or when the retirement benefit equals the disability pension. A surviving spouse would receive a survivor's pension if the disabled pensioner died before being eligible for a retirement pension. If the disabled pensioner died after being eligible for a retirement pension (after 25 years of services and/or on disability or age 60), then the spouse would receive a retirement pension.

FICA FORMULA

The social security formula is basically the same as that used for computing retirement benefits. The five lowest earning years are subtracted from total earnings. The total earnings are then divided by the number of years from age 21 to disability, minus the five lowest earning years. This computation results in an AIME which is basically the same as if the individual had worked until retirement in the income group they were in when they were disabled.

RESULTS

As indicated in Table 3, the percentage of income protected may differ by income group, by whether the coverage is under FICA or MSRS, and by whether an individual is single or has dependents. It does not vary appreciably according to the age at which the individual becomes disabled.

Comparing the results with those in Table 1, the percent of income protected in the different income groups under FICA is, with small variations, identical to that provided at age 65 for an individual who has worked from 1951 and retired in 1986. The percent of coverage is higher under MSRS in Table 1 because the pension is based on 36 rather than 33 1/3 years of service.

Examining the difference between FICA and MSRS disability coverage in Table 3 reveals the same basic patterns found in comparing retirement benefits. MSRS provides a higher pension for single individuals than FICA. The differences increase as salary group increases. For married couples and families, the LOW income group would be financially better off under FICA coverage and the benefits are basically equivalent under the two systems for the MIDDLE/LOW group. For the two highest groups, MSRS provides a larger pension than FICA.

The calculations for those under dual FICA and MSRS coverage is lower than might be expected because of an offset provision in MSRS. The MSRS disability pension is reduced dollar for dollar if the combined amount would exceed 80% of the average final compensation. Except in the case of the lowest group where FICA provides higher coverage, the maximum coverage is 77% of the final year of salary.

While not presented in Table 3, an individual moving from FICA covered to MSRS covered employment would immediately receive full protections of 64% of his or her salary under MSRS. An individual moving from MSRS covered employment to FICA covered would have to complete an initial vesting period before being covered under FICA disability insurance. In addition, the individual's eventual pension would be lower than it would have been if they had always been under FICA because the MSRS covered years will not be used to determine his or her total earnings but the number of years under MSRS will be used in the calculation of his or her average monthly FICA covered earnings (AIME). The years under MSRS will be considered as zero earning years for the purpose of computing average FICA earnings.

Table 3: Disability comparison of coverage under FICA and MSRS for single earners and one earner couples for individuals who remain in the same income group though out their career.

	LOW	MIDDLE/LOW	MIDDLE/HIGH	HIGH
1986 NET SALARY	$8725	$16,148	$30,230	$43,204
STARTED WORK AGE 21 DISABLED AGE 57				
SINGLE				
FICA	53%	45%	31%	22%
MSRS	64%	64%	64%	64%
MARRIED				
FICA	80%	67%	46%	33%
MSRS	64%	64%	64%	64%
FAMILY MAXIMUM				
FICA	80%	67%	46%	33%
MSRS	64%	64%	64%	64%
FICA & MSRS COMBINED				
SINGLE	77%	77%	77%	77%
MARRIED	80%	77%	77%	77%
STARTED WORK AGE 21 DISABLED AGE 47				
SINGLE				
FICA	53%	45%	32%	23%
MSRS	64%	64%	64%	64%
MARRIED				
FICA	80%	68%	48%	35%
MSRS	64%	64%	64%	64%
FAMILY MAXIMUM				
FICA	80%	68%	48%	35%
MSRS	64%	64%	64%	64%
FICA & MSRS COMBINED				
SINGLE	77%	77%	77%	77%
MARRIED	80%	77%	77%	77%
STARTED WORK AGE 21 DISABLED AGE 32				
SINGLE				
FICA	54%	46%	35%	27%
MSRS	64%	64%	64%	64%
MARRIED				
FICA	81%	69%	53%	40%
MSRS	64%	64%	64%	64%
FAMILY MAXIMUM				
FICA	81%	69%	53%	40%
MSRS	64%	64%	64%	64%
FICA & MSRS COMBINED				
SINGLE	77%	77%	77%	77%
MARRIED	81%	77%	77%	77%

SURVIVOR'S BENEFITS

MSRS FORMULA

The MSRS formula for ordinary survivor's benefits provides a fixed pension unrelated to earnings level or length of service. It allots $150 per month for the surviving spouse, an additional $150 for the first dependent child and $75 for each of the next two children. Once the pension is awarded the same inflation factor that is applied to the retirement pension is applied to the survivor's pension. The basic amounts for determining the initial pension are not adjusted for inflation. Instead of the flat amounts above, a surviving beneficiary could choose to have the accumulated contributions of the deceased employee returned or, if the deceased employee was eligible for retirement, to receive a reduced retirement pension. The reduced pension is applicable to survivors of an employee with 25 years of service. If death is due to a job related injury, MSRS provides and accidental death surviors benefit. This benefit is equal to 2-3ds of average final compensation for a spouse alone and 100% of average final compensation for a spouse with a dependent child or dependent children without parents.

The state also provides a group life insurance policy for state employees and pays the premium for the equivalent of one years salary. Teachers and participating district employees can participate in the life insurance program on an individual basis. It would be optional for their employers to provide the same coverage as the state provides for its employees.

FICA FORMULA

The FICA formula calculates the survivor's benefit basically on the same formula as the disability pension. The difference is that the surviving spouse receives the basic (PIC) amount. An early pension is also available to a spouse from age 60. The percentage reduction for early retirement is slightly different than that used for a retirement pension.

RESULTS

As is expected from the description of the formulas for calculating benefits, ordinary survivor's pensions are one area where FICA fairly consistently provides a greater percent of coverage of final salary than MSRS(see Table 4). Even the reduced individual FICA pension at age 60 is higher than the MSRS pension based on the early retirement option for the two lower income groups. Because the MSRS amount is a fixed amount varying only with the number of dependents in the deceased worker's family, the percentage of coverage increases as the number of dependents increase but decreases from the LOW to the HIGH income group.

Table 4: Survivor's benefits comparison of coverage under FICA and MSRS for single earners and one earner couples for individuals who remain in the same income group though out their career.

	LOW	MIDDLE/LOW	MIDDLE/HIGH	HIGH
1986 NET SALARY	$8725	$16,148	$30,230	$43,204
STARTED WORK AGE 21 DECEASED AGE 47				
INDIVIDUAL				
FICA-	53%	45%	32%	23%
FICA-	44%	37%	27%	19%
FICA-	38%	32%	23%	17%
MSRS: Ordinary	21%	11%	6%	4%
Early ret.	30%	30%	30%	30%
ONE CHILD				
FICA	80%	68%	48%	35%
MSRS: Ordinary	41%	22%	12%	8%
Early ret.	30%	30%	30%	30%
TWO CHILDREN				
FICA	82%	82%	57%	40%
MSRS: Ordinary	52%	28%	15%	10%
Early ret.	30%	30%	30%	30%
MAXIMUM				
FICA	82%	82%	57%	40%
MSRS: Ordinary	62%	33%	18%	12%
Early ret.	30%	30%	30%	30%
FICA & MSRS COMBINED (maximum alternative)				
INDIVIDUAL-60	63%	62%	53%	47%
ONE CHILD	121%	98%	78%	65%
TWO CHILDREN	133%	112%	87%	70%
MAXIMUM	144%	116%	87%	70%
STARTED WORK AGE 21 DECEASED AGE 32				
INDIVIDUAL				
FICA-	54%	46%	35%	27%
FICA-	45%	38%	29%	22%
FICA-	39%	33%	25%	19%
MSRS	21%	11%	6%	4%
ONE CHILD				
FICA	81%	69%	53%	40%
MSRS	41%	22%	12%	8%
TWO CHILDREN				
FICA	84%	83%	62%	46%
MSRS	52%	28%	15%	10%
MAXIMUM				
FICA	84%	83%	62%	46%
MSRS	62%	22%	18%	12%
FICA & MSRS COMBINED				
INDIVIDUAL-60	59%	44%	31%	23%
ONE CHILD	122%	91%	65%	48%
TWO CHILDREN	135%	111%	77%	57%
MAXIMUM	146%	117%	80%	59%

How well the FICA pension meets its intended goal of providing a pension equivalent to what the deceased worker would have received if he or she could have continued working until retirement age can be determined by comparing the results in Tables 1 and 4. In general the figures on the percent of coverage provided by FICA under the survivor's pension with that provided by the the straight FICA retirement pension indicates that they provide basically equivalent amounts. The slightly higher coverage provided by the survivors' pension is largely due to the increase in the salary ceiling for FICA contributions in recent years.

The same transition problem discussed regarding disability pensions applies to survivor's benefits. An individual moving from MSRS covered employment to FICA covered employment would have to wait until they have completed the vesting period before they would be eligible for survivor's coverage under FICA. The years they spent in MSRS employment would also detract from the size of their FICA pension.

TILLINGHAST REPORT

The commission reviewed the January 14, 1986 Tillinghast report, "Maine State Retirement System: Proposal for Designing a Program to Coordinate with the Federal Social Security System." The intent of the proposal was to provide a supplemental plan which in combination with Social Security would provide benefits which would provide a retirement pension at least as large as the present Maine State Retirement System plan. The proposed plan provides for a state pension from age 60 which is then coordinated with Social Security under the early retirement option at age 62.

The present MSRS plan calculates a retirement pension as 2% per year of service. On a forty year career, this would provide a pension equal to 80% of the average final compensation or what Tillinghast estimated to be 74% of the final years salary. Their proposed plan was for a MSRS pension based on 1 2/3% of average final compensation. For a 40 year career, this would provide a pension equal to 2/3ds of an individuals average final compensation or 62% of the final years salary.

At age 62 the MSRS pension would be coordinated with Social Security by an "offset" formula where by the MSRS pension would be reduced by 50% of the Social Security pension. Tillinghast estimated that the resulting combined pension would replace from between 84% of salary for employees with a final salary of $10,000 to 71% of salary for employees earning $40,000. While the combined plan provides a higher percent of salary coverage for lower income workers than higher income workers, by using an "offset" formula it reduces the degree of emphasis on low income workers present in the Social Security plan.

In the Commission's discussion of the proposal, Charles Sherburne, the AFSME representative, was opposed to the "offset" formula. The 50% offset reduces the MSRS pension by 36% for workers earning $10,000 while it only reduces the pension for workers in the $40,000 category by 15%. He felt that lower income workers had enough trouble living on their present low salaries and needed to retain their full MSRS pension amount in order just to stay even.

Claude Perrier, Executive Director of the Maine State Retirement System was also opposed to an "offset" plan. An "offset" plan subtracts a percentage of Social Security from the potential MSRS pension amount to determine the actual MSRS liability. This makes the MSRS pension depended upon all future changes in Social Security pension regulations. If there is a future reduction in Social Security pensions this would also reduce the "offset" amount and thereby increase the MSRS amount in the combined pension. Because Social Security does not provide contractual rights to a pension in the same way that members have a right to a MSRS pension, Social Security can change the benefits to be received by current workers. Members in the MSRS system, however, do have contractual rights to a pension. As a result, while Social Security can reduce their pension benefits for current employees, MSRS cannot reduce theirs. Under an "offset" formula, a reduction in the Social Security benefits would lead to a retroactive increase in the pension liability for the MSRS plan. The goal of the MSRS is to be a fully funded plan and to avoid retroactive increases in their liability, and, hence, "offset" plans should be avoided in favor of calculation formulas independent of Social Security. The formula should still provide for a reduction in MSRS benefits when a retired employee becomes eligible for Social Security. The amount of the reduction, however, would be specified in the MSRS provisions and not dependent on any future changes in Social Security benefits.

PUBLIC HEARING

Prior to the development of any Maine State Retirement System plan which could operate as a supplement to Social Security, basic policy questions need to be answered concerning who should receive, what kinds of benefits at what level. The preparatory information mailed to employer and employee organizations listed a series of specific policy questions. These were:

1. Under any new system existing pension recipients must have their present pension rights protected. Any new integrated plan could not include present retirees. Current employees must be able to remain in the present retirement coverage they presently have. Should the new system apply:

    a. Only to new employees?

    b. New employees and to those current employees who wish to transfer to the new system?

2. For individuals with the same level of income, Social Security tries to provide relatively equal retirement, disability or survivor's pensions.

    a. Should a supplemental state plan provide equal coverage in these three areas or emphasize one over the other?

    b. If it should emphasize one and provide larger supplemental pensions in one area than another, which area should it emphasize: retirement, disability or survivors benefits?

3. Social Security provides a lower percentage coverage of final salary for higher income earners than lower income earners. Should a supplemental state plan:

    a. Follow Social Security and provide higher percent of coverage for the salary levels of low income wage earners than high income wage earners?

    b. Try to equalize the overall percentage of salary protected by providing a greater percentage protection to higher income groups to counteract the higher percentage provided low income groups by Social Security?

    c. Provide an equal percentage coverage of salary for all income groups under the supplemental state plan regardless of the percent covered under Social Security.

4. Since low income individuals have a substantial percent of their income protected under social security, should the state plan provide an optional pension (annuity or deferred

income) plan to higher income earners with the individual's contribution increasing with the size of the pension coverage selected?

5. How should the supplemental state plan be paid for?

a. totally by employer?

b. employer share plus an equal percentage share for all employees?

c. employer share plus an employee share based on the amount of income the employee chose to protect?

6. The present Maine State Retirement plans are completely portable only for individuals moving between State employment and teaching in local school units. Should a supplemental plan insure portability among:

a. municipal employers?

b. municipal employers and State employment and teaching?

In addition to a general statement (see letter in Appendix B) supporting the work of the Commission, the Maine Committee on Aging made the following comments on the specific questions listed above. They would like to see a plan which provided for new employees but also allowed present employees the option of joining the new plan. They wanted equal coverage provisions under retirement, disability and survivors benefits. They favored the new plan following the pattern established by Social Security with a greater proportion of salary protection being provided to lower income workers. They felt higher income groups should be provided optional deferred income or annuity plans. They felt that there should be portability of benefits between municipal and state employment and among municipalities. They also felt that the cost of the plan should be born equally between employer and employee.

The Maine Municipal Association indicated that there were two major factors which precipitated the commissions work: the threat of federally imposed universal coverage and excessive cost to participating local districts for providing dual coverage under existing Maine State Retirement and Social Security plans. While they felt that universal medicare coverage was imminent, they did not feel that the federal government would impose universal social security. They also felt that for the towns presently offering both Social Security and Maine State Retirement the financial burden did not seem to be a problem. The benefit package elected by a participating district under Maine State Retirement has been negotiated between the municipal employer and their workers and was generally at an acceptable contribution level for the employer.

The Maine Municipal Association also cautioned the Commission not to push for a resolution of the policy questions immediately. The recently passed revisions of the federal tax code will have a substantial impact on the structure of plans that could be developed. The MMA felt it would be prudent for the commission to wait until the new tax regulations had been promulgated.

The Maine Municipal Association encouraged the Commission to develop an additional plan which could act as a supplement to Social Security which a town could then accept or reject in bargaining with their employees. They felt that the percent of employer and employee contributions should be left to collective bargaining rather than establishing a fixed percent employee's share as in the present statutes. They supported portability for vesting rights as under the present system and would encourage risk pooling among municipalities and hence probability among members of the pool. They felt that portability, otherwise, should be left as an optional mätter for the local units. The written testimony of the MMA found in Appendix B.

The Maine State Employees Association recognized that the questions asked by the Commission raised important value questions. They were not, however, willing to commit their membership to one set of alternatives over another. They shared with the Commission a recent Labor Relations Board ruling which supports their union's position that pension benefits are a negotiable item. They felt that the Commission should not try to answer the questions posed for the public hearing. The union felt that the answers to these questions would be based on value judgments which were best decided through collective bargaining.

A letter provided by the Maine State Retirement System from their actuary(see Appendix B) encouraged the Commission to proceed cautiously in developing any supplemental plan. They first suggested that the Commission should wait until the Federal government had promulgated its regulations for its new tax law. Second, while many of the impact of many of the provisions of the new tax law are still must be defined one issue seems to be clear. "Offset" type supplemental plans are not as advantageous as they once were.

LEGAL ISSUES

A critical part of the Commission's consideration of the implications of modifying the Maine State Retirement System to integrate it with or replace it by the Social Security System, is a determination of the extent to which the state may constitutionally modify the MSRS for current and new employees. This constitutional issue can further be divided into two parts. Part I will discuss employee rights to benefits under a pension plan and under what circumstances those benefits may be modified. Part II will look at how collective bargaining laws affect the issue of modification of pension plans.

PART I: EMPLOYEE RIGHTS TO BENEFITS UNDER A PENSION PLAN

A. Development of the contractual theory of pension benefits

As private pension plans developed in this country, courts traditionally considered them gratuities. Under that theory, an employee had no right to the pension benefit and the employer was permitted to modify or withdraw the plan at his pleasure. As pension plans became more frequent and more accepted, the courts began to discard the gratuity theory. Courts increasingly began to characterize pensions as a contractual right instead of a gratuity.

Public pension plans have experienced the same developmental pattern, at first being considered nothing more than a gratuity. The employee had no vested rights in a pension. (Throughout this section, the term "vested rights" shall be used in its broad constitutional sense to refer to rights which are so completely and definately accrued to a person that they cannot be interfered with by restrospective laws. It does not refer to the more limited meaning in which a retirement system member is said to have "vested" after a designated number of years of service.) In addition to being considered a gratuity, the employee's right to participate in the pension plan was subject to the legislative right to amend or repeal that plan. Initially, this view denied an employee any rights even after he or she had been granted a pension. Later cases recognized an employee's right to a pension once it had been granted, or in more liberal cases, when the employee had completed all the requirements for a pension except the age requirement. That right was not subject to legislative repeal or adverse modifications.

At the present time, state courts still vary in their interpretation of employee rights to public pension benefits. There are three distinct philosophies among the various jurisdictions.

1. Employee rights are subject to legislative discretion:

One line of jurisdictions holds that a contributing employee has no vested pension rights either before or after the pension has been granted. Under this view, the employee making such mandatory contributions is deemed to acquire no rights that will prevent the legislature from modifying or amending the statute establishing the pension system. In jurisdictions following this concept, it is within the power of the legislature to modify or abolish the pension plan at will, even though the pension fund is maintained in part by the contributions of the beneficiaries. However, the rule that the legislature may reduce or increase the amount of a pension at will is subject to the generally recognized exception that such reduction or increase cannot validly operate on pension installments or amounts already due under the prior pension statutes (Dodge v. Bd. of Education 58 S Ct 98, 1937).

2. Employee rights vest after meeting requirements for benefits:

Decisions in other jurisdictions have held that a contributing employee has no rights during the period before the employee fulfills the requirements for grant of the pension. Once the requirements are fulfilled, the employee's rights become vested and become immune from abolition or adverse change. (60 AmJur2d 921, § 49)

3. Employee has contractual right to benefits:

The more recent cases maintain that a contributing employee has vested rights upon rendition of service under a pension statute. Prior to retirement, rights may be modified to permit the pension system to accommodate changing conditions. Such modifications, however, must be reasonable and must be materially related to the theory and successful operation of the system. Rights are absolutely vested upon the employee's fulfillment of requirements for grant of a pension. Jurisdictions with this view see a pension not as a gratuity but as part of the compensation of an employee. (Yeazell v. Copins, 402 P2d 541, 1965; Hanson v. Idaho Falls, 446 P2d 634, 1968).

B. Current trends in pension rights theory:

The clear trend is toward the contractual theory of pensions. Statutes in several states make retirement benefits for public employees contractual rights which may not be diminished or impaired. Rights under these laws may not be diminished for anyone who is already a member of the system. Wary of the potential for legislative amendments to statutes, New York, Florida and Illinois have placed those rights in their Constitutions.

In places where the contractual right to pension benefits has not been placed in the constitution or the statutes, courts have been judicially adopting the contractual theory of an employee's right to pension benefits. Pensions are considered as much a part of the compensation to which an employee, under ordinary circumstances, is entitled as the salary which he receives. California, a leader in judicial adoption of the contractual theory, has stated: "A public employee's pension constitutes an element of compensation, and a vested contractual right to pension benefits accrues upon acceptance of employment. Such a pension may not be destroyed, once vested, without impairment of a contractual obligation of the employing entity." (Allen v. Board of Administration of the Public Employee's Retirement System, 665 P2d 534, at 538.)

Neither the Maine statutes nor the Maine judiciary has resolved the question of the nature of pension benefits in Maine. In 1983, the court was asked "to hold that the pension benefit provided for public employees is a part of the employment contract and is constitutionally protected from impairment. Under this view the pension benefit is considered to be deferred compensation rather than a gratuity, and although an employee does not obtain any absolute right to fixed benefits, there are strict limitations upon modifications of the pension system in effect during employment." (Soucy v. Board of Trustees of the Maine State Retirement System, 456 A 2d 1279, at n.3, p. 1282, 1983.) The court decided the issue in that case on other grounds and declined to rule on the contractual aspects of the question. "We have no occasion in this case to consider adoption of (that) rationale." (Ibid.)

Although Maine courts have not determined the rights that public employees have to a retirement benefit, at least one Attorney General opinion has determined that "employees who accumulate ten years of service credit are entitled to a pension as a matter of law (5 MRSA § 1121, sub-§ 1, par. A).... Thus, the rights of these employees must be regarded as 'vested' in the constitutional sense, which means that the Legislature cannot adversely alter them." (AG.Op. 85-25, p. 4, 1985.) A more recent Attorney General Opinion (86-7, p. 2, 1986) again presumes that the law establishing the MSRS creates some kind of contractual relationship between the state and the retirement system member and that the reasonable expectations of the member for a pension is protected, at least to some extent, by the provisions in the U.S. and Maine Constitution which prohibit impairment of contract.

C. The Constitutional protection for contractual rights and how it applies to employee rights in pension plans?

The contractual relationship between the state and the retirement system member which the court cases and Attorney General Opinions have been referring to is a constitutionally protected relationship. The United States Constitution prohibits any state from passing a law "impairing the obligations of contracts." (U.S. Const., art. I, § 10.) A parallel provision is contained in article I, section 11 of the Maine Constitution. It is this provision that courts employ when they seek to determine if modification of a public employee's pension plan (by legislative enactment) impairs the contractual obligation of the employing entity.

Not every amendment to a retirement system constitutes an impairment "of the obligations of contracts." Nor does every impairment of contract rise to the level of a constitutional violation. The U.S. Supreme Court has stated that they will consider the gains which the party reasonably expects to obtain from the contract in determining if there has been an impairment. "Laws which restrict a party to those gains reasonably expected from the contract are not subject to attack under the Contract Clause, notwithstanding that they technically alter an obligation of a contract. (El Paso v. Simmons, 379 U.S. 497, at p. 515, 1965)

California has defined the criteria which their legislature must follow in order to modify their retirement system. "A constitutional bar against the destruction of such vested contractual pension rights, however, does not absolutely prohibit their modification. With respect to active employees, we have held that any modification of vested pension rights must be reasonable, must bear a material relation to the theory and successful operation of a pension system, and, when resulting in disadvantage to employees, must be accompanied by comparable new advantages." (Allen v. Board of Administration of the Public Employees' Retirement System, 655 P.2d 534, 538, 1983, citing Allen v. City of Long Beach 287 P.2d 765, 1955) "As to retired employees, the scope of continuing governmental power may be more restricted, the retiree being entitled to the fulfillment of the contract which he already has performed without detrimental modification. Nevertheless, even here, it is necessary to perceive the terms of the contract and utilize those terms to measure the claimed impairment. (Allen v. Board of Administration of the Public Employees' Retirement System, 655 P.2d 534, 538, 1983, citing Lyon v. Flournoy, 271 Cal. App.2d 774, at p. 783, 1969).

D. Concluding remarks:

If Maine follows the recent line of judicial decisions in other states which holds that a public employee's pension constitutes an element of compensation and a vested contractual right to pension benefits accrues upon acceptance of employment, modification of the Maine State Retirement System statutes which affect the benefits of retirement system members would be subject to the Contract Clause of the U.S. and Maine

Constitutions. Any mandatory modification of vested pension rights for active employees:

1. must be reasonable,
2. must bear a material relation to the theory and successful operation of a pension system, and,
3. when resulting in disadvantage to employees, must be accompanied by comparable new advantages.

Any modification of vested pensions rights for active employees that are optional, i.e. may be accepted at the discretion of the employee, are constitutional. They do not violate the Contract Clause because they become a mutually agreed upon modification of the contract.

For retired employees, virtually every detrimental modification of the retirement plan is prohibited.

New employees, those who were hired subsequent to any modification of its provisions, are not parties to any previous retirement provisions. The state has incurred no contractual obligation with regard to these future employees. The retirement system laws may be modified or repealed as the Legislature sees fit in regard to future employees.*

PART II: The effect of collective bargaining on pension modifications

A. Are modifications to the retirement law bargainable?

The threshold question which must be asked in this instance is whether or not retirement provisions are subject to collective bargaining. Since 1949 when pensions were declared to be a bargainable issue in the private sector (Inland Steel Company v. National Labor Relations Board, 170 F. 2d 247, 251, 1949. Certiorari denied by the Supreme Court, 336 U.S. 960, 1949), bargaining over pensions has become common practice in those sections of the private sector subject to collective bargaining. It is the exception, however, for public employee unions to bargain over pensions.

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* Current employees who have the option to become members of the retirement system may have a reasonable expectation of being able to join the retirement system as it was prior to any detrimental modification. This paper does not address that issue.

In the majority of states, public pensions are not collectively bargained, partly because they are legislated and partly because the retirement plan has a wider scope of coverage than the bargaining unit. More fundamentally, there is an inherent conflict over the right of the legislature to legislate and the right of organized employees to collectively bargain. In most cases, it is necessary for the legislature to approve any pension bargain that might be negotiated between a political subdivision and a public employee union. If the legislature refuses to amend the pension law, the bargaining that took place would have no effect. The negotiated agreement would merely be an agreement to petition the legislature to amend the law. The collective bargaining agreement would not be an automatic guarantee that the law would be amended. Therefore, many collective bargaining units choose to go to the legislature in the first place.

B. <u>Are Maine state retirement laws subject to collective bargaining</u>?

Maine is currently litigating the question of whether pension provisions are bargainable. The state law which controls collective bargaining by state employees states that "All matters relating to the relationship between the employer and employees shall be the subject of collective bargaining, except those matters which are prescribed or controlled by public law." (26 MRSA § 979-D, sub-§ 1, para. E, sub-para. (1).

The current litigation over whether provisions of the Maine State Retirement System (MSRS) Laws are bargainable arose from the negotiations between the Maine State Employees Association (MSEA) and the State which commenced in 1982. MSEA proposed, as part of its bargaining package, four amendments to the MSRS laws, three proposals dealing specifically with benefit provisions and one proposal concerning purchase of military service credits. The state maintained that those provisions were "matters which are prescribed or controlled by public law" and thus not subject to collective bargaining.

In December, 1983, MSEA filed a prohibited practices complaint with the Maine Labor Relations Board (MLRB) alleging the State's refusal to bargain over the retirement proposals. By October, 1985, the State and MSEA had reached a collective bargaining agreement. They both agreed, however, that the question of bargaining for changes in the MSRS Law would likely occur again and continued to pursue the MLRB decision.

In July, 1986, the Maine Labor Relations Board concluded that the retirement law was subject to collective bargaining. (<u>Maine State Employees Association v. State of Maine</u>, MLRB No. 84-17, July 17, 1986.) The State has appealed that decision to Superior Court. Oral arguments are scheduled for early in 1987. It is anticipated that this case will eventually be decided by the Law Court. Unless the legislature takes decisive action, the results of this case will determine if Maine's state employee retirement laws are bargainable.

C. <u>What effect do the collective bargaining laws have on modifications to the MSRS statutes</u>?

If retirement provisions are not subject to collective bargaining, any modification to the retirement statutes is not subject to the collective bargaining process. Of course, these amendments would still be subject to the legislative process and, subsequently, subject to influence from representatives of all interested parties, including the state and the employee unions.

If retirement provisions are subject to collective bargaining, modifications to the retirement laws may be made by:

1. mutual agreement of the state and the employee union, as described by their final agreement. This could only affect those employees who are members of that particular employee union and would still require ratification by the legislature, or

2. legislative enactment, subject to the legislative process.

A more definitive answer will depend upon the law court's decision on the bargainability of pension rights.

A list of sources which were not cited are found in Appendix C.

CONCLUSIONS
POLICY QUESTIONS AND NEEDED INFORMATION

The Commission reviewed the eligibility and benefit structures of the Social Security System and the Maine State Retirement System. It had its staff prepare a model to compare the actual benefits received by employees at different income levels and different career patterns of MSRS and FICA coverage. It also reviewed the Tillinghast proposal for an integrated plan and found that it was inadvisable to accept that recommendation given the recent revisions in the Social Security System and federal tax codes.

The Commission feels that the analysis provided in the preceding report will provide a sound basis for future policy and actuarial decisions which are necessary for the development of an integrated plan. However, the Commission felt that final recommendations for a proposal needed to wait until the federal government had promulgated its regulations governing the effect of the new tax law on the relationship of private and state operated pension plans with Social Security. The question of whether the benefits under Maine State Retirement are issues for mandatory collective bargaining is also presently under litigation and a ruling is expected early this year.

Once these two issues have been decided, several important policy questions must be addressed. These are:

1. Should a supplemental plan option apply to:
All new employees?
Current employees who choose to join the new plan?
All Current employees?

2. Should the supplemental plan provide the same levels of benefits for retirement, disability and survivor's benefits or different levels of benefits?

3. Should the supplemental plan provide equal percent of salary protection for all income groups or (partially) reverse Social Security's emphasis on low income workers and families by providing higher benefits to higher income earners?

4. Should the supplemental plan be a plan which offsets a portion of an individual's Social Security pension or be calculated by a formula independent of an individual's eventual Social Security pension?

5. Should the supplemental plan help higher income workers protect their income level by providing a state match to the states present deferred income plan?

6. Should the supplemental plan be paid for entirely by the employer or shared between employees and employer?

The committee has discussed these issues and has reached tentative recommendations on some. The Commission decided that what ever plan is adopted it should not be an "offset" plan. This is because an "offset" plan would reduce the added support Social Security provides lower income workers and because of the potential of creating an unfunded liability if Maine State Retirement System benefits were dependent on future changes in Social Security regulations. The members also felt that any new plan should apply primarily to new employees but that current employees should have the option of joining if they wished.

RECOMMENDATION

The remaining questions, the Commission believed, are partly dependent on actuarial determinations of the cost of different options. It is the recommendation of the Commission, therefore, that the study of the Integration of the Maine State Retirement System and Social Security be extended for one year and that the funds be provided for the Commission to contract with the Maine State Retirement System to provide actuarial services to the Commission.

APPENDIX A

ASSUMPTIONS FOR THE MODEL

1. There are four income groups. The MIDDLE-LOW group equals the average earnings of individuals in FICA covered jobs. The LOW group is equal to 1/2 the average earnings. The MIDDLE-HIGH and HIGH groups are respectively 2 and 3 times the average earnings.

2. On 5 of the 8 career patterns studied, individuals remain within an income group throughout their work career.

3. Career coverage for retirement benefits can include the following 5 (same income group) options: FICA or MSRS alone (1951 to 1986 or 36 years), FICA and MSRS concurrently (36 years), FICA for 20 years followed by MSRS for 16, or MSRS for 15 years followed by FICA for 21. Three advancement careers are based on 5 years in the low income group, 15 years in the middle/low group and 15 years in the middle/average group.

4. The recipient is either single or a "traditional" family where there has been one earner (ie., not a family unit in which both spouses were contributing to retirement programs.)

5. The MSRS benefits are computed on the state employee or teacher plan. Not all participating districts have adopted the 50 year base for retirement. If they still use the 60 or 70 year base the retirement benefits will be lower than those computed here.

6. The estimated state and federal income tax rates for the groups are 0%, 7.47%, 13.39% and 17.48% respectively. The federal income tax estimate is based on the proposed new tax code.

7. MSRS pensions are taxable beyond the dollars contributed by the member. The tax rate used on MSRS pension for each group was that of the income group in which the individual was located prior to retirement. This assumes that the individual had other sources of taxable income which brought their total up to their employment level.

8. The MSRS pension for an individual is reduced in accordance with the age of the designated eligible survivor. The computation was based on a spouse of the same age. The reduced pension is 91% of the individual recipient pension.

9. The MSRS figures apply to participating districts which have adopted all the amendments to make their plan compatible with the 1/50th plan provided for state employees and teachers. Participating districts which still have 1/60th or 1/70 plans would provide lower MSRS benefits.

APPENDIX B

MAINE COMMITTEE ON AGING
State House Station 127
Augusta, Maine 04333

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Marjory Blood
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Statement of Marjory Blood

Member, Maine Committee on Aging

before the

Commission to Study the Integration of

Social Security and the Maine State Retirement System

December 9, 1986

Good morning. I am Marjory Blood, a member of the Maine Committee on Aging. I also happen to be a retired Maine state employee. Today's work force are tomorrow's retirees. For this reason, we must all be concerned about the issues before us.

Our comments today are of a very general nature. This is an enormously complicated area. We believe that integration of the Maine State Retirement System into Social Security is inevitable, and we are fortunate to have time to thoroughly explore the issues. We want this integration to work for the benefit of Maine citizens as well as for the Social Security system. An integrated system must contain protections which ensure that individuals receive more than Social Security and which ensures that this supplemental plan adequately provides for add-ons.

Because we are one of only five other states remaining without an integrated system, we strongly urge you to use the experiences from other states who have already gone through the integration process to Maine's best advantage.

Because future state employees will rely heavily on Social Security plus a supplementary state retirement plan, it must be adequate. We believe it is crucial that future retirees receive at a minimum the equivalent of what we receive today. For example, state retirees receive as a benefit the Blue Cross/Blue Shield Companion Plan and dental benefits. These necessities must remain in any integrated plan.

The Maine Committee on Aging strongly supports the concept of portability which would be achieved through integration and a shortened vesting period from ten to five years. In Maine, 75% of the over-65 population today relies on Social Security for their sole or primary (50% or more) source of income. Nationwide, in 1984 only half as many women (21%) received pensions as men (43%). This is in large part because women move in and out of the work force to care for children and older dependent adults. The one in five who did get a pension received only half of what men with pensions received on the average. We must improve our public policies if we are ever to improve the economic plight of older women. I would remind you that in 1980 the average retirement income was roughly $6,000 - $8,000 for men and $4,000 for women. It is time to plan ahead for future retirees to correct this imbalance which largely results from pension benefits.

A shorter vesting period is also an important incentive for older workers to enter the Maine state system. An individual 55 years of age or older is much less likely to begin employment with the State if he or she faces a required ten years of employment in order to gain any retirement benefits. We have all come to recognize the contributions older workers make. This change would greatly increase the desirability for an older worker to enter employement with the State of Maine.

Finally, another area that we would like to bring to your attention is that IRA's and Keogh Plans intended as retirement income currently are not protected in the event of a catastrophe. Although there is little that this study committee can do about that, it increases the importance of maintaining an adequate retirement system.

Thank you for the opportunity to comment. We look forward to future discussions with you.

Maine Municipal Association
COMMUNITY DRIVE
AUGUSTA, MAINE 04330
(207) 623-8428

December 12, 1986

Commission to Study the Integration of Social Security
and the Maine State Retirement System
c/o Lars H. Rydell
Office of Policy and Legal Analysis
State House Station 13
Augusta, Maine 04333

Dear Chairman Bonsey and Members of the Commission:

The Maine Municipal Association would like to take this opportunity to submit in writing the comments we verbally committed to you at your December 9 public hearing.

In light of the uncertainty surrounding federal tax reform, MMA would recommend extending the time which this Commission has to study the issue of integration. If a desire of this Commission is to make an integrated plan a qualified plan, meaning that employee contributions would be sheltered from the federal income tax, then it seems necessary to postpone final recommendations until more is known about new federal tax law in this area. MMA also questions the necessity for hurried recommendations, since univeral Social Security coverage does not seem to be the threat it was at the time the Commission was created.

In speaking with Maine's Congressional Delegation and with our colleagues at the National League of Cities, it seems certain that an attempt will be made by Congress to require all state and local government employees to be covered by Medicare. Congress seems to have created a distinction between Medicare coverage and Social Security coverage. That distinction seems to be a legitimate one. There are a large number of previous employees of state and local governments who now are eligible for full Medicare benefits. That is because only a minimum level of service with an employer covered by Social Security is necessary to receive full Medicare benefits. Social Security benefits, on the other hand, are based on service time and an employee would only receive the benefits he or she accumulated during their service with the covered employer. It seems then that the threat of universal Social Security coverage is not real in the next couple of years. Elimination of that threat, coupled with the uncertainty surrounding federal tax reform, would suggest that this Commission take more time beyond the January 1, 1987 reporting deadline to arrive at its final recommendations.

In developing final recommendations with respect to integration, MMA asks that the Commission recognize the differences between participating local districts and State employees.

The primary and most crucial difference is that retirement packages and benefit levels are bargained between the employer and the employee at the local level. This is not true for State employees, although that issue is before the Superior Court. When the Legislature allowed municipalities to join the Maine State Retirement System as participating local districts, it stated in the law that any changes to the benefit levels enacted by the Legislature would be optional to participating local districts. Benefit level changes are bargained at the local level. It is therefore essential that any new integrated plan also be optional. We are not suggesting that each participating local district be allowed to devise its own integrated plan. Rather, we are suggesting that the Legislature, with the assistance of this Commission, develop the integrated plan. The only option available to participating local districts would be to accept the plan or not to accept the plan. If they chose not to accept the plan, they would obviously continue with the benefit package already bargained between the district and its employees.

The other major difference between participating local districts and State employees, and another reason why an integrated plan must remain optional for participating local districts, is that the Legislature is not able or prepared to calculate the costs they would be imposing by a mandatory plan. That type of cost analysis is done with respect to the State budget, but is never done to determine whether it is within the ability of municipalities to pay for a new mandatory plan.

MMA asks that these major and basic differences be kept in mind as the Commission struggles with the issue of an integrated plan.

In addition to our first and foremost recommendation that any recommended plan remain optinal at the local level, we make the additional recommendations to the Commission:

1. MMA proposes that the percentage of employer and employee contributions to the Maine State Retirement System for the new integrated plan be subject to local agreements. Under the current statute, each local district is assessed a contribution which is based upon its own actuarial experience and its pro rata share of administrative costs. Thus, the annual local district contribution is subject to wide variation from year to year and to wide variation between participating local districts, while local district employees' contributions are set at a specific percentage of compensation.

   MMA recomends that the proportion of contributions by employers and employees be set by agreement within each district. In this way, contributions by both employers and employees would reflect actuarial experience and administrative costs. In this way also, employees could agree to make a greater contribution in return for a more beneficial retirement plan than that which the local district otherwise might be able to afford.

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STATE MAINE RETIREMENT SYSTEM

November 21, 1986

Mr. Claude R. Perrier
Executive Director
Maine State Retirement System
State House
Station 46
Augusta, Maine 04333-0046

Re: Design of an Integrated Plan

Dear Claude:

This letter is to express my concerns about developing a new pension program for units of government in Maine that may participate in Social Security. My concern is not that the present program will be satisfactory indefinitely, but that the proper foundation has not been laid for a new program.

The Tillinghast report of January 14, 1986, presenting a proposed integrated benefit plan, is not such a foundation. Although there are certainly elements of the report which will be of value, its primary thrust is to provide documentation of the recommendation that an offset plan be adopted. At the time the report was submitted, we might have accepted the recommendation, although with some reluctance -- offset plans are quite unusual in the public sector; moreover, the report bases some of its recommendations on Federal laws and regulations that are inapplicable to public plans.

Since the Tillinghast report was submitted, however, a major event has made the report obsolete, at least in most respects. The 1986 Tax Reform Act modified the rules for integrating with Social Security, even to the extent of changing the name to "permitted disparity" rules. Most drastically affected were offset plans, the type recommended by Tillinghast. Probably the best way of synthesizing the end result is by a quotation from Donald Grubbs from a recent edition of the BNA Pension Reporter (October 27, 1986, page 1845):

"Offset plans under tax reform may be best described in three words: 'Don't have one.'"

We concur, or at least would urge substantial reluctance to initiate an offset plan until the law is clarified with regulations.

All of this is not to say that work cannot be done on developing an integrated program at this time. Other approaches to integration were treated much less harshly in the Tax Reform Act.

Please call either Gene Kalwarski or me if you would care to discuss these issues further, Claude.

Sincerely,

Thomas P. Bleakney, F.S.A.
Consulting Actuary

TPB/jrw

cc: Mr. Eugene M. Kalwarski

APPENDIX C

Sources

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