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REPORT OF
THE COMMITTEE TO STUDY
THE RETIREMENT SYSTEM

March 1988

<u>**Consulting Actuary**</u>
The Wyatt Company
Kenneth A. Steiner, F.S.A.
Richard S. Hubbard

<u>**Staff**</u>
Grant T. Pennoyer
Office of Fiscal & Program Review

<u>**Membership**</u>
Robert A.G. Monks, Chairman
Susan M. Collins
Joseph G. Hakanson
Peter M. Leslie
Samuel Shapiro
David S. Wakelin

EXECUTIVE SUMMARY

Financial Condition

1. Fiscal Condition. This Committee finds that the fiscal condition of the Maine State Retirement System (MSRS) is satisfactory, although the level of assets as compared to benefit liabilities lags behind most other states. Benefit payments are secure as a result of the statutory commitment to fund the system on an actuarial basis.

2. Actuarial Assumptions. With the exception of the retirement age assumption, the assumptions used to determine the funding of the system are reasonable and realistic. The assumptions (particularly the retirement age assumption) used to estimate future benefits and contributions should be updated and amended to reflect actual practice.

3. Funding Schedule. The unfunded liability amortization schedule should be extended to a period not greater than 30 years, since the current schedule requires that state contributions escalate substantially each year through 2001 which unfairly allocates costs between generations of taxpayers. The unfunded liability of the "old system" teachers, presently being carried on MSRS books as a negative asset, should be recorded with the past service liabilities and, as a matter of generational equity, funded under the current amortization schedule.

4. Level Funding. By recommending an extended amortization schedule, the Committee supports a program of level state contributions as a percentage of employee compensation, consistent with regular actuarial analysis and update.

5. Legislative/Gubernatorial Involvement. The Committee understands the action taken by the Legislature and the Governor to postpone the full contribution requested by the MSRS for the 1987-89 biennium pending receipt of this report. Once action has been taken to reevaluate the MSRS actuarial assumptions and funding methods, however, the Committee recommends that the funds held in the "Rainy Day" account be transferred to the MSRS in amounts necessary to comply with the statutory mandate to fund the obligations of the System based upon the actuarial assumptions established by the Board of Trustees upon advice of the System's actuary, including interest earned on such amounts.

Benefits

6. Plan Design. The following anomalies have been identified within the MSRS benefit structure for state employees and teachers:

   a) The current system provides a financial incentive for employees to retire at relatively young ages rather than continuing to work until age 65.

   b) While benefits are indexed to the Consumer Price Index (CPI), such indexing is limited to 4% per annum with no provision to carry forward from year to year the excess of the CPI over the 4% limit. Therefore, during periods of high inflation, retiree benefits can be seriously eroded unless ad hoc increases are voted by the Legislature.

   c) The survivor benefits, although increased by recent legislation, do not provide adequate protection for spouses and families.

   d) The portability (transferability) of MSRS benefits are limited outside of state service, and are particularly uneven (and potentially unfair) for transfers within and outside the Participating Local District (PLD) plan group.

   Entrance into the Federal Social Security System for new employees would provide a framework for resolution of these plan design anomalies, but the Committee recommends against such action at this stage, on the assumption that the complex issues involved with such a move will better be resolved when and if entry into the Social Security System is mandated by Federal statute.

7. Disability Provisions. The disability provisions of the System should be changed to encourage rehabilitation and a return to active employment, rather than serving as substitute retirement provisions.

8. Employee Retirement Savings. The current deferred compensation plan available to state employees should be more vigorously marketed to encourage tax-deferred employee retirement savings. The State should consider making employee contributions to the MSRS either tax deductible or excludable through an employer pick-up or other arrangement.

9. Uniform Services. The Committee endorses the use of "special plans" in limited cases where retaining a younger, more vigorous workforce would serve to protect the public.

10. Retiree Medical Benefits. Retiree medical benefits are administered by the MSRS, but funded directly by the state on a "pay-as-you-go" basis. The State's obligation to pay retiree medical benefits is a potentially serious problem which may involve substantial liability to the State. When the costs are known, consideration should be given to pre-funding these liabilities as is the case with other retirement benefits.

Operations

11. Service. The quality of service provided to MSRS participants is unsatisfactory. The availability and accuracy of counseling in response to member questions should be improved. The service goals of the MSRS should include a comprehensive, accurate annual statement for each participant.

12. Automation. The MSRS administrative operations are unsatisfactory. The system needs to be computerized using state-of-the art hardware and software. MSRS automation plans should receive high priority status within the Office of Information Services (OIS). The Governor should appoint an ombudsman to ensure that OIS expedites the review and approval of MSRS plans.

13. PLD Consolidation. The multitude of retirement plans of the PLD's should be consolidated into 3 or 4 standardized programs (exclusive of uniformed services), with "risk pooling" and portability (transferability) within each program, to provide greater uniformity and fairness to participants. Consideration should also be given to the issue of portability between the PLD plans and the state employee and teacher program.

14. PLD Plan Independence. The PLD plans should remain independent from the state and teacher plan. The assets, liabilities, and administrative costs connected with the PLD plans should be properly identified and allocated to the applicable plan.

15. Board of Trustees. The selection process for membership on the Board of Trustees should be changed to provide that the retiree member currently selected by the other Board members would henceforth be selected by the Governor to represent the public. The composition of the Board should not otherwise be changed.

16. Executive Director. The Office of the Executive Director should be expanded to include two Associate Directors, one responsible for investment matters and one responsible for benefit payments and administrative matters. The Board would establish appropriate salary ranges for these unclassified positions within the ranges provided for state service. A complete review of other MSRS staffing should be conducted to determine the efficacy of reclassifying and/or declassifying certain MSRS personnel.

17. Claims Review Procedures. Hearing Examiners should be engaged to supplement the role of the Executive Director in making determinations of fact. The Board of Trustees should be the final Board of Appeals, but should not be required to make determinations of fact, rather focusing only on plan interpretations and broad policy issues.

Table of Contents

GRAPHS

APPENDICES

CHAPTER I
Introduction

This study of the Maine State Retirement System (MSRS) was initiated in response to proposed significant increases in the employer contributions rates paid to MSRS by the State for all State employees and public school teachers. The increase in rates was primarily due to a change in the actuarial assumptions, which are used to determine the rates necessary to meet estimated future benefit costs. Some of the assumptions did not reflect actual practice, particularly with respect to the age at which state employees and teachers were retiring. These assumptions understated future benefit costs. Aggregate contribution rate requests for state employees and teachers increased from 17.32% in Fiscal Year (FY) 1986-87 to 20.37% for state employees and 21.80% for teachers in FY 1987-88 representing a total one year increase of approximately $23 million.

Due to these uncertainties surrounding the financial condition of MSRS, the substantial financial impact on the State resulting from the recent changes in actuarial assumptions, and the indications that further changes in the assumptions would be required, Governor McKernan called for this special study. The Governor and the Legislature approved reduced contribution rates for the fiscal year ending June 30, 1988 and set aside appropriate funds to fully meet the System's request, pending the outcome of this study.

The legislation authorizing this study called for a six-member committee, with three members appointed by the Governor and three jointly by the Speaker of the House and the President of the Senate. The relevant sections of PL 1987 c. 68 are provided in Appendix A. With an authorized budget of $75,000 and the authority to contract for those professionals it required to assist it, the committee was established to review all aspects of the Retirement System, including but not limited to the following:

- the present and alternate systems or methods of funding and contributions;
- the present and future investment methods and incomes, including investment management, reporting and policies;
- the present and future expenses and costs of the System, including operating expenses, commissions, salaries and indirect costs;
- the present and future benefit plans and payment methods;
- the anticipated unfunded liability of the System, or other financial obligations that have not been presently met; and

- all other aspects of the laws, operations and procedures of the System that relate to its financial stability and fiscal soundness.

This ambitious task called for an aggressive schedule of meetings. After its first organizational meeting on May 26, 1987, the Committee began a schedule of meetings beginning June 29 and meeting every other week. Appendix B provides a listing of these meetings and a brief summary of their purpose. A complete listing of persons testifying before the Committee is also provided in Appendix C. The Committee decided at its first meeting that all meetings would be open to the public and that the Executive Director and the Board of Trustees, in particular, would be encouraged to attend and participate when appropriate.

The Committee invited several consulting actuary firms to make presentations before the Committee and to submit proposals or bids for the consulting services. (July 10th meeting) Of the four invited, the Wyatt Company represented by Kenneth Steiner and Richard Hubbard was selected on strength of proposal, prior preparation, cost and previous experience. (The Wyatt Company was involved in a prior study of Maine State Retirement System in 1980.) In addition to the consulting services of the Wyatt Company, the Committee paid for the services of several expert witnesses on the various related subject areas including employee pension plans, investment management, and management consulting. The expenditures for these and other items are detailed in Appendix D.

Through the indepth knowledge gained through the expert witnesses, consulting actuary, and other interested parties, the Committee identified several areas of concern which should be addressed. These areas are grouped into three major areas - financial condition, benefits, and operations. These three areas correspond to the major chapters in this report. Recommendations in each of these areas are provided at the end of the corresponding chapter.

A preliminary draft of this report was circulated to those who testified before the Committee and other interested parties. The Committee held its final meeting on January 29, 1988 at the State House in Augusta to review the comments received on the preliminary report and to make any necessary changes.

Chapter II
Background

The Maine State Retirement System (MSRS) is a joint contributory retirement system administering defined benefit pension programs to all state employees and public school teachers. With few exceptions, participation in the System is mandatory for all state employees and public school teachers, which based on fiscal year 1986 results number 14,274 and 19,204, respectively. The number of retired teachers receiving benefits from MSRS was 7,797 and 7,588 for state employees. In addition, local political subdivisions within the State may elect to have MSRS administer their pension programs. These political subdivisions have the option of participating in the MSRS. Approximately 260 participating local districts (PLD's) with an additional 8,925 employees and 4,184 retirees also participate in the System.

History

MSRS was orginally established by P.L. 1941 c. 328 as the "Employee Retirement System of the State of Maine" which provided pension plans for state employees and for the employees of political subdivisions which elected to participate in the system. It was not until 1951 that states and their political subdivisions were given the option of participating in Social Security. In 1947, legislation was passed which merged the "Old System" Teachers retirement plan and the Maine Teachers Retirement Association with the state employee plan. In 1949, the name of the System was changed to the Maine State Retirement System.

Numerous changes have been implemented in the design of the plans offered by MSRS to its participants for the most part resulting in increases in benefits. Some of the major changes include an increase in the membership service benefit formula from 1/70 of average final compensation to 1/50, a change in the average final compensation from average of 5 highest years earnings to average of 3 highest, and establishing minimum benefits originally set at $80 per month in 1970 and increased to $100 in 1973.

1980 Study of MSRS

In 1980, Governor Brennan and the Legislature authorized a similar, comprehensive study of MSRS. At that time, the Select Committee found that MSRS was not being funded on a realistic or prudent basis, major benefit deficiencies existed which were either overly generous, overly restrictive or poorly designed, and the Board of Trustees did not adequately represent the public and had too much latitude in the determination of actuarial assumptions. This report was not well received by the Board and the System's actuary and without any implementing legislation much of the study was ignored. This report must reaffirm many of the 1980 findings, however, the Committee hopes that by working with the Board, the Executive Director, and many of the constituency groups that many of these issues will finally be addressed.

Current Events

MSRS is currently in a very dynamic situation. A number of recent events and occurences have added to the importance and timeliness of this study, such as the System's change of actuaries and the subsequent increase in contribution rates, and the recent events in the stock market.

One of the major concerns behind this study was the increase in the employer contribution rates payable by the State. These contributions by the State to MSRS on behalf of State employees and teachers represent a significant portion of the budget. Therefore, it is no wonder that these increases would draw interest from policy-makers and holders of the purse strings. This, combined with the complexities and uncertainties surrounding actuarial valuations and the apparent direct link with the change of actuaries, led to a call for a complete review of the systems financial health.

The recent events in the financial markets, "Black Monday" and the current volatility of these markets, heightened the interest of the general public and the Committee in the investment practices of the System.

The Legislature also recognized the possibility of the federal government mandating Social Security coverage for all employees. Almost two years ago, the Legislature authorized a study in anticipation of such a federal mandate. The Commission to Study the Integration of the Maine State Retirement System with Social Security issued its report during the First Regular Session of the 113th Legislature (early 1987) in which it asked to continue its work due to some remaining unanswered questions. The final report of the Commission is due in January of 1988.

Chapter III
Financial Condition

The primary impetus behind the authorization of this study of the Maine State Retirement System (MSRS) was the concern of the Governor and the Legislature over the financial condition of the System, in the wake of the requests for significant increases in contribution rates. The Committee was required to review funding methods, investment methods and policies, and the unfunded liability and other financial obligations of MSRS. A major effort was directed toward reviewing the complex funding methods in an actuarially-determined, defined benefit plan. The Committee had to sift through the jargon of actuarial science in order to understand the concepts behind and the implications of the current funding methods and to review options.

In general, the Committee finds that the MSRS is in reasonably good shape. The assets are well managed and cash flow is positive. The actuarial assumptions used to estimate costs appear reasonable except for the projected retirement age assumption. Actual experience shows persons retiring sooner than assumed. While the current funding status of MSRS is not adequate as compared with public pension plans of other states and the unfunded liabilities of the MSRS are substantial, there is a plan in place to improve the funding status and reduce these unfunded liabilities.

Unfunded Liability

The term "unfunded liability" is often used by actuaries but its meaning is often misunderstood by most laypersons. In an actuarially-determined, defined benefit plan such as the MSRS, an actuary is needed to determine a target level of assets which will "fully fund" the benefits established. It is a generally accepted actuarial and accounting practice to fund the benefits of the employee while that person is working so that the taxpayers who have enjoyed that employee's services will have fully paid for that service during that person's working career. This means establishing a stream of contributions during the working career that when invested over the course of that person's career will provide a sum of money sufficient to make all the estimated retirement payments. An actuary is required to estimate these contributions and retirement payments.

The actuary determines at the end of each fiscal year the value of the assets held by the System, the estimated present value of benefits at the time of valuation, and the allocation of these benefits according to how they have been earned. Graph III-A depicts the results of this valuation process.

MSRS had assets of $677,665,796 with a present value of benefits payable at $3,027,516,715 as of June 30, 1986. In order to establish a funding target and determine the unfunded liability, the value of the benefits payable must be allocated between past service and future service. The red or "Inactive" portion of Graph III-A represents the value of the benefits that are payable to retirees and members who have terminated service with the State. The yellow or "Active Accrued" portion of the Graph represents the value of benefits payable as a result of the accrued service of active members of the MSRS or the service performed to date by state employees and teachers who are employed at the time of the valuation. The blue or "Active Reserve" portion represents the additional benefits that would be payable to active members because they will earn higher salaries in the future. The value of the benefits payable to state employees if they terminated service at a given point in time would be less than if they continued employment and earned a higher rate of salary and consequently had a future benefit based on the higher figure. The blue portion represents the increased benefits for past service due to the higher salary which employees are assumed to earn in the future.

These three portions of the Graph are allocated to past service and together determine the funding target, i.e., the level of assets required to fund past service. At the time of valuation, these are the benefits which ideally should be covered by the assets of the system. These portions represent benefits which are attributable to service credits earned prior to the time of valuation. Therefore, according to accepted principles these benefits should have already been funded, because the taxpayers have already enjoyed the past efforts or services of these employees. The green or top portion of the graph represents the value of benefits to be earned in the future.

The unfunded liability of the MSRS is simply the difference between the total of these three portions and the level of current assets of the MSRS at the time of valuation. As of June 30, 1986, the unfunded liability of the MSRS for state employees and teachers was $1,583,192,822. This unfunded liability results from three sources:

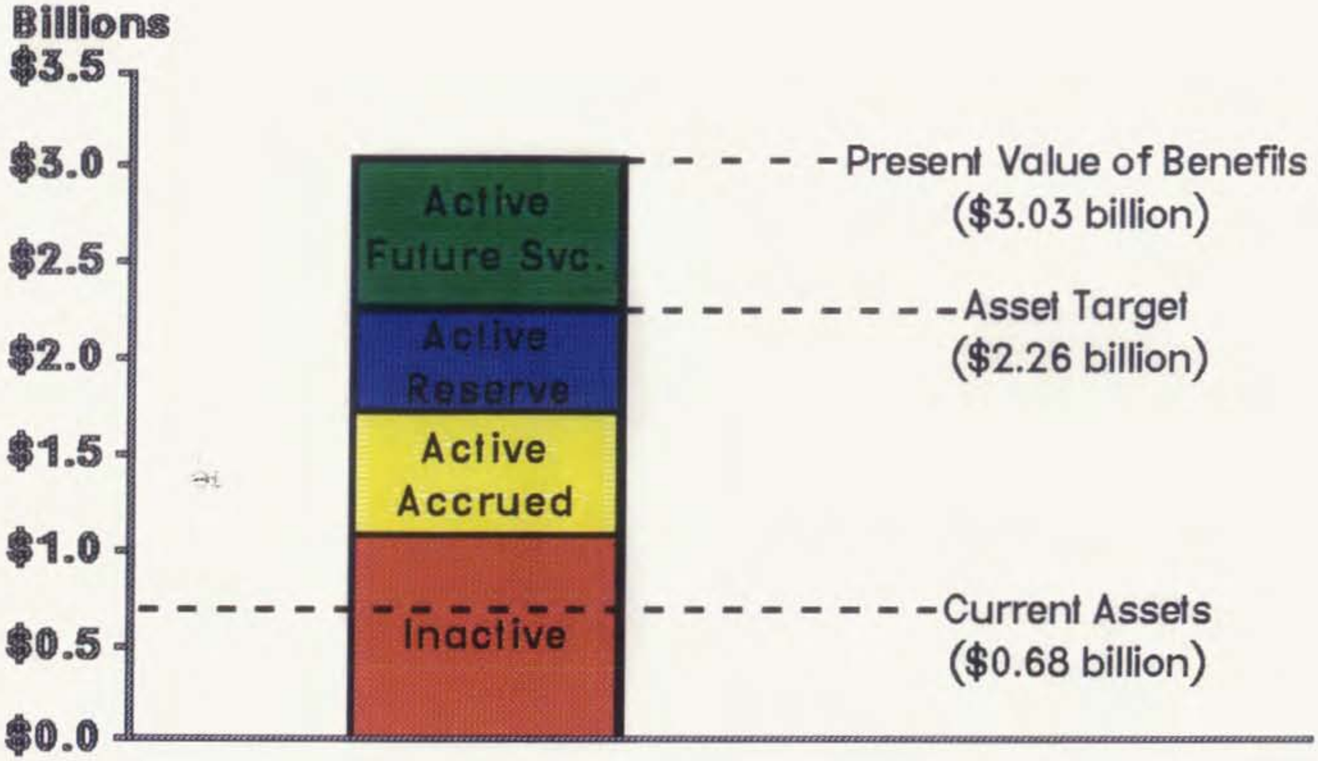
1. Changes in benefit levels for which the State and employees have not adequately contributed funds;

2. Changes in the assumptions by the Board of Trustees; and

3. Variances of actual experience from assumptions, i.e., assumptions proved to be too optimistic.

A common measure of financial soundness of pension plans is the Accrued Benefit Security Ratio. A 1986 survey of pension plans with more than 1000 employees conducted by the Wyatt Company indicated that the MSRS, with 39% of its accrued benefits covered by current assets, was in the lowest quintile or lowest 20% of these plans.

GRAPH III-A
MSRS ACTUARIAL ALLOCATION OF PRESENT VALUE OF BENEFITS
STATE EMPLOYEES AND TEACHERS
(1986 Valuation Results)



Asset Target - Current Assets = Unfunded Liability

1986: $2,260,858,618 - $677,665,796 = $1,583,192,822

1987: $2,776,266,578 - $792,904,096 = $1,983,362,482

This poor showing of the MSRS may be somewhat misleading with regard to the financial health of the System. The great majority of plans included in this survey were private pension plans which are funded according to different standards imposed by federal law. When compared with other public pension programs, MSRS still lagged behind most other states, but the difference was not as alarming. According to the 1987 Greenwich Association study, "Public Pension Funds, 1987 Report to Participants," the mean for other state public pension programs was 72%. It should also be noted that these measures of comparative financial health can be misleading because they do not account for differences in the assumptions used by the other plans.

The accrued benefit measure also gave the Committee some difficulty. Calculation of accrued benefits assumes, theoretically, that the employer dismisses all its employees and closes up - paying them exactly the benefits they have earned to that moment. This would not happen with most employers and would certainly not happen to a state. The expectation is that the state or business would continue into the future and that during this future period the employees would earn more benefits and salary increases which would result in much greater final retirement benefits than those calculated at any given point in time somewhere in the middle of an employee's career. This measure ignores the "Active Reserve" or blue portion of Graph III-A.

The amount needed to meet the MSRS asset target is about 130% of the present value of accrued benefits. Thus, the MSRS with a 39% funding level and a target of 130% would have to increase its assets by 233% in order to be fully funded. This represents a substantial commitment of state funds over the next two decades or so, but it is not unrealistic.

Actuarial Assumptions

In order to determine the value of benefits payable at the time of valuation and the resulting unfunded liability of pension plans, actuaries must make certain assumptions about future events which include social issues as well as financial ones. This is a very difficult task. It is hard enough to predict interest rates, stock market performance, salary levels, and inflation, but when one adds to this task the need to look thirty years or more into the future to predict at what age will people retire and at what age will they die, the task becomes mind boggling.

The MSRS is required by statute (5 M.R.S.A. § 17107) to designate an actuary to serve as technical advisor to the Board of Trustees regarding the operation of the funds. The Board actually establishes the assumptions and methodology used in the funding and valuation process based on the recommendations of the actuary. The Board reviews the assumptions recommended by the actuary for their reasonableness. Overly optimistic assumptions would understate the System's unfunded liability and vice versa for overly pessimistic assumptions.

The actuary is required to study the experience of the MSRS with respect to factors which affect the cost of the benefits provided by the System at least once every three years. The recent change of actuaries by the MSRS resulted in a review of and adjustments to the valuation methods and assumptions used by the prior actuary. As required by its authorizing legislation, this Committee also reviewed these methods and assumptions.

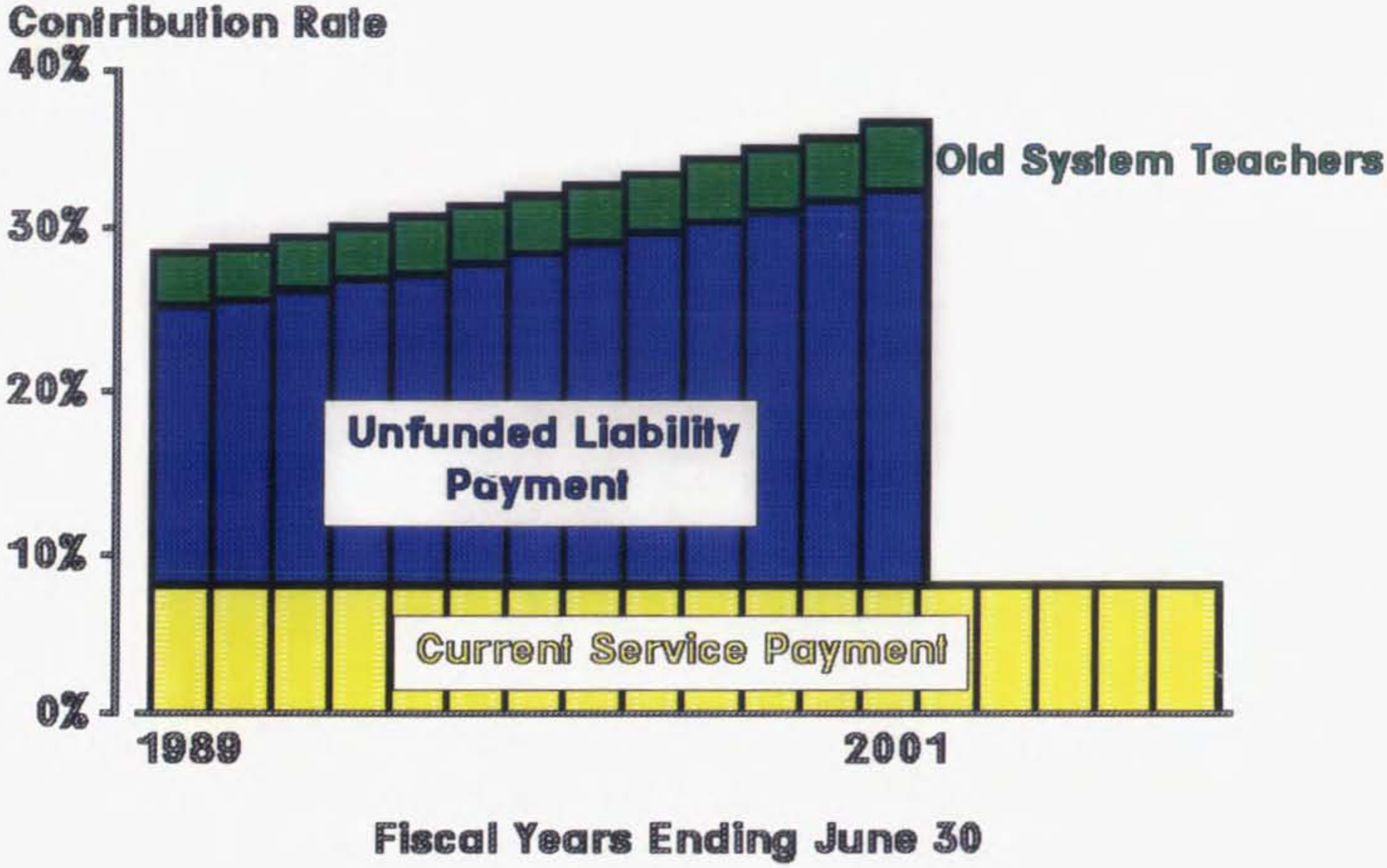
Two critical assumptions are closely tied to the inflation rate, the rate of return on investments and the rate of salary growth. According to the Wyatt Company "1986 Survey of Actuarial Assumptions and Funding" for final pay plans, MSRS appears to be well in line with the majority of plans in terms of the interest rate and salary growth assumptions used in the 1986 valuation. The 8-plus% interest rate assumption is consistent with the assumptions of over 40% of plans surveyed and is within 1 1/2% of over 90% of plans surveyed. The same appears to be true of the salary growth rate assumption. However, one of the more important aspects of these assumptions is the amount by which they exceed the rate of inflation, in other words, the real rate of return on investments and the real salary growth rate. The Committee found that the assumed real rates for these assumptions of 3% and 1%, respectively, are realistic and reasonable.

However, MSRS assumptions regarding the age at which teachers and state employees retire appears to differ significantly from actual experience. The MSRS had used a retirement age assumption of 65 prior to the change of actuaries in 1986. After an initial study by the new actuary, it concluded that this assumption should be revised to a retirement age averaging closer to age 60. Because of the significant increase in the unfunded liability that would result from the lowering of the retirement age assumption, the Board of Trustees decided to adjust this assumption partially to age 62 average and to make further adjustments in this assumption after the new actuary had an additional year to analyze actual retirement experience.

Amortization

Once the actuarial assumptions are established by the Board of Trustees and the unfunded liability is derived, the Board with the advice of the actuary must then decide how it wishes to reduce this liability or pay off this debt. The method and length of the time to reduce this liability to zero, the amortization schedule, is the other key determinant of the employer contributions to the MSRS.

GRAPH III-B
MSRS PROJECTED EMPLOYER CONTRIBUTION RATES
STATE EMPLOYEES AND TEACHERS
(1987 Valuation Results)



GRAPH III-C
MSRS PROJECTED EMPLOYER CONTRIBUTIONS RATES
STATE EMPLOYEES AND TEACHERS
30-Year Level % vs. Present Funding Method
(1987 Valuation Results)

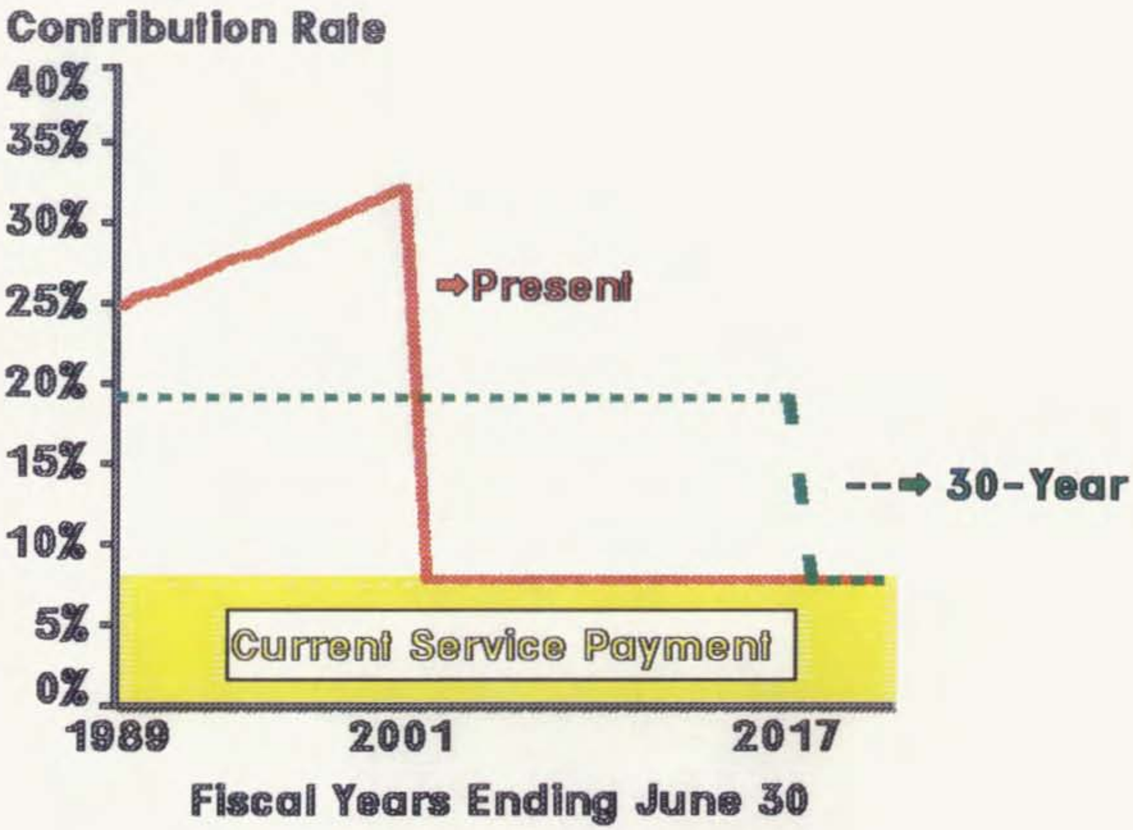


TABLE III-A
ESTIMATED STATE CONTRIBUTIONS
for
STATE EMPLOYEES AND TEACHERS
(% of Payroll)

FY ENDING JUNE 30	OLD ASSUMPTIONS 14	OLD ASSUMPTIONS 20	OLD ASSUMPTIONS 25	OLD ASSUMPTIONS 30	NEW ASSUMPTIONS 14	NEW ASSUMPTIONS 20	NEW ASSUMPTIONS 25	NEW ASSUMPTIONS 30
	AMORTIZATION PERIOD							
1988	21.44	20.52	18.36	16.93	25.68	24.54	21.88	20.14
1989	23.81	22.14	19.80	18.25	25.30	23.53	21.03	19.38
1990	24.29	22.14	19.80	18.25	25.81	23.53	21.03	19.38
1991	24.78	22.14	19.80	18.25	26.34	23.53	21.03	19.38
1992	25.28	22.14	19.80	18.25	26.87	23.53	21.03	19.38
1993	25.81	22.14	19.80	18.25	27.43	23.53	21.03	19.38
1994	26.34	22.14	19.80	18.25	28.00	23.53	21.03	19.38
1995	26.90	22.14	19.80	18.25	28.59	23.53	21.03	19.38
1996	27.47	22.14	19.80	18.25	29.20	23.53	21.03	19.38
1997	28.06	22.14	19.80	18.25	29.83	23.53	21.03	19.38
1998	28.66	22.14	19.80	18.25	30.47	23.53	21.03	19.38
1999	29.29	22.14	19.80	18.25	31.14	23.53	21.03	19.38
2000	29.93	22.14	19.80	18.25	31.82	23.53	21.03	19.38
2001	30.59	22.14	19.80	18.25	32.53	23.53	21.03	19.38
2002	7.88	22.14	19.80	18.25	8.34	23.53	21.03	19.38
2003	7.88	22.14	19.80	18.25	8.34	23.53	21.03	19.38
2004	7.88	22.14	19.60	18.25	8.34	23.53	21.03	19.38
2005	7.88	22.14	19.80	18.25	8.34	23.53	21.03	19.38
2006	7.88	22.14	19.80	18.25	8.34	23.53	21.03	19.38
2007	7.88	22.14	19.80	18.25	8.34	23.53	21.03	19.38
2008	7.88	7.88	19.80	18.25	8.34	8.34	21.03	19.38
2009	7.88	7.88	19.80	18.25	8.34	8.34	21.03	19.38
2010	7.88	7.88	19.80	18.25	8.34	8.34	21.03	19.38
2011	7.88	7.88	19.80	18.25	8.34	8.34	21.03	19.38
2012	7.88	7.88	19.80	18.25	8.34	8.34	21.03	19.38
2013	7.88	7.88	7.88	18.25	8.34	8.34	8.34	19.38
2014	7.88	7.88	7.88	18.25	8.34	8.34	8.34	19.38
2015	7.88	7.88	7.88	18.25	8.34	8.34	8.34	19.38
2016	7.88	7.88	7.88	18.25	8.34	8.34	8.34	19.38
2017	7.88	7.88	7.88	18.25	8.34	8.34	8.34	19.38
2018	7.88	7.88	7.88	7.88	8.34	8.34	8.34	8.34
2019	7.88	7.88	7.88	7.88	8.34	8.34	8.34	8.34
2020	7.88	7.88	7.88	7.88	8.34	8.34	8.34	8.34

NOTE: Percentages for the Fiscal Year ending June 30, 1988 are based on June 30, 1986 valuation results. All remaining percentages are based on 1987 valuation results. These results do not include contributions for "old system" teachers, retiree health insurance, or administration.

SOURCE: Millman & Robertson, Inc.

TABLE III-B
ESTIMATED STATE CONTRIBUTIONS
for
STATE EMPLOYEES AND TEACHERS
(Millions of $)

FY ENDING JUNE 30	OLD ASSUMPTIONS AMORTIZATION PERIOD 14	20	25	30	NEW ASSUMPTIONS AMORTIZATION PERIOD 14	20	25	30
1988	143.1	137.0	122.6	113.1	171.5	163.8	146.1	134.5
1989	173.6	161.5	144.4	133.0	184.5	171.6	153.3	141.3
1990	187.7	171.2	153.0	141.0	199.5	181.9	162.5	149.8
1991	203.0	181.4	162.2	149.5	215.8	192.8	172.3	158.8
1992	219.6	192.3	171.9	158.4	233.4	204.3	182.6	168.3
1993	237.6	203.8	162.2	168.0	252.5	216.6	193.6	178.4
1934	257.1	216.1	193.2	176.0	273.3	229.6	205.2	189.1
1995	278.2	229.0	204.8	188.7	295.8	243.4	217.5	200.4
1996	301.2	242.8	217.1	200.0	320.2	258.0	230.6	212.4
1997	326.1	257.3	230.1	212.0	346.7	273.5	244.4	225.2
1998	353.1	272.8	243.9	224.6	375.4	289.9	259.1	238.7
1999	382.4	289.2	258.5	238.2	406.6	307.2	274.6	253.0
2000	414.2	306.5	274.0	252.5	440.5	325.7	291.1	268.2
2001	448.8	324.9	290.5	267.7	477.2	345.2	308.6	284.3
2002	122.6	344.4	307.9	283.8	129.6	365.9	327.1	301.4
2003	129.9	365.1	326.4	300.8	137.4	387.9	346.7	319.4
2004	137.7	387.0	346.0	318.8	145.7	411.2	367.5	338.6
2005	146.0	410.2	366.7	338.0	154.4	435.8	389.6	358.9
2006	154.7	434.8	388.7	358.2	163.7	462.0	412.9	380.5
2007	164.0	460.8	412.0	379.7	173.5	489.7	437.7	403.3
2008	173.8	173.8	436.8	402.5	183.9	183.9	464.0	427.5
2009	184.3	184.3	463.0	426.7	194.9	194.9	491.8	453.1
2010	195.3	195.3	490.8	452.3	206.6	206.6	521.3	480.3
2011	207.0	207.0	520.2	479.4	219.0	219.0	552.6	509.1
2012	219.5	219.5	551.4	508.2	232.2	232.2	585.7	539.7
2013	232.6	232.6	232.6	538.7	246.1	246.1	246.1	572.1
2014	246.6	246.6	246.6	571.0	260.9	260.9	260.9	606.4
2015	261.4	261.4	261.4	605.2	276.5	276.5	276.5	642.8
2016	277.1	277.1	277.1	641.5	293.1	293.1	293.1	681.3
2017	293.7	293.7	293.7	680.0	310.7	310.7	310.7	722.2
2018	311.3	311.3	311.3	311.3	329.4	329.4	329.4	329.4
2019	330.0	330.0	330.0	330.0	349.1	349.1	349.1	349.1
2020	349.8	349.8	349.8	349.8	370.1	370.1	370.1	370.1

NOTE: Programs for the Fiscal Year ending June 30, 1988 are based on June 30, 1986 valuation results. All remaining figures are based on 1987 valuation result. These results do not include contributions for "old system" teachers, retiree health insurance, or administration.

Source: Milliman & Robertson, Inc.

MSRS had established July 1, 2001 as the date by which it will fully fund the System and pay-off the outstanding liabilities for state employees and teachers. Graph III-B on page 11 illustrates the current amortization schedule. The main characteristic of this schedule is the increasing rates of contributions until 2001. Contribution rates are scheduled to increase at a rate of 3% per year, currently at 21.4% for fiscal year 1987-88 and increasing to 30.6% for fiscal year 2000-01 or approximately 24.3% and 34.7%, respectively, when the contributions for "old system" teachers are factored in. Notice the significant decrease in the contribution rate, or "cliff" on the graph which occurs when the unfunded liability is paid off and the system is fully funded.

The graph consists of three portions, the repayment of the unfunded liability, the current service payment, and the repayment of the "old system" teachers liability. This graph shows the current service payment running at a constant 7.9% of salary based on 1987 valuation results. This is the amount that the State would need to contribute for current employees if the system was fully funded, i.e., with no unfunded liability. The increasing contribution rate inherent in the current amortization schedule is due to the method chosen by the Board to repay the unfunded and "old system" teachers liabilities.

The Committee was unable to find documentation in the minutes of the Board of Trustees' meetings of their reasons for establishing this particular amortization schedule. The schedule was assumed to have been adopted in 1976 with the MSRS moving to full funding over a 25-year period. There are numerous other possible alternatives to amortize the unfunded liability. Graph III-C on page 13 depicts the effect on the contribution rates of the different amortization schedules. The red (solid) line shows the MSRS present policy of increasing contribution rates through the year 2001. The green (dotted) line represents funding the unfunded liability over a thirty year period with contributions at a constant percentage of salary. This graph illustrates the inverse relationship between the length of the amortization schedule and the contribution rates attributable to the unfunded liability repayment. The current service payment would be the same under all these alternatives as long as the assumptions remained the same.

The tables on pages 15 and 16 generated by Milliman & Robertson, the current actuary for the MSRS, show the effect on contribution rates (Table III-A) and total contributions in dollars (Table III-B) of changing the amortization period using two possible retirement age assumptions. The first four columns correspond to a 62 year old average retirement age assumption. The last four are based on a 60 year old average retirement age assumption. The amortization period is changed from left to right from the current schedule to 20, 25, and 30 year amortization schedules.

Old System Teachers Liability

Similar to the unfunded liability is another liability of the MSRS. This liability resulted from the State's commitment to provide retirement benefits to Teachers hired prior to July 1, 1924 for whom no funds had been contributed to a retirement plan. This liability is presently being carried on MSRS books as a negative asset. This liability, created at the time of the merger of the teachers retirement with the State employee system, was ignored by the State until 1982. At that time, Governor Brennan made a commitment to pay off this debt or unfunded liability at a schedule which would increase at 9% per year after June 30, 1989. A schedule of the contributions is provided in Table III-C below.

TABLE III-C
Old System Teacher Contributions

Fiscal Year		Fiscal Year	
1982	$12,100,000	1992	$27,802,978
1983	$13,200,000	1993	$30,305,246
1984	$14,300,000	1994	$33,032,718
1985	$15,500,000	1995	$36,005,662
1986	$16,809,197	1996	$39,246,172
1987	$18,236,894	1997	$42,778,327
1988	$19,787,030	1998	$46,628,377
1989	$21,469,000	1999	$50,824,931
1990	$23,401,210	2000	$55,399,174
1991	$25,507,319	2001	$60,385,100

This liability has been increasing since 1982. At the 1986 valuation, this liability was $198,790,059. It increased slightly to $198,914,936 in the 1987 valuation. Because this liability is classified as a negative asset on MSRS books, it is increasing at the rate earned by assets in MSRS funds. The amount is expected to begin to decrease as a result of contributions received in fiscal year 1988 and be reduced to zero by July 1, 2001 on a schedule similar to the unfunded liability. Graph III-B illustrates the effect of the "old system" teachers liability as a percentage of salary although these contributions are made by direct General Fund appropriation and not as a percentage of salary.

Contributions and Funds Flow

The assumptions and amortization schedule established by the Board provide the foundation upon which the employer contribution rates are determined. The State contributes a percentage of the salary earned by teachers and state employees to MSRS. MSRS recommended contribution rates are submitted biennially to the Governor and the Legislature as part of the budget process.

These employer contributions are one of three major sources of income to the MSRS. The other two sources are income from investments and individual member or employee contributions. Table III-D below provides an analysis of these three major sources of MSRS funds. Column 1 provides the income to the MSRS from all three sources. Column 2 provides an analysis of the net flow of funds but ignores the income from investment which includes a significant amount of unrealized capital gains. Column 3 takes this analysis a step further and removes the effect of employee contributions which may be withdrawn by members upon termination of service. This analysis is provided for the past ten years.

TABLE III-D
MSRS CASH FLOW ANALYSIS

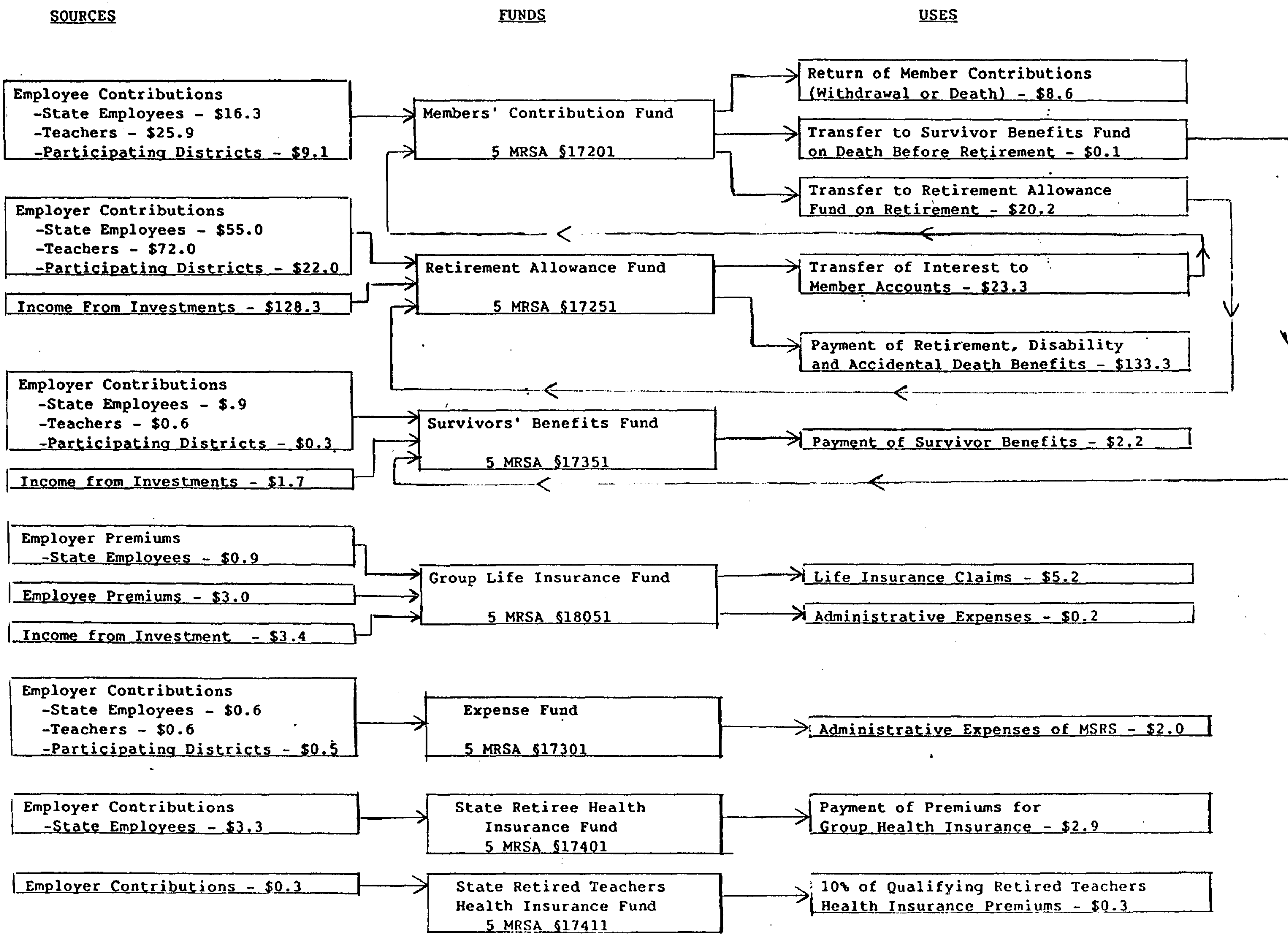
Fiscal Year Ending 6/30	Net Increase (Decrease) in MSRS Trust Fund 1	2	3
1987	$183,985,117	$53,955,375	$ 2,622,688
1986	171,658,694	47,170,499	333,408
1985	122,126,436	38,970,880	(4,900,835)
1984	86,981,404	36,734,805	(3,379,774)
1983	107,857,799	32,025,828	(5,810,153)
1982	80,277,330	33,745,715	(2,228,256)
1981	65,952,432	18,880,480	(17,121,302)
1980	52,586,672	18,680,918	(15,024,848)
1979	21,450,397	4,074,296	(26,470,324)
1978	16,427,080	3,905,872	(24,096,686)

Column 1 = Net change in Trust Fund Reserves.
Column 2 = Net change less income from investments.
Column 3 = Net change less income from investments and employee contributions.

Excluding the employee contributions and income from investments from this analysis of the net flow of funds to MSRS provides a very conservative measure of the funds available to the System. Income from investments may represent a significant amount of unrealized gains and individual members have the right to withdraw their contributions upon termination of service with the State. However, those funds contributed by the State to the MSRS, according to the Maine Constitution (Article IX, Sec. 18), are to be held in trust by the MSRS for the exclusive purpose of providing benefits and cannot be used for other purposes. Even this most conservative measure of cash flow showed positive cash flow for the past two fiscal years. Under the current amortization schedule, cash flow excluding investment income should remain positive until 2001. At that time, MSRS will no longer need to maintain the higher contribution levels. MSRS will have an investment base sufficient to pay benefits from investment income and the lower contributions.

FIGURE III-A

MSRS FLOW OF FUNDS
($ in Millions)



Employee contributions are established by statute at 6.5% of salary. There are some exceptions to this requirement. For example, confidential employees, legislative employees, and certain institutional workers can receive a reduced gross salary in exchange for the State paying the employee share. However, for most employees, their contributions are collected in a separate Fund made up of accounts for each individual member. Interest income is allocated to each member's account at a rate established by the Board of Trustees. The rate is currently 7%.

Employer contributions are much more complex with several different components. Employer contributions are allocated to several different Funds by statute according to type of benefits payments. Figure III-A on the preceding page illustrates the accounting flow of MSRS funds. Figures included are based on fiscal year 1986-87. The allocation of the employer contributions will be discussed more fully in the next chapter which discusses benefits and their costs.

Present Budget Situation

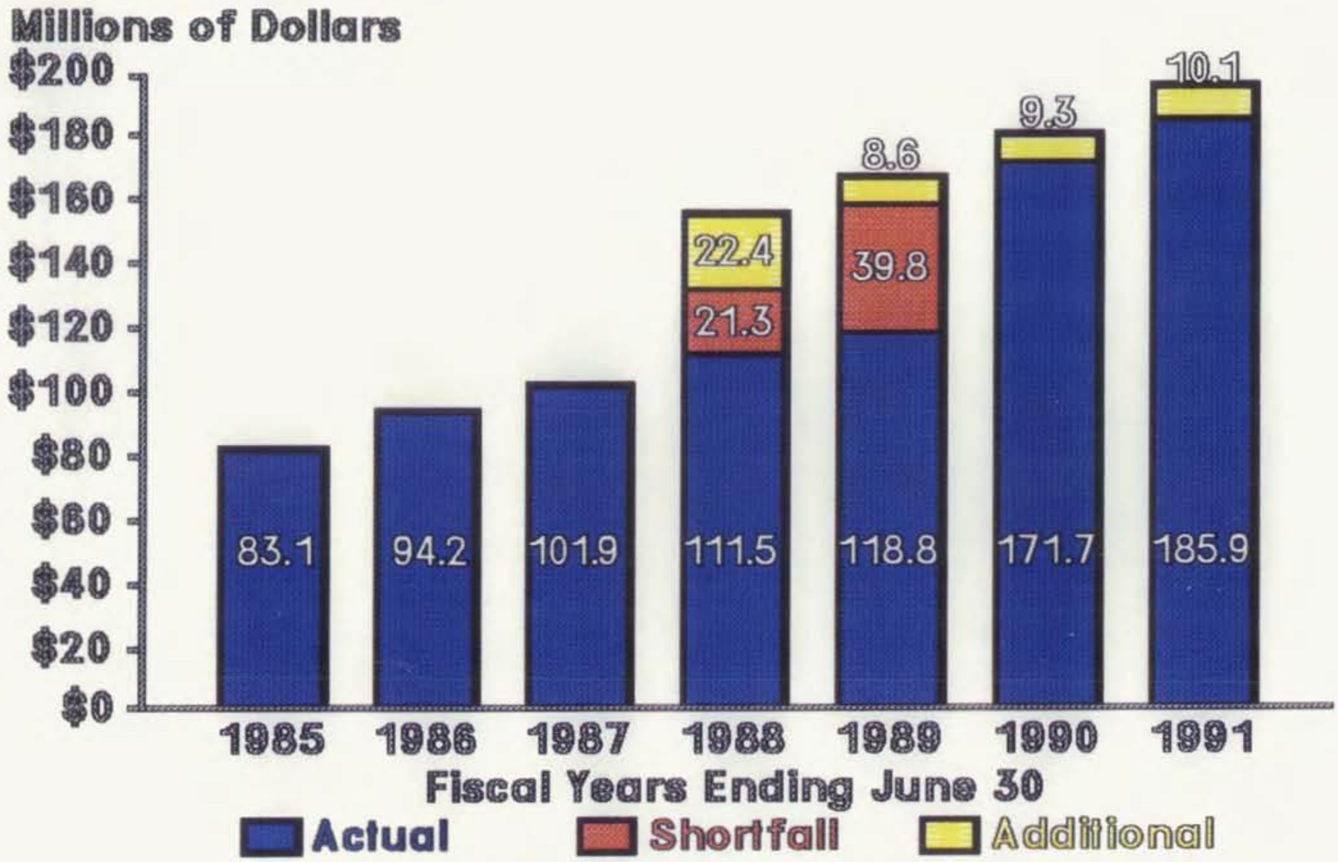
As a result of the changes in the assumptions adopted by the Board of Trustees, the subsequent jump in the contribution rates, and the questions raised by the actuary in his report regarding the possible need for further changes, the Governor and the Legislature, pending the outcome of this Committee's work, did not authorize the complete request for contributions to the MSRS. This would appear to be contrary to MSRS statute (5 MRSA §17153) which states that the Legislature shall appropriate and transfer those funds that the Board of Trustees calculates to be necessary to maintain the System on an actuarially sound basis. Instead, funds were to be transferred from the Maine Rainy Day Fund pending the outcome of the this study. To make sure that the necessary funds were available, the limit of the Maine Rainy Day Fund was raised from $25 million limit to $48 million and additional funds were appropriated to bring the Fund to that limit for Fiscal Year 1988-89.

The original estimates for the cost to the General Fund was $36.1 million for teachers and $3.8 million for state employees (see L.D. 538, 113th Legislature, page 26). However, the schedule of payments generated by the System's actuary indicated that the General Fund cost could be higher than that projected originally and would be significantly higher if the retirement age assumption was reduced further to 60 year old average. Some initial rough estimates of the various effects on General Fund contributions of changing the assumptions and the amortization schedule are provided in the Graphs and Table on the following pages.

TABLE III-E
GENERAL FUND CONTRIBUTIONS TO MSRS
($ in Thousands)

FISCAL YEAR ENDING JUNE 30	1985	1986	1987	CURRENT BIENNIUM 1988	1989	1990	1991
1. Current Amortization Schedule (2001)							
A. Actual or Budgeted Contributions	83,138	94,181	101,869	111,494	118,799	171,684	185,877
Acturial Projections:							
Ave. Retirement Age of 62	--	--	--	132,836	158,613	171,684	185,877
Ave. Retirement Age of 60	--	--	--	155,272	167,224	181,006	195,989
B. General Fund Shortfall	--	--	--	21,342	39,814	--	--
C. Additional Shortfall due to Assumption Change	--	--	--	22,436	8,611	9,322	10,112
Current Biennium Shortfall (Ave. Retirement Age of 62) = 61,156							
Current Biennium Shortfall (Ave. Retirement Age of 60) = 92,203							
2. Thirty Year Level Percentage Amortization							
A. Actual or Budgeted Contributions	83,138	94,181	101,869	111,494	118,799	134,791	143,612
Actuarial Projections:							
Ave. Retirement Age of 62	--	--	--	109,136	126,539	134,791	143,612
Ave. Retirement Age of 60	--	--	--	126,042	133,096	141,743	150,959
B. General Fund Shortfall	--	--	--	(2,358)	7,740	--	--
C. Additional Shortfall due to Assumption Change				16,906	6,557	6,952	7,347
Current Biennium Shortfall (Ave. Retirement Age of 62) = 5,382							
Current Biennium Shortfall (Ave. retirement Age of 60) = 23,463							

GRAPH III-D
GENERAL FUND CONTRIBUTIONS TO MSRS
CURRENT AMORTIZATION SCHEDULE

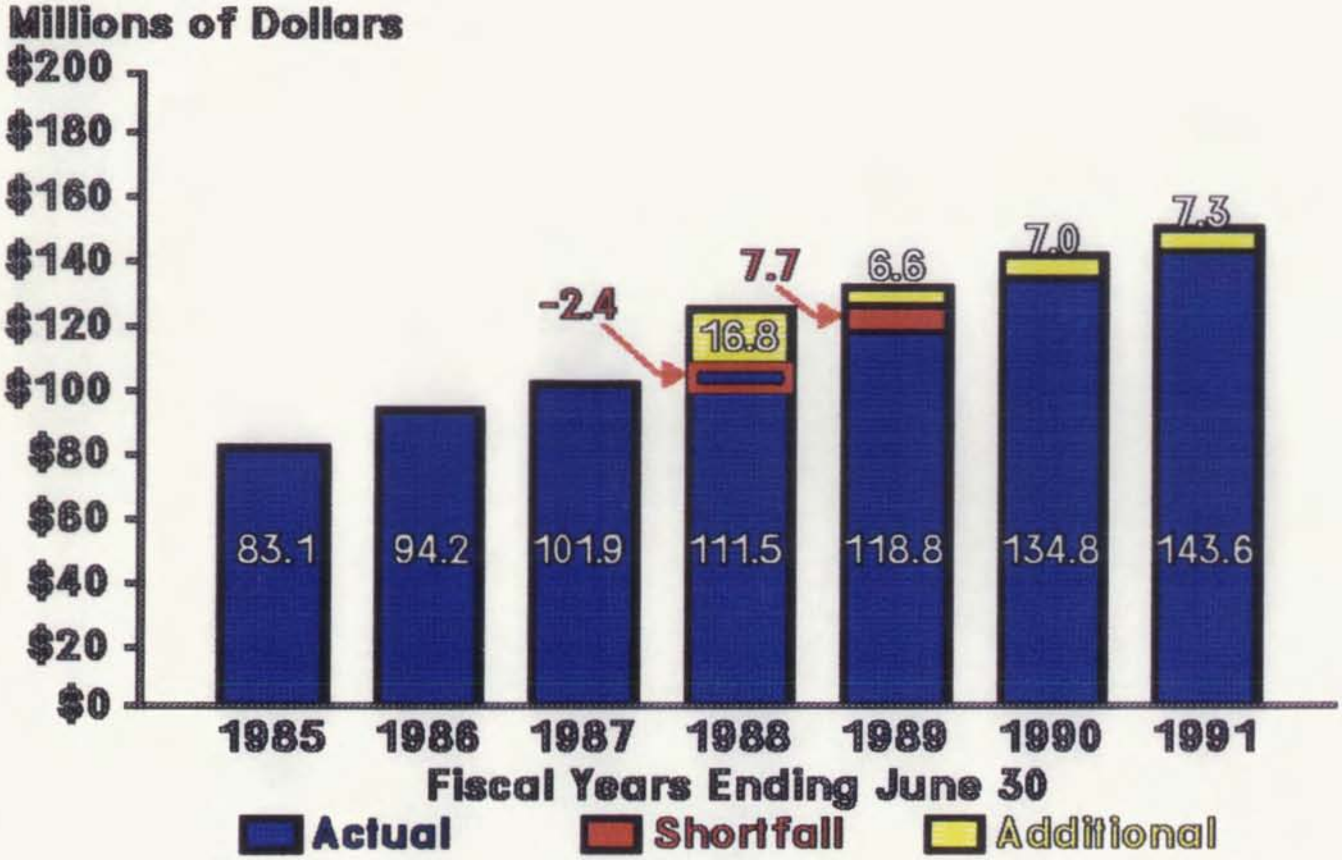


ACTUAL = Actual General Fund Contributions

SHORTFALL = Shortfall Based on Current Assumptions

ADDITIONAL = Shortfall Due to Change of Assumptions

GRAPH III-E
GENERAL FUND CONTRIBUTIONS TO MSRS
30-YEAR AMORTIZATION SCHEDULE



ACTUAL = Actual General Fund Contributions

SHORTFALL = Shortfall Based on Current Assumptions

ADDITIONAL = Shortfall Due to Change of Assumptions

Graph III-D depicts the General Fund contributions to MSRS on behalf of the old system teachers, teachers, and General Fund state employees. This graph highlights the amount of the General Fund shortfall in the current biennium based on the actuary's estimates of contributions required under the current amortization schedule and demonstrates the additional shortfall that would result from changing the retirement age assumption. Graph III-E is provided to compare with Graph III-D to illustrate the difference in contribution rates and General Fund shortfall if a 30-year level percentage amortization schedule had been in place for contributions beginning July 1, 1987.

Table III-E on page 22 provides the figures used to generate these graphs. As noted earlier, these figures in Table III-E may be significantly different from the actual figures used by the MSRS to determine the final shortfall and actual contributions. However, the figures and the graphs are valuable in demonstrating the relative effect of changing the assumptions and the amortization schedule.

Investments

MSRS investment policy is established by the Board of Trustees. To carry out this responsibility, the Board is authorized by statute (5 M.R.S.A. §17104) to employ or contract with the necessary persons for investment counsel or advice. MSRS has contracted with The Boston Safe Deposit and Trust Company, Inc. to act as the custodian of the System's assets. As part of its function, the Boston Company provides a monthly accounting report and quarterly reviews of the investments. Table III-F at the top of the next page provides a summary of the market value of the assets and the managers of the various funds.

The Committee invited Fred Settelmeyer, Vice President of the Boston Company, to testify before the Committee. His report of the system's investment policy was generally favorable. MSRS performance compared to similar trust funds was slightly better than average. Over the past 5 years, the Maine State Retirement System was in the 60th percentile which means that MSRS did better than 60% of other portfolios of similar Trust Funds. Over the past 3 years, the System ranked above 54 percent. Over the past year, MSRS investment performance was in the 57th percentile. In addition, Mr. Settelmeyer reviewed the performance of the individual managers. The quarterly report provides a comparison of how each manager performs within his category established by a manager's general investment strategy.

TABLE III-F
Equity and Fixed Income Investments

Investment Manager	Market Value (6/30/87)
Equity:	
FLA Management	$ 138,607,000
Putnam Equity	$ 122,362,000
Maine National Bank	$ 118,097,000
Casco Bank	$ 89,894,000
Alliance Capital Management	$ 82,923,000
Gouws Capital Management	$ 28,273,000
Dillon Read Capital	$ 17,119,000
Evans & Moxon	$ 6,127,000
Futures	$ 769,000
Total Equity	$ 604,171,000
Fixed Income:	
Mass Financial Services	$ 102,968,000
Alliance	$ 101,048,000
Putnam Fixed	$ 87,919,000
Total Fixed Income	$ 291,935,000

Note: This Table excludes Real Estate investments, Special Assets, and certain other investment which could not specifically be classified as either Equity investments or Fixed Income investments.

MSRS and the Boston Company establish a desired asset mix, the percentage of assets that are to be invested in the different investment categories. Once determined the asset mix is implemented through the process of selecting investment managers. Over the past few years, the Board of Trustees have made a deliberate decision to increase equities and reduce cash held by the investment managers. Cash that used to be held is now being put into index funds which are essentially equity investments. The asset mix has changed considerably since 1984, as follows:

	% of Assets Invested	
Type of Investment	1984	June 1987
Equity	40%	58%
Bonds	40%	37%
Cash	20%	5%

Despite this aggressive asset mix, the portfolio of the MSRS was not as badly damaged as might be expected during the record decline of Monday, October 19th. The MSRS had made some adjustments to its portfolio the Friday before the record drop of the stock market; selling some stock and some futures used as portfolio insurance. The portfolio of the MSRS has declined from the levels attained during the extended Bull market this past year, yet because of some very timely actions it has performed better, declined less, than the market indices.

Unfunded Liability and State's Credit Rating

The Committee was very fortunate to have several expert witnesses discuss this topic in both theoretical and practical terms; i.e., the effect of the System's unfunded liability as a financial obligation of the state on the state's credit rating. Professor Dutch Leonard provided an excellent theoretical discussion of pension systems which provided the Committee with an understanding of pension obligations created by employers. Pensions are a device through which employers compensate employees. Pension benefits are valuable to both employers and employees alike. They force workers to save and provide for their retirement. To the employer, these benefits are less costly in the short run than current salaries or other benefits currently payable. They have created a liability payable in this future. In this sense, the creation of retirement benefits is a form of debt.

The United States Government and the State of Maine as employers have used this form of debt financing extensively. According to Jamie Cowen, Government Retirement and Benefits, Inc., the unfunded liabilities of the federal civilian and military systems approximates the annual federal budget, $1 trillion. This $1 trillion debt is not included or reflected in the national debt figures. Like the federal government, the unfunded liability of MSRS also approximates the annual budget of Maine State Government, exclusive of federal funds. In Fiscal Year 1986, the annual budget for Maine was approximately $1.8 billion. This unfunded liability of the MSRS is not reflected in the outstanding debt obligations of the State. The unfunded liability of the System is also not subject to the constitutional limits on the debt financing obligations of the State; hence, it has been referred to as "back-door" debt. Unfunded liabilities are common among public pension plans because Legisaltures can postpone the cost of benefit enhancements to the future and avoid current budgetary constraints.

Given this substantial future obligation of the State to pay these pension benefits, the Committee's next logical pursuit in its study was to determine the relationship between MSRS pension obligations, particularly the unfunded liability, and the credit rating of the State of Maine. If changes in the unfunded liability of the System affected the credit rating of the State or were considered by the rating firms as debt obligations of the state, should the State issue bonds to pay the unfunded liability and realize arbitrage profits? The System and the Committee were aware of the potential for additional profits to the System and a further reduction of the unfunded liability by taking advantage of the tax-exempt status of the State by issuing debt obligations and reinvesting the proceeds at a higher rate of return.

The Committee invited two persons to testify to this question, Steve Rappaport of Prudential Bach, the financial advisor to the state, and Clair Cohen of Moody Investment, whose primary responsibility is rating the credit of the 50 states. From their testimony, it is clear that pension liabilities in prefunded systems are not a major focus of the rating agencies as is the actual bonded debt of the state. The rating firms establish a credit rating primarily based on the states' ability to pay for general obligations which include current service obligations and bonded debt. Unfunded liabilities of pension systems are considered but in a much more vague, less precise manner. Analysts do not consider it bonded debt. However, the actual bonding of the unfunded liability or a portion of it would have several implications:

- This would certainly be considered a "stronger" financial commitment on behalf of the state and could hurt its rating; and

- It might weaken the market for the state's normal capital construction bond issues considering Maine's 7% of revenue limitation on debt service.

The other major concern of the Committee with respect to the relationship of the state's credit rating and the unfunded liability was the effect of any change in the amortization period of the unfunded liability. Again, the reply was that the effect would be unclear due to the vague treatment of unfunded liabilities. The general opinion appears to be that as long as there is a sound plan to gradually reduce the unfunded liability, the state's credit rating will not be significantly affected.

SUMMARY AND RECOMMENDATIONS

1. Fiscal Condition. This Committee finds that the fiscal condition of the MSRS is satisfactory. Many of the serious issues identified during the 1980 study have begun to be addressed. The evidence presented in this chapter demonstrates the improvement in MSRS financial condition. Cash flow has been positive and increasing, providing an increasing pool of funds which can be invested. Investments have been well managed with MSRS faring better than many similar pension funds in the recent decline and volatility of the financial markets. In this area, the Committee saw no reason to recommend any restrictions on this process since it appears to be functioning quite well.

While MSRS fiscal condition is satisfactory, the Committee was concerned that the System's level of assets relative to benefit liabilities is lagging behind other states' public pension plans. Based on current assumptions, MSRS would have to increase its level of assets to three and one-third (3 1/3) times their current level. Depending on the changes in the assumptions and amortization schedule recommended to the Board of Trustees by the actuary, this requirement to more than triple current assets may not signficantly change contribution rates above their current levels. With the exception of the current budget cycle, the Legislature has met its statutory commitment to provide the necessary funds to maintain the system on an actuarially sound basis. Benefit payments are secure as there appears to be no indication of a change of heart by the Legislature or the Governor.

2. Actuarial Assumptions. Actuarial assumptions play a central role in the determination of the financial health of a defined benefit pension plan. A change in actuarial assumptions can significantly affect the amount of benefit liabilities. The effect of the change of the retirement age assumption on the unfunded liablity and the contribution rates, highlighted in this chapter, points this out very clearly. The annual report of the system's actuary should provide an accurate assessment of the financial status of the plan at a given point in time similar to the annual report of corporation. Like accountants, actuaries are guided by professional standards in establishing these valuations.

In addition, the actuary of the MSRS is required to evaluate the accuracy of the assumptions every three (3) years. Milliman & Robertson as part of the transition of becoming the System's new actuary conducted an evaluation of the assumptions used by the prior actuary. As a result many of the assumptions were "strengthed." However, the process also raised a lot of questions regarding the assumptions, in particular the retirement age assumption. The Board adopted most of the actuary's recommendations except the retirement age. They decided to partially strengthen this assumption but to postpone a complete reduction in the age assumption until the actuary had had an additional year's experience with the plan.

The Committee recommends that Board of Trustees adopt the lower average retirement age assumption, if recommended by the actuary, and recognize the increase in the unfunded liability that would result.

3. Funding Schedule. Once an accurate assessment of the unfunded liabilities has been determined guided by the professional standards of the actuary, the Board of Trustees must establish an amortization schedule to determine the employer contribution rates. The Committee found no justification for the current rapid amortization of the unfunded liability of the MSRS. Instead, the Committee concluded that the "cliff" and increasing contribution rates inherent in this amortization schedule, see Graph III-B and Graph III-C, represented an inequity in the allocation of these liabilities among taxpaying generations.

Under the current amortization schedule, the whole burden of reducing the unfunded liability from $1.5 billion to $0 would be the responsibility of the taxpayers of the next 15 years. These taxpayers are not solely responsible for the creation of this liability. The Committee considered many aspects of integenerational equity and concluded that the burden of paying for past service liability should not appropriately be passed on to a single generation. The outstanding amount of the liability should be reduced every year in relative terms.

The Committee concluded that the basic security for the retirement promise to employees is the credit of the State. The assets within the MSRS do not constitute collateral; are not the specific property of individual employees; and reflect a governmental decision of how best to pre-fund its retirement promises. The decision as to amortization period, therefore, is one that should be considered from the perspective of the taxpayers of the State of Maine. There seems little to no justification for the "cliff" which would result in the year 2001 under the present system following the full funding of past services liabilities. This would represent a kind of windfall that does not seem equitable or appropriate.

The necessary change in the retirement age assumption would increase this burden further and create a greater inequity. Therefore, the Committee recommends that the amortization should be extended to a period not greater than thirty (30) years. The extension of the amortization schedule, based on testimony received by the Committee, would not adversely affect the State's credit rating. MSRS liabilities would better reflect actual liabilities and the burden of paying back this debt would be shared more equitably among taxpaying generations.

However, the Committee after much discussion decided that it was better to treat the "old system" teachers unfunded liability differently from the other unfunded liabilities of the MSRS. This liability was ignored prior to the 1980 Study of the MSRS and a funding schedule to repay this debt was not implemented until 1982. The Committee felt that this debt is long past due since the benefits underlying these liabilities have almost been completely paid. The institutional memory inherent in this liability should remain intact.

4. Level Funding. By recommending an extended amortization schedule, the Committee supports a program of level State contributions as a percentage of employee compensation, consistent with regular actuarial analysis and update. The Committee feels that the current amortization schedule with its increasing contribution rates is inappropriate. Level contribution rates would provide greater intergenerational equity and would allow for better stability in budget planning. Contributions rates would vary due to changes in the unfunded liability. However, only the variations from the level percentage would have to be considered in budget planning.

5. Legislative/Gubernatorial Involvement. The Committee understands the action taken by the Legislature and the Governor to postpone the full contribution rates requested by the MSRS for the 1987-89 biennium pending receipt of this report. The circumstances surrounding the MSRS budget request warranted some type of action. The questions raised by the system's actuary in his report were serious enough in the eyes of the Governor and the Legislature to postpone the significant increases in the requests until a thorough study could be conducted.

Once action has been taken to reevaluate the MSRS actuarial assumptions and funding methods, however, the Committee recommends that the funds held in the "Rainy Day" account be transferred to the MSRS in amounts necessary to comply with the statutory mandate to fund the obligations of the MSRS based upon the actuarial assumptions established by the Board of Trustees upon advice of the System's Actuary. The amount transferred should include interest to compensate the system for interest income lost during the period when these funds were withheld.

Chapter IV
Benefits

The Committee to Study the Retirement System was charged with reviewing the present and future benefit plans and payment methods as set forth in P.L. 1987 C. 68. The Committee considered what its role should be in evaluating the MSRS benefits package. Clearly, it was not empowered to determine the optimum combination of benefits and aggregate costs. This optimum can only be established by the parties pursuant to collective bargaining (the exact scope of the authority of collective bargaining in the determination of retirement benefits awaits a ruling by the Maine Supreme Judicial Court) or the Legislature. The Committee was very sensitive not to appear to substitute its judgement for those empowered by law to determine the public policy of the State of Maine.

It was apparent from the authorizing language that the Legislature wished the Committee to investigate broadly the present condition of MSRS and to provide guidance as to possible future practices. The Committee was able, due to its legislative appropriation, to secure the testimony of several nationally-recognized experts who provided substantial analysis placing in context the present Maine system. The Committee therefore was of the view that it should make clear both its opinions as to the efficacy of the present system and its recommendations of possible desirable alternatives.

During its review of the MSRS, the Committee noted the lack of an explicit statement of Maine's public pension policy. The development of MSRS benefit policy appears to have been done on an ad hoc basis without any clearly defined goals. Over the years, the Legislature, the Governor, the Board, union leadership, and other interested parties, have interacted in the development of benefits in a piece meal fashion. Each party may have had their own agenda with respect to developing an overall benefits policy, yet, when it came down to implementing the policy, items were implemented on an individual basis without a complete understanding by all those involved of the overall effect. They have not negotiated or legislated an overall benefits policy with explicit goals, such as establishing what type of employee the State wants to attract, what benefit design would be most beneficial to that type of employee, what level of aggregate costs should be paid toward benefits, and what trade-offs should be made in benefit components.

Therefore, the Committee felt that the best legacy which it could leave for present and future policy makers is a clear understanding of the implicit benefit policy which has developed over the years. This chapter will review national trends in benefit policy and compare MSRS benefits with other pension plans. Each benefit component will be explored in terms of cost, relative attractiveness, and other implications. Alternative benefits design models will also be provided as well as a discussion of Social Security and its relation to MSRS policy. Armed with this understanding of the component parts, the implications of some of the benefit design anomalies of MSRS benefits, and the relative cost of each component, interested parties can better make an informed decision as to the future benefit policy.

Trends in Benefits

Dallas Salisbury, President of the Employee Benefit Research Institute noted several trends in the pension and benefits area that should be considered by policymakers and those involved in the determination of these benefits through collective bargaining. The results of a survey of employers and employees indicated that:

- Employees are increasingly reviewing benefits as part of a total compensation package and are showing a preference for cash based benefits that allow them mobility and the ability to take the benefits with them;

- Employers are focusing on the total cost rather than present costs, are designing their programs around universal government programs such as social security to hold down costs, and are moving to consolidate employer benefit programs to allow easier mobility of employees and reduce administrative costs;

- Employers are moving away from setting their benefits to be comparable within their industry, due to greater competition for qualified workers;

- Employers, in light of demographic studies, are redesigning benefit programs to encourage workers to last longer, cutting back on inflation adjustments, redefining disability to be an inability to do all jobs rather than the present job, and increasing the cost for employees; and

- Employers and employees are showing a preference to having a portion of employee benefits invested in the company.

These results demonstrate in general a growing preference for Social Security and Medicare as more universal programs which provide greater portability for employees and holds down costs for employers. Defined Contribution plans are also gaining in popularity due to their greater predictability of costs for employers and due to the ability of employees to take this cash based benefit with them when they terminate employment.

TABLE IV-B

COMPARISON OF MSRS TO OTHER SYSTEMS

(Dallas Salisbury - Employee Benefit Research Institute)

DESCRIPTION	MAINE	STATES (#)	FEDERAL	N.E. STATES	PRIVATE SECTOR
Contribution Rate as Percentage of Salary					
-Employer Contribution Adj. for SSA Net	21.4% -5.2 16.2%	9.71% (49)	DB = 14.8 ('87) 12.5 ('88)	MA - None NH - Varies VT - Varies	DB = 5%, DC = 5%
-Employee Contribution	6.5%	5.35% (37)	DC = 1.3 ('87) .94 ('88)	MA - 5-8% NH - 4-6% VT - None	DB - No, DC = Vol.
Mandatory Retirement Age	None	None (38) 70 (12)	None	None	None
Full Vesting	10 years or age 60 and one year	7.6 years (50)	5 years	MA - 6 years NH - 10 years VT - 10 years	5 years
Normal Full Benefit Requirements Minimum Age/Years of Service	60/25 years	17 - Better 23 - Worse	55-57/30 years	MA - Better NH - Better VT - Better	62/30
Minimum Benefit	Yes	Varies	No	NA	No
Early Retirement	2 and 1/4% per year reduction	Varies across states	Reduced 5% for each year less than age 62 unless 30 years of service	Varies	Reduction varies from 3% to 6% for each year below 62 or 65
Average Final Compensation (AFC) Benefit Formula	2.00% x Yrs. x AFC	1.76 x Yrs.	1.00% x Yrs. x AFC	NH - 1.67 VT - 1.67	1-2% x Yrs. x AFC
Participation in Social Security	No	Yes (43)	Yes	MA - No NH - Yes VT - Yes	Yes

TABLE IV - B (CONTINUED)

DESCRIPTION	MAINE	STATES (#)	FEDERAL	N.E. STATES	PRIVATE SECTOR
Cost of Living Adjustment	CPI up to 4%	Ad hoc (16) CPI (16)	CPI up to 2% then CPI - 1%	MA - CPI NH - No VT - CPI	Ad hoc
Dependent Provisions	Elec.options	Elec.options (12)	Elec.options	MA - Elective NH - VT - Elective	Elec.options
Restrictions on Earnings	None	Limit on amount (12)	Limited	-	None
Section 414(h) Employer Pick Ups*	No	Yes - 30 No - 20		MA - No NH - Yes VT - No	No
Retiree Health Availability	Yes - Anyone who retires from the govt. with a pension in pay status.	Yes - 48 Varies across states	Yes - Anyone who retires from the govt. with a pension in pay status	MA - Yes NH - Yes VT - Yes	Yes, if you retire from the company with a pension in pay status
Retiree Health Contribution Rate					
-Employer Contribution	St. emp'ees 100% Teachers 10%	All or some % (26)	60%	MA - $125.63 NH - 56.33 VT - 33.69	Over 90% of employers pay some or all of the cost
-Employee Contribution	St. emp'ees 0% Teachers 90%	0 or some (26)	40%	MA - 17.24 NH - 0 VT - 6.60	More than 60% of employees pay 0. More than 30% pay part of the cost.
Disability Benefit Present Job or Any Job	Yes Present job	Yes Varies	Yes Present job	Yes Varies	Yes Any job

* Sect.414(h) - Government employers are permitted to pick the mandatory contributions required of covered employees. This allows the workers's pension contribution to be deducted from pay pre-tax rather than post.

NOTE: Survey data is often not fully reliable, and even source information on the Maine system varies by source.

Overview of MSRS Benefits

MSRS gets mixed reviews in terms of the levels of benefits provided. In the case of most benefits, MSRS benefits are below or are less generous than other state plans and private pension plans, although some of the benefits such as the early retirement provisions are more generous. However, MSRS costs more as a percentage of salaries to provide these benefits. Table IV-A below, developed by the Wyatt Company, provides a scorecard of MSRS benefits relative to other state pension programs, the Federal Employee Retirement System (FERS) and private pension programs. Table IV-B on the preceding two pages, developed by Dallas Salisbury of Employee Benefits Research Institute, compares the MSRS benefit plan more specifically with other pension plans. Appendix E provides a more complete comparison of State pension plans.

Table IV-A
MSRS Benefit Comparisons
(The Wyatt Company)

	VERSUS STATES	VERSUS PRIVATE	VERSUS FERS
NORMAL RETIREMENT AGE	Slightly Below	Generous	Slightly Below
NORMAL RETIREMENT BENEFIT	Below	Slightly Below	Below
EARLY RETIREMENT PROVISIONS	Generous	Very Generous	Above
DISABILITY BENEFITS	N/A	Average	Slightly Above
COST	High	Very High	Comparable
NO D.C. PLAN	Average	Below	Below

As mentioned earlier, Maine appears to have no overall goals with respect to its benefit policies. Over the years, a benefit policy has developed with the following implications:

- employees are encouraged to retire early or seek employment covered by Social Security after retirement;
- the provisions of retiree health insurance encourages people to collect retirement benefits sooner;
- discourages employees from returning to work after being on disability retirement; and
- discriminates against higher quality professionals and other short-term employees.

In addition, MSRS costs are high relative to other states. The reasons behind Maine's high costs are as follows:

- relatively poor funding status with substantial unfunded liabilities;
- rapid pay-back schedule for these unfunded liabilities;
- less than full actuarial reduction for early retirement; and
- automatic COLA's.

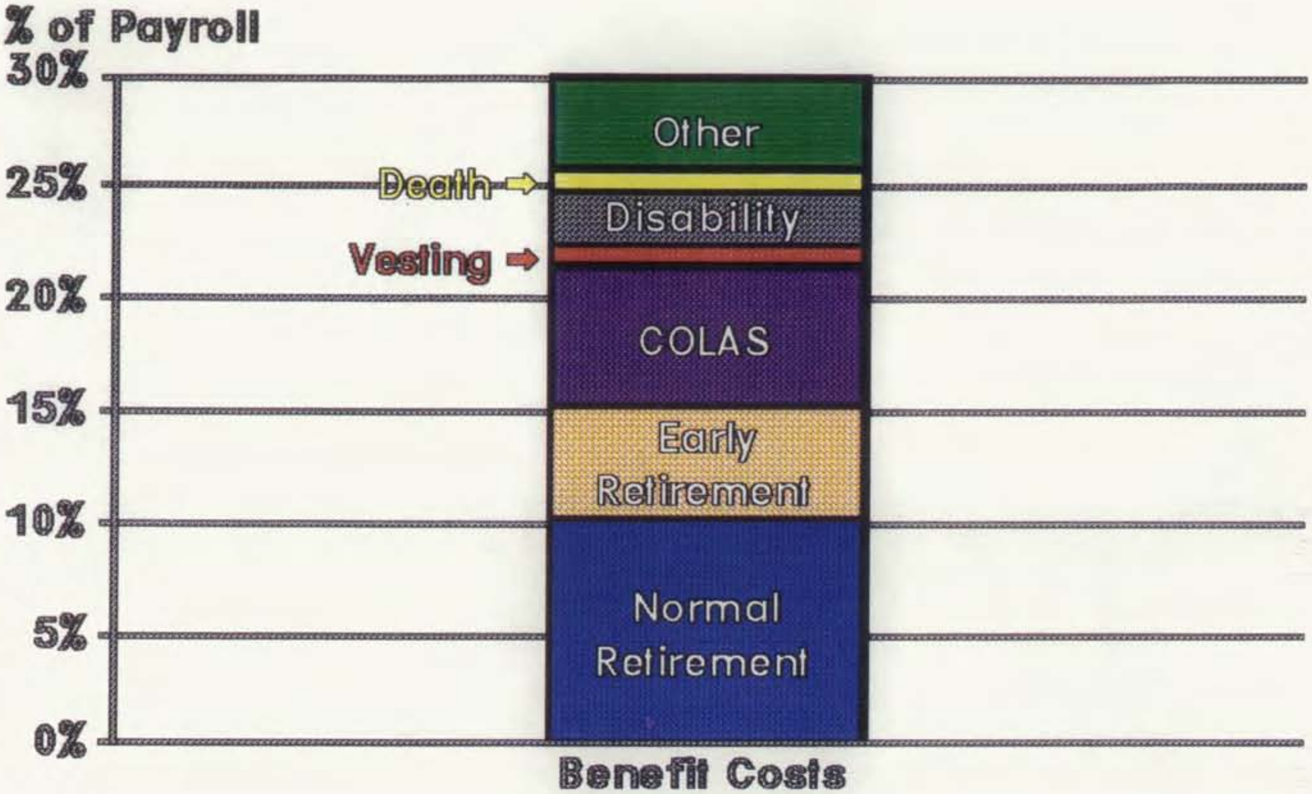
The first two reasons have been addressed in the recommendations of the previous chapter. However, the last two are directly related to the choices made with respect to MSRS benefit policy in the past. The remainder of this chapter will discuss the various benefit components of the MSRS. The discussion will focus on the cost and other implications of MSRS benefits.

Graph IV-A on the following page highlights the allocation of costs among the different benefit components of the plan for state employees and teachers. These figures, detailed below the graph, are projected costs for fiscal year ending June 30, 1989 and incorporate the strengthened assumptions and a thrity year amortization schedule. Like the rates calculated in the previous chapter these are composite rates. Actual rates would be for different groups of employees. These rates also include the 6.5% of salaries contributed by state employees and teachers. Therefore, the benefit cost figures presented in this chapter represent rough estimates and should be viewed in relative terms. For the fiscal year 1988-89, total state contributions to the MSRS would be approximately $217 million or 30% of teachers and state employee salaries.

Normal Retirement

MSRS normal retirement age is 60. There are some exceptions, such as those groups of employees under special plans, which will be discussed later. At age 60, state employees and teachers may retire and receive a annual pension based on 2% of their average final compensation for each year of creditable service. A retiree's average final compensation is the average of that person's three highest earning years of salary. These years do not necessarily have to be consecutive. The minimum benefit for retirees who are vested (have ten years of creditable service) is currently $100.

GRAPH IV-A
COST ANALYSIS OF MSRS BENEFITS



PROJECTED BENEFIT COSTS FOR FY 1989

	$ Millions	%
ACTUARIALLY DETERMINED BENEFITS:		
Normal Retirement	$ 75.8	10.4
Early Retirement	36.5	5.0
COLA	45.2	6.2
Vesting	7.3	1.0
Disability	16.8	2.3
Death	6.6	0.9
	$188.2	25.8
"Other" or MSRS DETERMINED BENEFITS:		
Administration	$ 2.3	0.3
Old System Teachers	21.5	3.0
Group Life Insurance	.3	0.1
Ret. Health Insurance	5.1	0.7
	$ 29.1	4.1
TOTAL	$217.3	29.9

MSRS normal retirement age and benefit is generous relative to most private pension plans which are based on Social Security and therefore have a normal retirement age of 62 or 65. On the other hand, MSRS normal retirement benefit is less generous than many other state pension plans and FERS. It is difficult to assess the implications of this facet of MSRS benefit policy without comparing the other benefit aspects provided by the other public employers. If Maine is comparable or more generous in other benefits and current salaries, then Maine may be competitive in the hiring process and attract persons with the necessary qualifications.

According to Graph IV-A, normal retirement accounts for the largest portion of the total cost relative to other benefits; approximately 10.4% of salaries or about $75.8 million.

Early Retirement

MSRS early retirement provisions are more generous than most public and private pension plans. These early retirement provisions have created a positive incentive for state employees to retire before the normal retirement age of 60. A 55 year old retiree would face only a 13% reduction in benefits in the MSRS, while the 55 year old retiree with less than 30 years of service from the federal system would have a reduction of 35%, and, by federal law, many future private sector retirees face a reduction of 60%.

A hypothetical example provided by the Wyatt Company indicated this incentive for an employee with 25 years of service contemplating switching jobs at the age of 50. While the total retirement benefit from MSRS and new job will be about 80% of the MSRS benefit if the employee continued with the MSRS until 65, the present value at age 55 of total retirement payments will be about 50% higher if the new job is taken. This example points out the incentive for a state employee to have two careers, one in state service and the other with some other employer.

The System's independent actuary, Milliman & Robertson, recently completed a special study of early retirement benefits. Some of the more interesting findings include:

- 25.85% of current state retirees (excluding special groups) retired prior to age 60, with 29.55% of teachers retiring before age 60 and 21.75% of regular state employees retiring early;
- With respect to total annual benefits, 34.13% of all benefits currently in pay status are attributable to early retirees with the average early retiree benefit of $10,307 compared with the $7,804 average for the members retiring at age 60 or later;

- 36.66% of the full funding target for retirement benefits is attributable to early retirees;

- Early retirees, on average, retire about 5 years prior to normal retirement;

- The reduction factor actually applied to MSRS early retirees (11.16%) is less than one-third of the true actuarial reduction (34.71%);

- On an annual basis the state is providing a subsidy to early retirees of about $7.5 million, an average of $2,676 per early retiree, or 8.86% of total payments made by the state for current retirees; and

- The full funding target resulting from this subsidy being paid to current early retirees is over $103 million.

Milliman & Robertson (M & R) concluded the following from this study:

- Over 10% of the system costs are attributable to the subsidy in early retirement benefits. This would translate to about a 2 1/2% of the payroll contribution being made by the state with respect to these benefits.

- Some level of early retirement subsidy exists with respect to most retirement systems, both public and private. It is rare to find a system that reduces early benefits by the full actuarial reduction. A commonly used reduction factor would be 1/2 of 1% reduction for each month prior to normal retirement, which equates to a 6% annual reduction prior to age 60. This would translate to a 30% reduction at age 55. However, many states provide a full unreduced normal retirement benefit after 30 years of service regardless of age. This is more liberal than Maine's early retirement provision. Therefore, if the State of Maine seeks to be comparable with other state-wide systems, M & R would estimate a cost reduction less than the 10.33% determined in this study, perhaps somewhere between 5% and 6% of System costs. This would translate to a contribution rate deduction of about 1 1/4% to 1 1/2% of payroll to the state.

- The decision by a member to retire early must in some degree be affected by the reduction factor that is applied. Therefore, any revision in the reduction factors (i.e. to increase the reduction factor) should also have the effect of reducing the rate at which members retire early. This would produce additional system cost decreases. Reflecting this factor will produce in our estimation a net decrease (considering the prior points above) in state costs of about 1 1/2% to 2% of payroll. Again, this cost decrease presumes that the objective of the System would be to apply early retirement reduction factors that are comparable to those factors found in other state-wide systems.

- Finally, as part of this study, M & R analyzed the source of the current factors used by the System for determining early retirement reductions. They discovered that these factors are based on an incorrect actuarial formula which may or may not have been intentional.

This study points out the expensive nature of subsidizing early retirement for employees. However, it focuses primarily on one type of cost, retirement benefit costs. It does not, as union representatives were quick to point out, take into consideration other costs and savings, both tangible and intangible. Union representatives presented an example of some offsetting cost savings resulting from salary reductions when a higher paid employee is replaced by a younger, lower paid worker. Early retirement may also serve as an important factor in recruitment for some employees. These provisions used as a tradeoff may also have held down salary costs for some employee groups in the collective bargaining process.

The Committee heard extremely strong support from most persons testifying for the continuation of this benefit despite its cost. For fiscal year 1988-89 early retirement benefits account for approximately $36.5 million or 5.0% of salaries. Early retirement accounts for a proportion of the total cost that is nearly one-half of what normal retirement costs. In other words, it increases the cost of normal retirement by approximately 50%.

Special Retirement Plans

There are some exceptions to the normal retirement age of 60. Several groups of employees receive a higher percentage of average final compensation and lower normal retirement age due to the nature of their service. These special groups include State Police, State Prison Guards, Sea and Shore Wardens, Game Wardens, Forest Rangers, and Liquor Inspectors. Several representatives from some of these groups testified before the Committee. Their comments all seemed to call for a continuation of the special retirement programs. These higher retirement benefits may be valued as highly as a pay raise for these employees.

A study of these special retirement plans was concluded in February 1984 (Second Regular Session of the 111th Legislature) by the Joint Standing Committee on Aging, Retirement and Veterans. The Committee supported the rationale that these special plans were necessary to protect the public by retaining a younger, more vigorous workforce. However, the legislation enacted as a result of this study provided that only State Police and State Prison Guards would continue to receive special retirement provisions. All other new employees hired into the other special groups after September 1, 1984 would not be eligible for special plans.

Cost of Living Adjustments (COLA's)

MSRS Cost of Living Adjustment (COLA) provides a 4% non-cumulative adjustment based on the consumer price index (CPI). The 4% non-cumulative feature means that COLA's may not exceed the 4% limit. However, if the CPI is below the 4% then the CPI becomes the COLA. The amounts by which the CPI exceeds the 4% limit in years with high inflation may not be added to the COLA when the CPI is below the 4%. This automatic indexation adds significantly to the costs of other benefits, and represents a cost to the State of approximately $45.2 million or 6.2% of salaries for fiscal year 1988-89 or more than one-fifth the total of all benefits.

Legislation was proposed during the First Regular Session of the 113th Legislature to make the COLA's cumulative, i.e. carrying forward percentage increases above the 4% when the CPI was below 4% (see L.D. 1012). However, the excessive cost of this proposal, estimated by the actuary to be in excess of $100,000,000 in terms of additional unfunded liabilities requiring annual contributions of approximately $8 million increased at 9% per annum, was enough to keep this proposal from being enacted into law.

While Maine's automatic indexation is expensive, MSRS benefits have not matched the inflation protection provided by Social Security. Table IV-D at the top of the next page developed by Jamie Cowen of GRB, Inc., comparing the adjustments over the last 10 years of Social Security and MSRS benefits.

If a Social Security beneficiary is assumed to have received $4,800 per year, or $400 per month, in 1976 the cost of living increases would have raised that to $8,958 per year or $747 per month in 1986. A MSRS retiree receiving $4,800 per year in 1976 would find his/her benefit at $7,528 per year now or $627 per month. Because of the 4% cap on MSRS COLA's, Social Security clearly accords greater inflation protection.

Table IV-D
Cost of Living Adjustments
MSRS VS Social Security
(GRB, Inc.)

	SOCIAL SECURITY	MSRS
1977	5.9%	10.88%
1978	5.0%	4%
1979	9.9%	4%
1980	14.3%	4%
1981	11.2%	6%
1982	7.4%	4%
1983	3.5%	4%
1984	3.5%	4%
1985	3.1%	3.7%
1986	1.3%	1.7%

Vesting, Forfeiture, and Portability

The vesting period, the length of creditable service before a previously terminated employee is entitled to receive MSRS retirement benefits, is 10 years. However, an employee over 60, only needs to serve one year to be vested. Maine's vesting period is longer than the average for all state plans which is 7.6 years. Vesting in the Federal Employee Retirement System and private pension programs are closer to 5 years.

In this service-oriented economy, government service must compete with numerous other organizations for the best young professionals. However, the longer vesting period for government service and Maine state service in particular tend to encourage "career-service" individuals rather than the young professionals who would prefer a greater degree of mobility. This factor combined with the inability of the Hay System, the system used by Maine's Bureau of Human Resources to establish salaries, to fully account for competitive offerings at other organizations external to the system, have placed the State at a disadvantage vis-a-vis other employers with respect to certain types of professionals.

At the time a member of the System terminates his/her employment with the State, that person may apply to the MSRS and request a refund of his/her individual contributions. For most State employees, the individual employee contribution is 6.5% of salary. However, some special groups such as the State Police and other state law enforcement personnel must contribute 7.5% of salary for the first twenty years of their employment as law enforcement personnel. For certain "confidential" employees the State pays the employee share in lieu of higher salaries. These individual contributions earn interest at an established rate set by MSRS. These contributions continue to earn interest for five years after the termination of a member, who has not vested.

However, when members withdraw their contributions, they no longer are considered members of the system and forfeit their rights to retirement benefits. This does not significantly affect the person who terminates before becoming vested, but it does allow members of the system who are vested to forfeit future retirement payments in favor of cash in hand. Members who return to State service must wait two (2) years before they can begin paying back their withdrawn contributions and regaining full rights to retirement benefits for which the State has invested funds on their behalf.

This forfeiture of benefits in favor of cash in hand when members terminate service effectively reduces the cost associated with vesting. Vesting is expected to cost approximately $7.3 million or 1.0% of salaries for fiscal year 1988-89. According to Dallas Salisbury, private pension plans have had to move to a five year vesting period to conform with the requirements of the Tax Reform Act of 1986. Public plans are exempt from this requirement. However, should these requirements be extended to public plans such as MSRS, costs would increase significantly.

There was some confusion surrounding the cost of vesting. Some would think that a 10 year vesting period would be a savings to the system rather than a cost. It is a matter of perspective. The actuary views vesting as the additional cost of providing benefits to terminated employees who were not in pay status at the time of retirement. Therefore, the cost results from having to pay retirement benefits to these terminated employees. However, most employees would tend to view the retirement benefits earned for each year of service as a right. Therefore, the forfeiture of these benefits by short-term employees, those who do not accummulate 10 years, would be viewed as a savings to the System.

This rather long vesting period and the lack of portability of MSRS benefits combine to discriminate against the shorter term employee, the so-called inners and outers. Since Maine has decided not to participate in the Federal Social Security System, members who leave service prior to vesting in MSRS are unable to carry any benefits with them to their new jobs other than the withdrawal of employee contributions. These persons must serve a certain number of quarters before they are eligible for Social Security benefits such as disability. Should they become disabled prior to becoming eligible under Social Security, they would not receive any benefits.

Portability of MSRS benefits is limited even for members transferring within the System, particularly for members of participating local districts. Most creditable service is additive within the System; members working in one district or in State service can use these years in combination with service in another district to meet vesting and early retirement requirements. However, benefits are calculated based on the different average final compensations earned in each different district or State service. In most cases, this results in a reduction in the amount of benefits received.

Disability Benefits

Maine provides the most expensive possible form of disability benefit for the first five years. The MSRS disability program provides members with long term income protection should they become disabled from their current employment position. The benefit is calculated at two-thirds of the member's average final compensation and is not limited by the number of years of creditable service. The member continues to earn credit for years of service toward normal retirement and receives health coverage while the member is collecting disability benefits. Costs are estimated for fiscal year 1988-89 at $16.8 million or 2.3% of salary.

The disability retirement program of the MSRS as currently designed does not encourage return to service, resulting in a much greater expense to the State.

This is another area in which the MSRS is proposing to develop improvements which include:

- Guaranteeing full pre-disability wages should an individual return to work in a new position, with a maximum benefit specified;

- Providing rehabilitation training for individuals in order to provide them with the skills to obtain a new position; and

- Providing the individual with a reasonable trial work period to determine if their new employment position is suitable.

Death and Survivor Benefits

MSRS ordinary survivor benefits provides a fixed pension unrelated to earnings or length of service. It currently allots $150 per month for the spouse and $150 for the first dependent child and $75 for the next two dependent children. There is an option to have the accumulated contributions of the deceased member returned or, if the member was eligible for retirement, survivors could receive a reduced pension. If the death of the employee was related to service, MSRS provides an accidental death benefit equal to two-thirds of average final compensation for a spouse and 100% of average final compensation for a spouse with a dependent child or a dependent child without parents.

Recognized by the Board of Trustees as a priority problem, MSRS received its lowest marks in the area of survivor benefits. Efforts were made this past legislative session to address some of the deficiencies in these benefits during the

First Regular Session of the 113th Legislature. (P.L. 1987 C. 529) The real increases mandated by this legislation will not occur until after June 30, 1989. The MSRS also plans to submit proposals to increase these benefits further.

For fiscal year 1988-89, the estimated cost of death and survivor benefit provisions is approximately $6.6 million or 0.9% of salaries.

Group Life Insurance

In addition to the death benefits mentioned above, the MSRS Board of Trustees also administers a group life insurance program which is available to all state employees, all public school teachers and the employees of participating local districts which elect to provide the plan for their employees. The cost of the basic plan, which offers insurance equal to the members' annual rate of pay rounded up to the nearest $1,000 is paid for state employees by the State. Members can purchase supplemental plans and dependent plans at their own expense.

Current premiums paid by the State for state employees are contributed to MSRS at $0.13 biweekly for each employee for each $1000 of coverage. The State's premiums for teachers are based on $0.08 biweekly for each $1000 of coverage. Teachers must pay their own premiums. This corresponds to approximately $300,000 or 0.1% of salaries which were the figures derived for use in Graph IV-A and Table IV-C.

Retiree Health Insurance

This program is actually run by a separate board, the Maine State Employee Health Insurance Program within the Department of Administration. This program provides sickness, accident, and health insurance programs for all state employees and retired state employees. The State pays for the workers coverage with the worker having the option of extending that coverage to his/her spouse and dependents with a payroll deduction.

The State's health insurance program was extended to retired employees in 1971 (50% state paid in 1971, P.L. 1969 C. 588 and 100% state paid in 1975 by P.L. 1975 C. 90). Until this year, retired teachers had to pay all of their own health insurance costs. The 113th Legislature passed legislation which would have the State pay 10% of their health insurance costs in retirement. The Legislature would appear to be aware of the expensive nature of this benefit, as it was not willing to extend the same generous coverage to teachers as it had for state employees.

By grouping the retirees with the active state employees, the retirees health insurance costs are held down. In effect, state employees are subsidizing retirees health insurance costs. Health insurance costs for retired state employees are billed monthly to MSRS by Blue Cross/Blue Shield for the Board of Directors at the same cost as the state pays on behalf of its active employees. The Maine State Retirement System calculates the percentages of payroll necessary to cover the costs billed to it for retiree health insurance. Unlike all the other benefits of the MSRS, this benefit - although subsidized by active state employees - is funded on a pay-as-you-go basis with no limit on the increase in the amount of future liabilities.

This promise of a retiree health benefit is standard for many state and local governments but it is far more expensive than either the federal government or private employers are willing to pay. The State contributes about 1.4% of state employee salaries to pay the retiree health insurance premiums. This is in addition to paying for the premiums of active employees. The cost used in Graph IV-A and Table IV-C for retiree health insurance was adjusted to account for the fact that teachers only receive partial coverage. The amount used is approximately one-half of the rate contributed by the State for state employees, 0.7% of salaries or about $5 million.

Deferred Compensation Plan

The State's deferred compensation plan is eligible for tax deferred status under section 457 of the Federal Tax Code. This plan is administered by the Commissioner of Finance, not MSRS. The Commissioner has approved (or contracted with) three insurance carriers - AETNA, Hartford, and VALIC to provide this savings program. VALIC is the agency which administers the program. This is a totally optional program with very little state involvement, i.e. the State has no matching commitment. In this respect it differs from the Defined Contribution plans which are becoming more popular. The State also contributes very little effort in the marketing of these programs to state employees. The major incentive to participate in this program is the deferral of taxes. No other incentive to increase employee savings for retirement on their own behalf exists under the current system. The result has been low participation rates by state employees.

Social Security

A critical consideration is the applicability of the Federal Social Security System to the public employees and teachers of the State of Maine. The Committee heard substantial testimony on the one hand to the effect that Social Security was undesirable and unacceptable from the representatives of public employees and, on the other hand, that it contains benefits very much needed by Maine participants which can not be obtained from any other source. The Committee heard substantial conflicting testimony as to the possibility of the federal government mandating involvement by Maine public employees in Social Security in the relatively near future.

Currently, Maine is one of seven states that has elected not to participate in Social Security for its employees and one of fourteen public teacher retirement plans. Up until the Social Security amendments of 1983, federal employees, state and local government employees and non-profit organizations could opt not to be covered under Social Security. The 1983 amendments extended coverage to new federal employees and non-profit organizations and provided that state and local governments currently covered could not elect out. New state and local government employees must also participate in Medicare.

Extending the coverage of Social Security to new employees of state and local governments would appear to be the next logical step in this progression. One of the major reasons cited for the expansion of Social Security coverage was the effort to help lower the federal budget deficit. Presently, social security revenue is not segregated from other federal revenues. Therefore, an expansion of social security coverage would expand the revenue base. This, combined with the present surpluses beginning to develop as a result of the "baby boomers" now paying into the system, results in a positive effect on the deficit. However, Social Security payments are scheduled for segregation from the unified federal budget in 1991.

This is not the only reason for the federal government wishing to extend coverage to include more persons. There are benevolent motivations as well. Very few firms or even states can afford the type of coverage provided by Social Security that is backed fully by the United States government. The advantages to employees of Social Security coverage outweigh the disadvantages, particularly since the 1983 amendments. These amendments eliminated two major advantages of working in uncovered employment:

1. The so-called windfall benefit of retiring early from non-covered employment to work a relatively short period under Social Security and being eligible to receive a substantial Social Security benefit has been eliminated (a penalty has now been added); and

2. The spousal benefit allows a two wage-earner family with one working in uncovered employment and the other subject to Social Security to draw an additional Social Security benefit. This has been eliminated.

Some of the other advantages of social security coverage include:

- Enhance portability of benefits between public and private sectors;
- COLA's are higher under Social Security (see Table IV-D);
- Better income protection for lower wage earners (those earning less than $25,000 annually);
- Spousal benefit provides a 50% increase when one spouse has not worked or worked only intermittently; and
- Survivor benefits are much better.

Partially offsetting these advantages are the facts that Social Security is expensive and some control over benefits would be given up. Union representatives testifying before the Committee have highlighted these disadvantages as some of the reasons that Social Security is not a "good buy." It has been this strong opposition from the unions which has prevented any serious consideration of integrating MSRS with Social Security.

The November 1985 proposals for a reform of the MSRS plan was set forth in the "Tillinghast" report which was initiated by the former executive director, Roberta Weil. This plan centered around integrating the System with Social Security. This proposal contained an "offset" formula which reduced MSRS benefits by 50% of the Social Security pension. The "offset" proposal received criticism from union representatives and the executive director. The unions felt that the offset affected the lower income workers more, reducing their MSRS pension by a greater amount then for high income workers. The current Executive Director opposed the offset formula because it would leave the benefit payments under the MSRS plan completely dependent on changes in the Federal Social Security System.

The Maine State Legislature presently has authorized an ongoing study of this integration of the MSRS with Social Security. The 112th Legislature originally authorized this study in anticipation of any new federal proposals to require all state and local governments employees to be incorporated into Social Security. The Commission to Study the Integration of the Maine State Retirement System with Social Security issued its report to the First Regular Session of the 113th

Legislature. The Commission was able to provide a foundation on which to analyze future policy and actuarial decisions. However, the Committee felt that final recommendations would need to wait until the federal government had promulgated its regulations governing the new tax law on the relationship of private and state operated pension plans with Social Security. There was also a pending ruling in the courts on whether the benefits under the MSRS are issues for mandatory collective bargaining.

The Commission recommended that the study be continued for one year so that the above mentioned unsettled matters could be addressed and that the Commission receive enough funding to contract with an actuary so that the options available to the Committee could be evaluated based on the actuarial determination of their costs. The Commission's final report is expected out by January 15, 1988.

Alternative Benefit Designs

The Committee considered two alternative plan designs which could be implemented in the wake of mandatory Social Security participation. The Committee asked both the Wyatt Company and Milliman and Robertson to submit analyses of the alternative plans. A more complete description of the two plans, detailing the assumptions and costs, is described in letters submitted to the Committee from the two actuarial and benefits consulting firms. These letters are included in Appendix F of this report.

The two alternatives are based on the recently implemented Federal Employee Retirement System (FERS). At the Committee's request, Jamie Cowen of GRB, Inc. reported on the federal situation and the processes involved in implementing the redesign of the federal employee retirement system. Cowen served as Chief Counsel to the U.S. Senate Subcommittee on Civil Service and was the primary architect of the new plan. The plan took over five years of research and design before the successful passage of FERS could be implemented January 1, 1987. Maine's situation today is comparable to the federal climate six years ago with significant unfunded liabilities and rapidly increasing costs as a percentage of salary.

However, Cowen noted that to successfully implement the redesign of the federal system "took tremendous time and effort on the part of many individuals, years of educating the various interested parties, deliberate design strategy to fulfill the goals we established yet meet the needs of the interest groups and, finally, extensive negotiation. In order for the state to seriously consider an extensive reform, the state must be prepared to devote years to the task. But planning must begin now." Therefore, the Committee presents these alternative plans to further the education and planning process.

The goals of the federal redesign effort were to reduce costs, structure the plan around private sector models, to base the system on Social Security, to fully fund the new plan, and to subject a portion of the employees' benefits to the risks and rewards of the economy. The result was a three part plan:

1. The Old Age and Survivors and Disability Insurance (OASDI) portions of Social Security (Medicare coverage has already been mandated for new employees);

2. A defined benefit plan, similar to the current MSRS plan which defines a benefit based on a persons average final salary and the years of service; and

3. A thrift plan or defined contribution plan which requires the employer to match on a full or partial basis the contributions made by employees to a tax deferred savings plan.

Plans A and B presented below are both based on the OASDI portion of Social Security as the foundation plan. Plan A on one hand offers a 1% defined benefit plan (MSRS is currently a 2% defined benefit plan) with a thrift or defined contribution plan. Plan B, on the other hand, offers a 1.5% defined benefit plan with no thrift plan. Graph IV-B on page 57 compares the benefit levels of the current MSRS plan with these two alternative plans. The red line represents the assumed benefit levels of Plan A. The green line represents benefit levels for Plan B.

The primary difference between the two alternatives, A and B, is the exchange of additional defined 0.5% benefit in B for the thrift plan of A. The actual benefit levels of A may vary across income levels due to the optional nature of the thrift plan. Thrift plans (see the proposal in Appendix F for a more complete discussion) provide a greater opportunity for higher income employees to offset low Social Security coverage and a much more portable benefit for short-term employees in addition to more stable costs for the employer. It should also be noted that if a lower retirement age was used Plan A would show greater benefit levels. Therefore, early retirement benefits would be higher under Plan A. However, the thrift plan does shift more of the risks from the employer and taxpayer, in the case of a state public pension plan, to the employee. However, as Milliman and Robinson point out in its proposal, the 1% defined benefit and thrift plan could generate additional pressures for plan improvements when new employees start retiring from the new plan. This could result from the optional nature of the thrift plan as some employees may not choose to join the thrift portion and therefore the actual benefits received in retirement may be inadequate, or perceived to be. There is also the additional risk aspect to the new employees should periods of sustained high inflation and/or poor investment returns prevail.

Graph IV-B illustrates the possibility for improved benefit levels for lower income employees (annual salaries below $25,000) due to the benefit skewing nature of Social Security noted in the previous sector of this report. However, what is not pointed out is the fact that these alternative plans, because they are based on Social Security, would increase the normal retirement age, reduce early retirement and provide no COLA protection on the MSRS deferred benefit portion for retirees under the new plans. On the other hand, portability would be significantly enhanced, and inflation protection during periods of high inflation would be improved, in addition to greater protection for lower income employees.

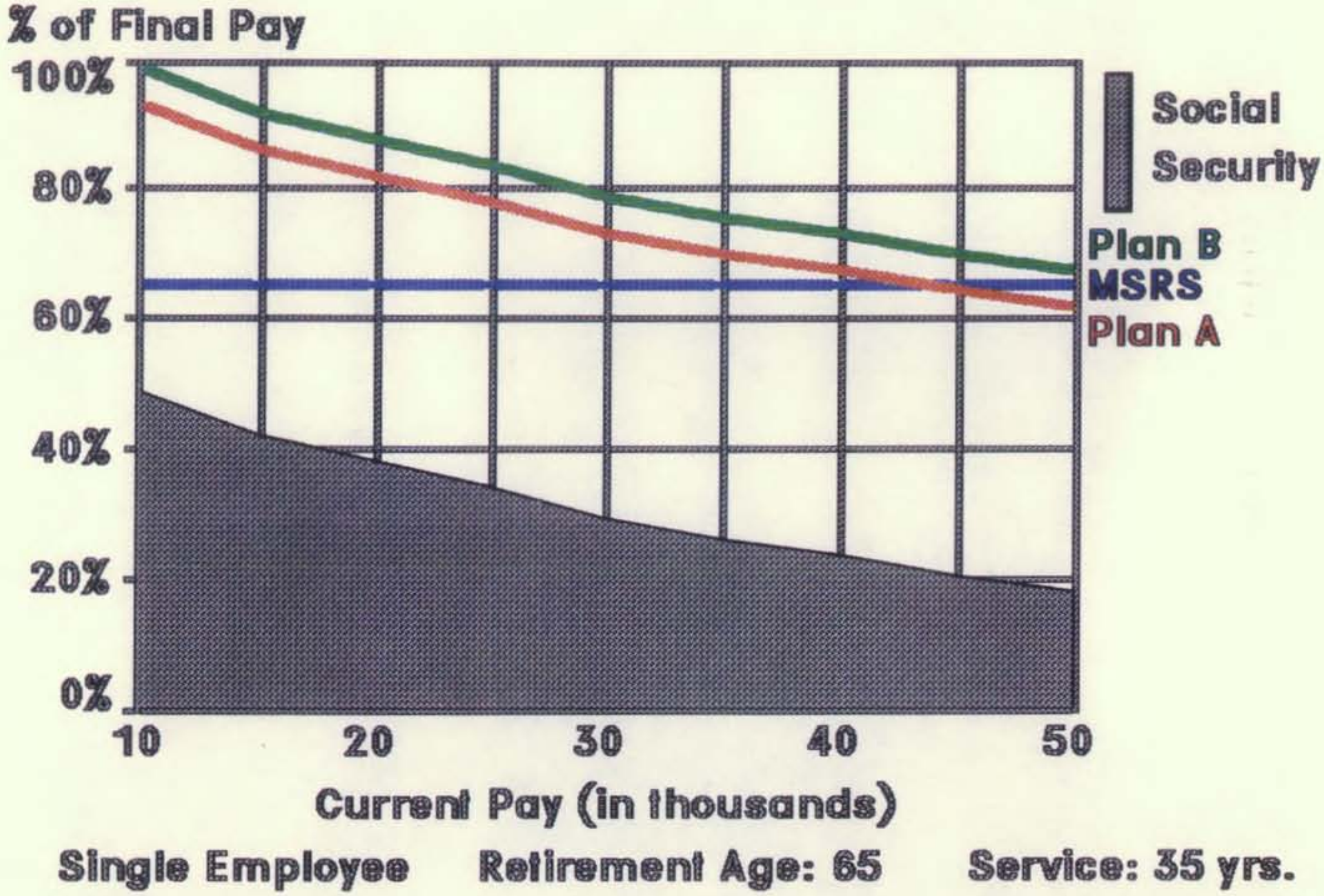
Graph IV-C on page 59 attempts to provide an illustration of comparable costs, both employer and employee costs, of the two alternative plans and compares these costs with the current MSRS defined benefit plan. It should be noted that comparing the costs of different benefit plans is a very difficult process. The costs analyses (based on 1986 evaluation results, unlike earlier costs described in this chapter) should be viewed as a crude comparison for the following reasons:

- Although amortization schedules for each plan have been adjusted to a 30 year level percentage, the question should be raised whether the amortization of the unfunded liability attributable to the current MSRS should be amortized against new employees who would not be eligible for the benefits and changes which resulted in the unfunded liability of the current MSRS plan. These analyses distribute the burden of the current system's unfunded liability with the new employee. The treatment of the unfunded liability would affect the normal and unfunded liability contributions for both old and new employees.

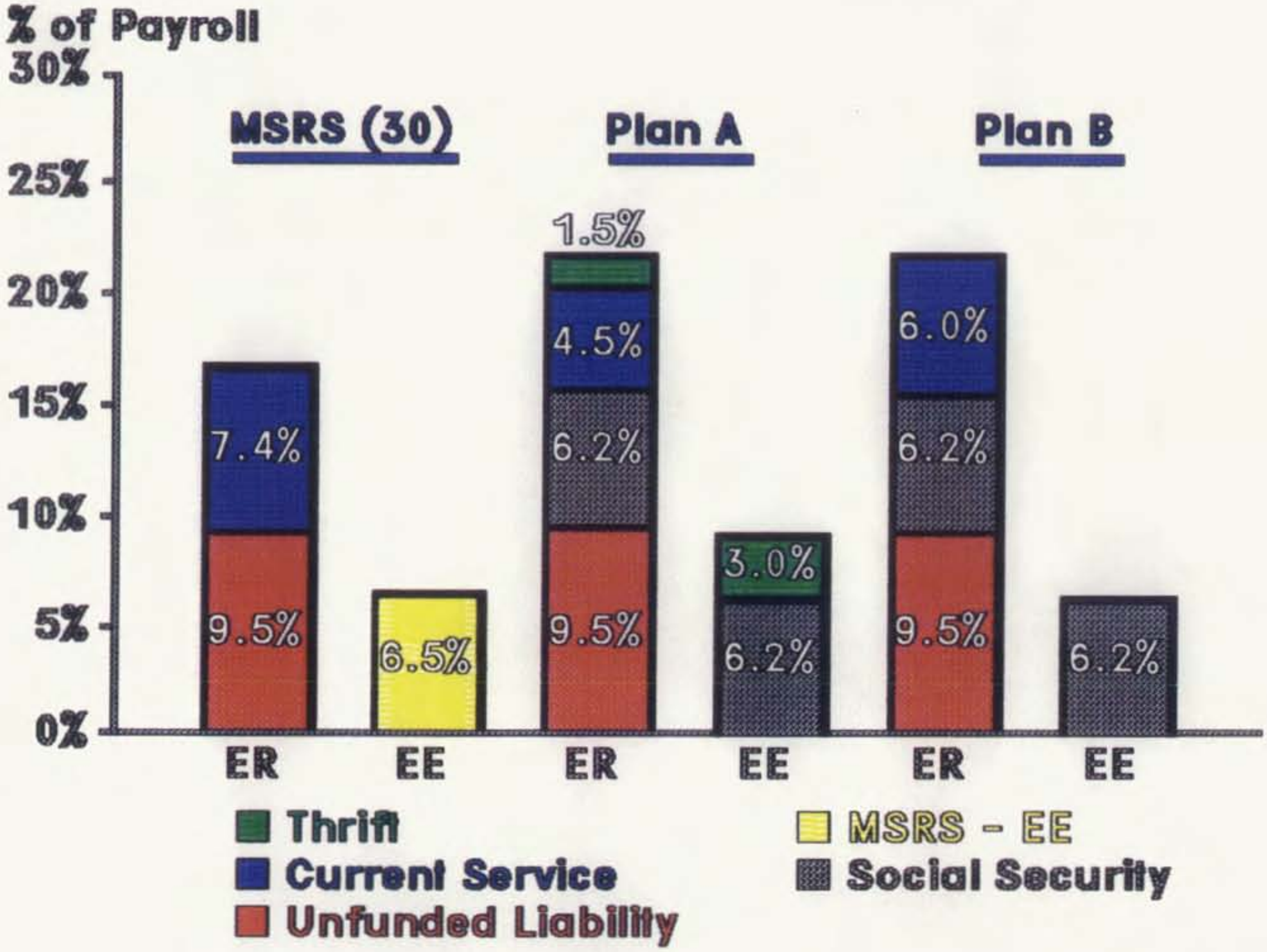
- These cost analyses are on a per employee basis and may present a misleading picture of the total cost to the State. The costs represent the total, ultimate cost to the State. Old or current employees would remain in the current MSRS plan and cost differences would not occur until new employees enter state service and/or replace current employees.

This comparison of the alternatives shows both the alternative plans with higher employer costs (approximately 4.8% higher). Again, these costs of the alternative plans assume a sharing of the unfunded liability contribution for new employees under the alternative plans. Employee costs would be slightly less under Plans A and B (6.2% versus 6.5%). Plan A would have the additional employee contribution component for the thrift plan. Again, this is optional. Plan A assumes that new employees will contribute 3% of salary with the State contributing $.50 for each $1.00 employee contribution. The maximum contribution eligible for matching under the thrift would be 4%. Employees could contribute up to 10% of salary and take advantage of the tax deferred status of the plan.

GRAPH IV-B
BENEFIT COMPARISON OF MSRS
WITH
ALTERNATIVE SOCIAL SECURITY BASED PLANS



Graph IV-C
COST COMPARISON OF MSRS
WITH
ALTERNATIVE SOCIAL SECURITY BASED PLANS



ER - Employer Contributions   EE - Employee Contributions

SUMMARY AND RECOMMENDATIONS

The Committee did not interpret its charge as the responsibility for developing a precise new retirement system for teachers and public employees of Maine. Rather, the Committee was charged to review all aspects of the present system including "the present and future benefit plans." Consideration of the current MSRS plan, its benefits and its costs, necessarily involve the Committee in a consideration of what is offered by the private sector, by other States, and by the Federal government. These considerations in turn have led to the Committee's decision to provide policymakers with material in a form suitable for evaluating alternatives. This has involved, in the immediately preceding material, analysis and consideration of the specific benefits of the current MSRS plan.

6. The Committee decided not to recommend the adoption of a system based on Social Security at this time, but to describe in some detail and to make clear its own conviction that a Social Security-based system provides an excellent alternative to the current MSRS plan with its anomalies summarized below.

- The current System provides a financial incentive for employees to retire at relatively young ages rather than continuing to work until age 65.

- While benefits are indexed to the Consumer Price Index (CPI), such indexing is limited to 4% per annum with no provision to carry forward from year to year the excess of the CPI over the 4% limit. Therefore, during periods of high inflation, retiree benefits can be seriously eroded unless ad hoc increases are voted by the Legislature.

- The survivor benefits, although increased by recent legislation, do not provide adequate protection for spouses and families.

- The portability (transferability) of MSRS benefits are limited outside of state service, and are particularly uneven (and potentially unfair) for transfers within and outside the Participating Local District plan group.

Although some of these anomalies and the implications of the implicit benefit policy could be addressed without participating in Social Security, the lack of portability could best be resolved by a Social Security based system. It would also be very expensive to provide the type of inflation protection offered by Social Security. There is also the possibility that Social Security may be mandated in the near future. Therefore, the Committee has provided two alternative plan designs which are similar to the new Federal Employee Retirement System.

James Cowen notes the following:

"Ideally, retirement income should be able to maintain one's pre-retirement standard of living into retirement. For low income employees, this often means benefits that approximate 80% of pre-retirement salaries. For higher income employees, benefits equal to 60% of salaries are normally adequate. In the design of the federal plan, both these factors - cost and benefit adequacy - played a major role. The new federal plan was designed to cost 10% less than the older one, but in many cases benefit adequacy was greater in the new one. This resulted from redistributing the value of overly generous features existent in the old plan into a wider spectrum of benefits to a broader class of individuals in the new one. For example, early retirements and cost of living adjustments are the most expensive features of the old federal plan. In the new plan the subsidy for early retirement was cut substantially. However, benefits for those who stayed later increased. Also benefits to the "inners and outers" were increased as well.

Additionally, some of the responsibility for retirement income adequacy was shifted to the employees, particularly those at the middle and higher income levels. Retirement experts have traditionally stated that retirement income should come from three sources - the public source such as Social Security, the employer through an employer pension plan, and personal savings. Savings rates in this country are deplorably low. If it wasn't for the existence of large employer-sponsored pension funds, capital formation would have come to a stand-still. Individuals must be encouraged to save for their benefit as well as for the national and state economy. The new federal plan accomplished this by creating a typical private sector thrift/savings plan where an employee is encouraged to contribute to it by an employer match.

Prior to tackling retirement redesign, there must be determinations made as to what the new plan is designed to accomplish. Whatever is established will impact demographics of the workforce, the compensation structure of the state economy generally, future state budget priorities, and the health of the Maine economy overall. It is best to decide what the impacts should be and design the pension plan accordingly."

In developing a new plan or reevaluating MSRS current benefit policy, the Committee urges the parties involved to consider the following objectives.

- Provide an adequate income for career employees who retire after normal retirement;
- Balance early retirement provisions and their costs against the need for additional benefits;
- Provide adequate inflation protection for retirees;
- Increase portability;
- Provide a program which is more appealing to younger, non-career employees, which encourages additional retirement savings;
- Maintain or reduce current employer and employee costs; and
- Consider to what extent outside forces make it possible to realize savings, such as a making employee contributions more tax efficient through an 414(h)(2) employer pick-up.

7. The disability provisions of the MSRS should be changed to encourage rehabilitation and a return to active employment, rather than serving as substitute retirement provisions. MSRS Board of Trustees and staff have been working on developing legislation to address these problems. The Committee supports their efforts. Legislation drafted as a result of these efforts will be submitted with this report.

8. The State should take a more active and vigorous role in the marketing of the current deferred compensation plan. The current efforts to communicate the benefits of this plan have not been sufficient to encourage wide spread use. Consistent with the objectives listed above, the State should consider making employee contributions to the MSRS either tax deductible or excludable through an employer pick-up or other arrangement.

9. The Committee endorses the use of "special plans" in limited cases where retaining a younger, more vigorous workforce would serve to protect the public. Without having had the time to study the specific issue, the Committee must defer to the recommendations of the 1984 study of these special plans.

10. It is outside the scope of the Committee's charge to consider the existing program for medical benefits. Many witnesses have commented, however, on the serious implications that may arise on account of not knowing (i) the extent of the accrued liability represented by the medical promise; (ii) its current and ongoing cost; (iii) the appropriateness of qualifying standards (as little as one year of state service); and (iv) the unfortunate practice of those leaving state service who unknowingly abandon this benefit. The Committee has not made an investigation of what would constitute an optimal program. It does recommend that the Legislature and the Governor investigate soon and with care. It also recommends that the administration of the medical program be coordinated with the retirement program.

The Committee felt that although this retiree health insurance program is not within the MSRS statutes, it should not be treated differently from other benefits, particularly in terms of its funding. The Board of Trustees in consultation with the actuary should establish a pattern of funding for this benefit similar to other benefits, i.e. set a percentage of salary that over the working lifetime of the employee would provide sufficient funds to meet the estimated future premiums when the emloyee retires. The process to pre-fund this benefit is already in place. A separate account exists in MSRS to collect contributions for this purpose.

The Committee recommends that either the Department of Administration or the MSRS or both authorize a study of the liabilities of retiree health insurance. Milliman & Robertson has submitted an estimate of the cost of doing this study at $27,000 in professional fees.

Chapter V
Operations

Although the primary focus of the Committee was the financial soundness of the MSRS, its review extended to a probe of the System's operations. In general, the Committee found that the level and quality of the services provided to members and retirees of the System were not satisfactory. Operations were not being carried out in an efficient manner resulting in additional administrative costs and expensive errors in benefit calculations.

To try to determine the reasons underlying the inability of the MSRS to provide better quality services to participants and improve the efficiency of its operations, the Committee reviewed the legal, structural, and operational parameters within which the System operates. This chapter will discuss these operational problems and these parameters.

Quality of Service

Several persons testifying before the Committee indicated their dissatisfaction with the System's services. Milton Wright of the Maine Teachers Association indicated the Association's pleasure with the retirement counselors and the service provided, yet indicated that MSRS is unable to provide continuity when counselors are absent. He also noted the System's lack of personnel to assist members with financial planning with respect to their retirement and expressed displeasure at the fact that the telephones are left unanswered from 8:00 A.M. to 9:00 A.M.

The two most recent Executive Directors were both aware of the operational problems facing the System and their effect on members services. Claude Perrier, the current Executive Director, presented testimony at the Committee's meeting on July 24th which all too clearly pointed out the poor service provided by the System, the cost of and the reasons for this poor service.

He was disappointed in the System's abilities to carry out its responsibilities, even the most basic services to the members and retirees. The System has been slow to respond to member inquiries, particularly estimates of contributions, unable to issue annual statements with the most basic information regarding individual membership status, and a lack of timely completion of routine task such as refunds and paybacks.

Beyond the lack of adequate servicing of participant needs, these MSRS operational problems result in additional costs to the System. Mr. Perrier pointed out two examples in particular where cases were presented to the Board in which individuals had received excess benefits amounting to over $40,000 as a result of inadequate administrative control. Since the individuals had submitted the information properly, the System accepted the blame and waived repayment. At the request of the Committee, the Executive Director performed a spot audit of some ledger cards to see if the calculations had been done properly. Each of the five cards audited was found to contain at least one error. This caused sufficient concern among Committee members to recommend that the Board of Trustees perform a more complete audit of the ledger cards. At the suggestion of the Committee, Peat Marwick submitted a proposal, a copy of which is provided in Appendix G.

From the testimony of Peat Marwick, the Committee has been able to point out several areas of need:

- documentation and internal controls are lacking;
- the workforce is not adequately trained; and
- the System is understaffed.

Automation

One of the most alarming aspects of MSRS operations was the heavy reliance on antiquated machines, namely 1950 NCR - date/ledger card entry machines, to track the individual accounts of teachers, both active, inactive and retired and members of participating local districts. The records of state employee members have been automated to a great degree. The inefficiency of MSRS operations shocked committee members. One committee member noted that if a billion dollar mutual fund had this type of accounting and reporting system, it assuredly would not be able to sell any new shares.

The MSRS has been trying to move toward an automated record keeping and benefits determination for all members and retirees. In fact, they currently have a plan to implement many of the recommendations initiated by Peat Marwick in 1984. This relationship with Peat Marwick has involved five studies. The goals and objectives for MSRS involvement with Peat Marwick were four-fold:

1. to increase processing speed;
2. to decrease errors;
3. to enhance internal control; and
4. to enhance information reporting and service levels.

The estimated cost of automating the system and undertaking a review and possible revision of policies and practices are as follows:

Automation................	$800,000
Review of policies and practices.............	$300,000
Archival System..........	$100,000
Total	$1,200,000

The payback period could not be identified. Some payback would have a tangible monetary value resulting from more effective administration through better access to information and planning and from reducing costly calculation errors. However, the greatest payback of automation would be to membership in the form of better quality services.

One impediment to implementing the automation strategies developed with the assistance of Peat Marwick, according to Claude Perrier, has been the inability of the MSRS to gain approval through the Office of Information Services (OIS) for any information systems purchases or leases or to contract for information systems services. During the early stages of these studies of MSRS operations, the System had a good working relationship with Central Computer Service, the predecessor of the OIS. However, the amount of analyst time previously available to the MSRS from OIS was cut. This has affected the relationship between the MSRS and OIS during the tenure of Mr. Perrier. He contends that, in an effort not to take a combative approach with OIS, MSRS has attempted to operate within the standard procedures governing the purchase of computer equipment. The Committee would note that OIS has a new head, George Barker, and hopes that this situation will improve.

In addition to the delays in dealing with OIS, the size of the monetary outlays is also a problem. Questions were raised as to the best method of securing approval for such a large expenditure. No major funding requests for capital equipment have been submitted to the Legislature. This $1.2 million request, seemingly out of the blue, may come as a shock to those responsible for funding decisions.

Staffing

The Executive Director pointed out that many of MSRS operational problems are due to staffing and compensation levels. According to his testimony, efforts in these areas have been impeded by the strictures of the state personnel system. MSRS employees are subject, by statute, to the rules and guidelines established by the Bureau of Human Resourses (BHR). Problems internal to the Hay system (the system used by Bureau to set salary levels for positions) result in recruiting problems when openings occur in highly technical positions or positions which are in high demand in the private sector. This is particularly true within MSRS whose operations are similar to private firms in the life insurance banking and investments fields; yet the pay for technical positions are not par with the private sector firms.

Mr. Perrier highlighted a recent example of trying to fill a very important position at MSRS from within the System. He noted that it took the BHR over 10 weeks to screen MSRS employees in order to present the Executive Director with a list of MSRS employees who could be considered for the vacancy. BHR also has a new director, Nancy Kenniston, who, the Committee hopes, can address these issues.

The Legislature

The Legislature's primary means of oversight of the MSRS is through its power to approve expenditures of all MSRS funds as a result of the Unified Budget Act of 1983. Like all state departments and agencies, MSRS must submit a biennial budget for each of its funds to the Budget Office within the Department of Finance. These are reviewed by the Governor and submitted to the Legislature as part of the Current Services or Part I Budget Bill. In addition to the authorization of expenditures from the MSRS funds, the Legislature also approves the contribution rates submitted by MSRS through the Budget Office as these rates affect the budgets of almost all state programs.

The most important control with regard to MSRS operations is the required approval of the MSRS Expense Fund by the Legislature. The Legislature authorizes the amount that can be spent for MSRS administration, the number of positions authorized, the personnel related costs, capital expenditures, and all other administrative costs. MSRS cannot create and hire additional personnel without legislative approval. However, most other adjustments in expenditures, increases or transfers, may be handled by financial order. Financial orders are executive branch tools which can be used to make budgetary adjustments when the Legislature is not in session. Each financial order is reviewed by the Joint Standing Committee on Appropriations and Financial Affairs and becomes effective 30 days after being approved by the Governor.

The Governor

The relationship of the Governor and the Executive Branch to the MSRS is unique. MSRS is not represented on the Governor's cabinet and has its own policy making body, the Board. It is classified as a quasi-independent state agency. In the course of the Committee's review of the operational problems of the MSRS, several questions have been raised about the authority of the executive over the MSRS. The only clear authority appears to be in the areas of budgetary control and personnel policies. MSRS employees, as mentioned earlier, are subject to the Civil Service Law and the guidelines and procedures of the Bureau of Human Resources within the Department of Administration. The Governor's and the Legislature's budgetary control over MSRS was discussed in the previous section.

However, in the areas of contracting and computer equipment purchasing, the authority of the Governor and the executive branch are unsettled. The Department of Administration contends that MSRS is a state agency and is, therefore, subject to the rules and procedures established by the Department, most notably the Office of Information Services. On the other hand, the Attorney General's Office, in response to recent inquiry by the Executive Director, noted that this relationship was not clearly established. Appendix H contains the correspondence between the Executive Director and the Commissioner of Administration regarding this unresolved relationship.

Participating Local Districts

One of the primary problems facing MSRS in its efforts to improve the quality of services provided to its members and retirees has been the proliferation of Participating Local District (PLD) retirement plans and the difficulty in administering these numerous plans. Political subdivisions within Maine have had the opportunity to "participate" with state employees since 1942 with the establishment of the "Employee Retirement System of the State of Maine". Those political subdivisions which have opted to contribute to the MSRS and use the System to fund the retirement benefits of its employees are called Participating Local Districts. Prior to the 1983 Social Security Amendments, local government units have had the option to participate in the MSRS either independently or in conjunction with participation in Social Security. The MSRS also administers the collection of Social Security contributions for participating local districts.

According to Roberta Weil, the former Executive Director of the MSRS, the primary stumbling block to implementing the recommendations of the series of studies by Peat Marwick was the impracticality of administering the many different Participating Local District plans. She had begun to work with the parties involved in the collective bargaining process to simplify and consolidate these various plans. Mr. Perrier has indicated that the "PLD problem" has not been a major stumbling block to the automation process. Rather automation must occur before or actually simultaneously with the consolidation of PLD plans.

The advantages to local units of participating in the MSRS are numerous. The local unit is able to tailor a defined benefit plan to meet its own needs and maintain control over it, while taking advantage of State's economy of scale in the areas of administration. Local units also benefits in the area of investing contributions. A PLD's funds are combined with the funds for the teachers and state employees as well as the funds of other PLDs. The pooling of funds allows for potentially greater returns for a given level of risk due to the greater diversification that is possible with pooled resources.

The MSRS currently includes approximately 260 PLD's, with almost as many distinctly different retirement plans. This proliferation of plans among the PLD's has been a direct result of the lack of Board of Trustees or statutory limitations on the variety of plans which could be bargained for. Given no limitations and separate collective bargaining agents in all districts, the number of distinctly different plans has consequently increased over time.

The sheer number of these plans has created an administrative nightmare for the MSRS and affected the ability of MSRS staff to provide adequate services to MSRS members. The number of participants and the variations in the plans have hampered the development of standardized forms to be submitted from the local districts. PLDs have suffered the most in terms of the quality of services provided to members. Unlike state employees whose salary and other related personnel information is entered electronically, the information from PLD's must be manually entered onto ledger cards. The backlog is this area is about 9 months at this time and steadily increasing.

Another problem centering around the administration of PLD plans is the inability of the present method to allocate administrative costs fairly. The cost of actuarial services provided to individual PLD's is billed directly to that district. However, the other administrative costs are not being fairly distributed. PLD's create a disproportionate share of the administrative burden due to the problems cited above, yet carry less than their share of the cost. Appendix I illustrates the difference between actual administrative costs incurred by and the amounts received from the PLD's. The difference was over $375,000 in 1987. This is the amount which is subsidized by the state employee and teacher plans.

The distinct nature of each plan requires that its costs be actuarially determined individually. However, the size of the districts creates a potential problem for many of them. In order to be actuarially determined on a sound basis, a district should have at least 100 covered employees. Only 20 districts meet this criterion and there are many districts with less than 10. In these instances, the actuary is forced to apply general rules of thumb rather than more accepted actuarial procedures, often resulting in widely varying costs from valuation to valuation. This could have serious financial implications for the small units should severe rate changes occur from year to year.

Responsibility for the pension liabilities of a district which is in financial distress must be clarified. MSRS statutes state that the individual districts are completely responsible for their pension liabilities. In addition, the MSRS and the State have specific means of accessing funds from the State to offset any such PLD liability, such as the district's school subsidy, State-Municipal Revenue Sharing, or other forms of financial assistance coming from the State to the troubled PLD.

Most parties involved with the PLD issue recognize the need for change. The MSRS has been meeting with representatives of the PLDs, employee representatives, and other interested parties to address the problems highlighted above.

Board of Trustees

The Board of Trustees, as the policy-making body overseeing the MSRS operations, meets monthly to conduct its business. In addition to the regular meeting the Board often must meet as frequently to address special issues. Regular meetings are day long and must cover the following responsibilities:

1. Discharge all administrative and supervisory matters;

2. Act as Board of Appeals in disputed retirement benefit cases;

3. Review statutory amendments (all legislative documents affecting MSRS during the legislative session);

4. Contract with investment advisors and review investment policy;

5. Make final determinations on all administrative and financial decisions including actuarial assumptions and amortization periods; and

6. Appoint an executive director to carry out its policy directives and to oversee the administration.

In carrying out its responsibilities as the final board of appeals in disputed retirement benefit cases, the Board must often act in a fact finding capacity. Many facts in these cases are not presented clearly until they reach the final appeal stage.

The Board consists of eight (8) members (7 voting members). The Treasurer of State or his designee serves as a non-voting member. One member each is elected from the Maine Teachers Association and the Maine State Employees Association. Three persons are appointed by the Governor; two of whom must have experience in either investments, banking, accounting or law, and the third must be selected from a list of 3 names submitted by the Maine Retired Teachers Association. The Maine Municipal Association also appoints one person to the Board from a PLD. The final person on the Board of Trustees is selected by the other members of the Board from a list or lists of retired state employees or retired PLD employees.

The appointing process results in 5 of the 7 voting members being selected from "constituency" groups. The 5 constituency groups consist of 1 member from the Maine State Employee Association, which is the largest union representing state employees, and one from the largest teachers union. An additional member is selected from the Maine Retired Teachers Association. One person from a PLD appointed by the Maine Municipal Association. The other member must be a retiree selected by the other Board members.

The taxpaying public is represented by only two members directly and by the Treasurer of State or his designee indirectly. The Treasurer is elected by the Maine State Legislature and serves on the Board of Trustees as a non-voting member. A number of issues have been raised by interested groups with respect to the membership of the Board of Trustees.

The Committee found no suggestion that the Board of Trustees was acting with any conflict of interest or against the best interests of the members of the System or taxpayers. In fact, there was every indication that the Board was functioning well with member acting relatively independently of their constituency groups and demonstrating a great deal of dedication. However, this does not obviate concern that these potential problems may surface with future Boards

In discussing issues of Board membership and the fiduciary duties of the Board, the question was raised, "Whose money is it that is held by the MSRS, the Taxpayers or the retirees and members (employees) of the System?" The answer to this question will have implications regarding the appropriateness of the current membership arrangement. There is clearly an interest of both parties in MSRS funds. Taxpayers are ultimately responsible for the payment of future benefits and ensuring that sufficient funds are available to cover these obligations. Members and retirees look at this pool of funds as part of their compensation.

The 5-2 voting membership in favor of participatory groups could affect the investment strategy employed as well as other policy considerations. Two pieces of legislation submitted during the first Regular Session of the 113th Legislature attempted to increase MSRS Board membership by adding a retiree appointed by the American Federation of State, County, and Municipal Employees, AFSCME, (LD 361) and making the Treasurer of State a voting member of the System (LD 1203). AFSCME appealed for a place on the Board in light of its representation of a significant number of local and state employees, according to Charles Sherburne, State of Maine Coordinator of AFSCME. They also feel that the member appointed by the Maine Municipal Association is management rather than participant or membership oriented. The bill to add the Treasurer of State as a voting member proposed the argument that the Treasurer of State is better qualified and should be given an equal voice in the investment decisions made by the Board.

Beyond the membership of the Board, the Committee also reviewed how the Board functioned. Board meetings tend to be very long, which can largely be attributed to the number of appeals which the Trustees must hear as the final Board of Appeals for disputes on retirement benefits. Although the present Board has been able to cover all the tasks and the demanding hours required of it, future Boards may not be able to and other Board responsibilities may suffer, i.e. administrative matters and investment policy decisions may not receive the full attention that they deserve. This problem extends itself to the duties of the Executive Director.

Executive Director

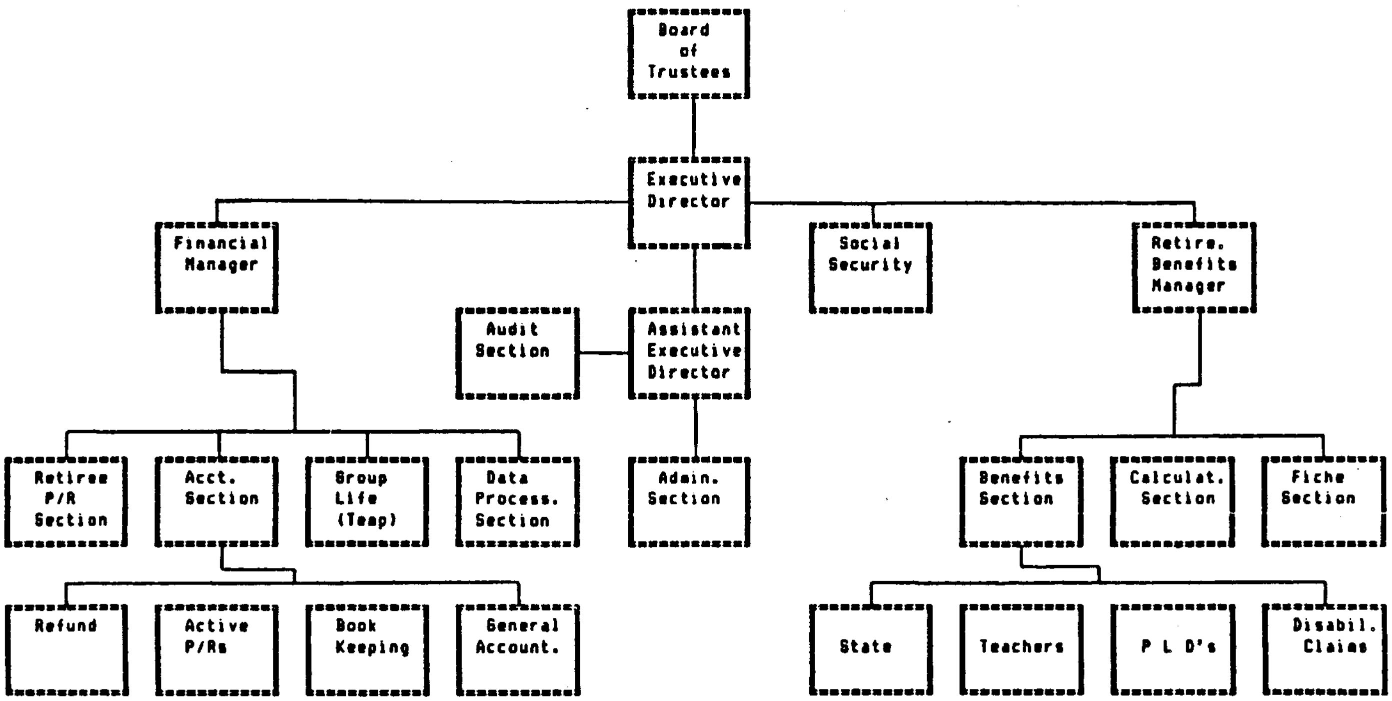
The Executive Director of the MSRS is the chief administrative officer of the System and in this capacity is responsible for carrying out the policy directives of the Board. The Director is appointed by and serves at the pleasure of the Board. Although no requirements for this position are established by statute, it is clear that the Executive Director should have a thorough understanding of administration, operations, investment management, and benefits management.

Along with the Board of Trustees, the Executive Director shares the responsibility for the proper operation of the System. However, during testimony before this Committee, the Executive Director expressed frustration with certain restrictions placed on the MSRS. The Director contends that he is statutorily responsible for proper functioning of the System, yet has no real authority to carry out these responsibilities. Unlike other Department heads or Commissioners, the Director has virtually no representation on the Governor's cabinet. Although many Commissioners face these same problems, they have a forum to air their problems. MSRS employees are considered state employees and are therefore subject to the numerous personnel rules. The administrative budget of the MSRS must also be allocated by the Legislature and approved by the Governor as part of the unified budget process.

Organization

The Organizational Chart, Figure V-A, on the following page, illustrates the current organizational structure of MSRS. This organization includes two upper management positions, one to administer the financial areas of accounting, payroll actuarial and the other to administer benefits and related calculations. This organizational scheme incorporates the changes suggested in a 1986 study conducted by Peat Marwick to prepare for the automation of the System.

Figure V-A
MSRS Organizational Chart



Summary and Recommendations

11. The quality of service provided to MSRS members and retirees has been unsatisfactory. The availability and accuracy of counseling in response to member questions should be improved. One of the means to improve services is to provide an annual statement for each member which would accurately detail the member's creditable service, member's contributions, and the value of the accrued benefits. The Committee felt that such information provided on an annual basis would provide another check to assure data collected on individual members was correct. It would also serve to communicate the value of the MSRS programs to employees.

12. The Committee recommends that the MSRS continue with its proposed plan to automate its operations. Part of this plan will need special attention in seeking legislative and/or gubernatorial approval of the estimated $1.2 million in outlays required to implement the plans for the automation of the System. The Committee will submit legislation to authorize the expenditure of these funds, funds that would be earmarked for investment portfolios. These funds are part of the cash flow in excess of the benefits payable.

In addition, the Governor should appoint an ombudsman to ensure the necessary cooperation from OIS. The quality of service and operational problems necessitate expediency in the implementation of this recommendation. The Committee hopes that this oversight of the MSRS-OIS relationship will avoid many of the problems encountered in the past.

13. Simultaneously, the Executive Director should continue current efforts to work with the interested parties to conclude an agreement which would consolidate the retirement plans of the PLDs. The Committee agrees with the concepts underlying the plan presented to it by the Executive Director. Particular care should be exercised by the System in seeking out a consensus among employer and employee groups. The guiding principles and/or goals which the Committee hopes will guide the System are the following:

- The menu of plans offered should be reduced to a workable level (3 or 4);
- Risk-pooling for small units should be increased;
- Portability should be increased within PLD plans;

- Administrative costs should be fairly allocated by some method such as by value of assets rather than size of payroll.

14. The consolidated PLD plans should remain separate and independent of the system for state employees and teachers. The assets, liabilities, and administrative costs associated with the PLD plans should be properly identified and allocated to the applicable plan. The State should not be shouldered with the additional unfunded liabilities of each PLD nor the additional administrative costs. On the other hand, PLDs should not have to be burdened with other than their own liabilities and costs.

15. The Committee recommends only one change in the composition of the Board. The Governor should appoint a public member knowledgeable in the field of investments, banking, accounting, or law instead of having the other members of the Board elect a retiree. This one change would address two concerns. First, the additional public member substituted for a constituent member would reduce the imbalance in the voting representatives. Taxpayers would still be outnumbered by the constituency groups 3 to 4. Secondly, by removing the selection process from within the Board, the potential for internal strife over this appointment would be eliminated. In the legislation to be submitted to implement this recommendation, an additional change will be proposed to select the remaining retiree member from lists submitted from all retiree groups rather than just retired teachers.

The Committee was in general agreement that the current and past Boards have not reflected the potential problems set forth above. The actions of constituency members have not been dictated by the views of the groups from which they were appointed. However, the Committee felt that the imbalance of representation between taxpayers and constituency groups should be corrected.

The Committee feels that the Board is of a well-functioning dynamic size, therefore its expansion is not deemed desirable at this time. In addition, the Committee does not want a situation created where the voting might be deadlocked, which necessitates keeping an odd number of voting members.

16. The Committee recommends that at least two Associate Directors be hired to assist the Executive Director. One to oversee investments and the other to assist with the operations of the System. These two positions and the Executive Director should be unclassified positions. The two Associate Directors should serve at the pleasure of the Executive Director. The Board should also have the authority to set salaries for these positions and the Executive Director, based on their assessment of a competitive rate of compensation to attract well-qualified persons. However, these salaries should be limited to those ranges provided for state service.

In considering the staffing problems, the Committee discussed whether the MSRS should be established as a body completely independent from state government. The nature of the pension benefits business provides strong arguments in favor of MSRS as an independent body. The System performs services that are widely offered by banks, investment firms, and insurance companies in the private sector. Doubts have been raised by many involved that a pension system which is part of the state government's bureaucratic procedures will always have to overcome impediments which do not exist in the private sector. If this is the case, the State and PLD's may be paying more for a service of lesser quality.

On the other hand, there are numerous political considerations which must be weighed. Primary among these is the value that the Legislature and the Governor (executive branch) place on having control over funding decisions. The Legislature at this time would not willing give up its authority to allocate or authorize the level of expenditures for the administration of the System.

The Committee felt that at this time the MSRS should remain as part of state government, maintaining its quasi-independent status. However, the Committee was concerned with the staffing problems detailed during testimony. Without the time or the expertise to devote to this matter, the Committee felt that this issue was worthy of further study.

A complete review of this issue should be conducted to determine whether reclassifying and/or declassifying certain MSRS would be appropriate and effective in addressing the previously mentioned staffing problems. One possible venue for this study would be before the Joint Standing Committee on Audit and Program Review. The MSRS is currently scheduled for sunset review during the Committee on Audit and Program Review's next review cycle.

17. To address the burdens of the lengthy appeals process, the Committee proposes that hearing examiners be hired on a contractual basis. These hearing examiners would act as impartial observers, ensuring that all facts are presented and all arguments clearly summarized. This would free up a considerable amount of the Executive Director's time. The Executive Director is currently responsible for reviewing these disputed cases as the first line of appeal. The Board of Trustees is the final appeals board. The time the Board dedicates to this purpose at each meeting would be reduced as a result of a better presentation of arguments prior to the Trustees' meeting which may result in many cases not having to go to the final appeals stage. The Hearing Examiners would substitute for the Executive Director and the Board in the fact finding process.

CHAPTER VI
CONCLUSIONS

The Committee to Study the Retirement System concludes its study with the submission of this report. It has been an extensive and thorough review of the financial and operational issues facing the MSRS during 1987 and into the future. Many of the emergent issues come as no surprise to the Board of Trustees and the Executive Director of the System, who have been engaged in attempts to address them for some time.

The financial concerns of the Governor and the Legislature which prompted this study were the initial foci of the Committee's efforts. A great deal of attention was given to understanding the complex financial issues involved and suggesting improvements. The Committee found that the System's fiscal condition is satisfactory and, with some changes in the amortization schedule, could be further improved. This report should provide policymakers and other interested parties with a tool for understanding actuarial science and the finances of the retirement system.

The Committee was also charged with reviewing the benefit policies. Through its analyses, the Committee again provides a new framework for looking at the relative cost of each benefit component. Future legislative actions and collective bargaining agreements should benefit from this increased understanding. Increased awareness of these implications is timely, particularly in light of potentially mandated Social Security participation. The finding regarding the expense of the retiree health issue should prepare policymakers for the future costs inherent in this benefit component.

One of the more unexpected discoveries by the Committee was of the poor quality of service and operational problems facing the System. Many of these problems have been long-standing issues, previously identified but not addressed. The MSRS has been moving toward solutions to these persistent problems. Perhaps with the assistance provided by the Committee and its report, MSRS will be able to put these problems behind them.

Another realization arising from the study was the power of the Board of Trustees and the Executive Director to implement many of the Committee's recommendations without any legislative action. Much progress has been made by the MSRS toward addressing many of these ongoing issues as a result of the Committee's discussions. In fact, the Board of Trustees implemented some of the recommendations contained in the "Financial Condition" chapter of this report. (See Addendum for a summary of Board actions.)

Although many of the Committee's recommendations require no special legislative action and are being or have been implemented by the Board of Trustees, this report should assist the Board and Executive Director in implementing more financial and operational improvements in the future by providing an informative justification for MSRS needs and actions. In working closely with the Executive Director and the Board, the Committee has assisted in clarifying and articulating several obstacles, both existing and potential, and identifying possible avenues of redress.

While many of the Committee's recommendations require no legislative action, there are three important pieces of legislation which are included as part of this report. Appendix J contains a draft of the legislation to be submitted. The recommendation addressed in these bills are:

- Board of Trustee membership and executive director and associate directors salary and accountability issues;
- Additional allocation of funds for MSRS automation plans; and
- Disability benefit improvements.

ADDENDUM

There were several items that were released or decided after the Committee had concluded the major portion of its work and which could not easily be incorporated into the analyses and recommendations within the body of this report. In the interest of providing a comprehensive report, a brief discussion of these important items is included below.

Financial Recommendations of Trustees

At its most recent regular monthly meetings in December and January, the Board of Trustees of the MSRS reviewed several items relating to the financial condition of the System. Of particular interest to this Committee was the decisions reached with respect to the assumptions and amortization schedule. The Board adopted recommendations which are consistent with those included in Chapter III of this report.

In summary, the Board adopted strengthened assumptions as proposed by Milliman and Robertson. These strengthened assumptions included a significant reduction in the retirement ages, particularly for teachers. The change of these assumptions has been one of the major factors in the increase of the unfunded liability which went up by more than $400 million between 1986 and 1987.

The Board, after much discussion, decided on adopting a thirty-year level percentage amortization schedule. They also concluded that the "Old System" Teacher liability should continue to be funded at its current schedule. The final impact of these recent financial changes adopted by the Board has not yet been calculated. However, it would initially appear that the combined effect of the strengthened assumptions and longer amortization schedule will be a slight net reduction in the rates originally requested by the MSRS. The reduction in rates was not as great as originally anticipated by the Committee. This is primarily due to some experience losses in the teacher group; such as the significant increases in salaries resulting from recently mandated minimum salaries.

The actual funds to be transferred from the Maine Rainy Day Fund should be determined shortly by the Bureau of the Budget and the MSRS. In addition, it should be noted that the 1987 Annual Report of the MSRS should also be distributed soon.

Recommendations of Integration Study

As mentioned earlier in this report, the Commission to Study the Integration of the Maine State Retirement System with Social Security was concurrently studying the benefit plan of the MSRS in light of the possibility of mandated Social Security participation. The Commission released its supplemental report in January 1988. Copies of the report are available from the Office of Policy and Legal Analysis, Maine State Legislature. Some of the significant recommendations of the Commission are provided below.

Retirement Benefits:
The retirement benefit should be calculated at 1.5% X AFC X years of service. The normal retirement age should be 65 with 5 years vesting. A member can retire at age 62 with an actuarially reduced pension for the number of years under age 65. A member with 30 years of service may retire at age 60 with no reduction in benefits. The benefit should be increased by the Consumer Price Index or 4%, whichever is less. The plan would be funded by the employer with no employee contribution.

Disability Benefits:
The retirement system would determine the average net earnings needed to maintain an individual's standard of living in different income ranges. The disability benefit should equal the amount needed to replace 100% of the individual''s net replacement income. If the individual is eligible for Social Security, the amount paid by Social Security shall be used to offset the Maine State Retirement pension. Earned income above $7,000 or up to 100% of gross prior earnings, whichever is greater, shall be offset against the combined Social Security and Maine State Retirement benefits dollar for dollar. The definition of disability would be based on inability to perform their current job for the first two years and any suitable work for disabilities lasting over two years. The benefit, prior earnings and $7,000 cap should be adjusted annually for inflation by the Consumer Price Index or 4%, whichever is less.

Survivors' Benefits:
The Commission members decided to leave the survivors' benefits either as they are in present law or a benefit completed as if the deceased individual had retired on the date of death. In the latter case, the pension would be actuarially reduced by the normal amount to provide a spousal retirement benefit and to adjust for retirement age before 60.

Ruling on Bargaining for MSRS Benefits

Also referenced in the report was the pending ruling of the Maine Supreme Judicial Court regarding the negotiability in the collective bargaining process of MSRS benefits. The Court issued its decision on February 23, 1988. All four of the union proposals in question here were considered to be statutory benefits; i.e., prescribed or controlled by statute, and therefore the state was not obligated to bargain on these proposals. A copy of the Maine Supreme Judicial Court decision is provided in Appendix M.

APPENDICES

Appendix A	Authorizing Legislation
Appendix B	Schedule of Meetings
Appendix C	Persons Testifying before the Committee
Appendix D	Committee Budget and Expenditures
Appendix E	Comparison of State Retirement Plans
Appendix F	Alternative Benefits Designs
Appendix G	Audit Proposal of Peat Marwick
Appendix H	MSRS and Department of Administration
Appendix I	Allocation of Administrative Costs
Appendix J	Draft of Proposed Legislation
Appendix K	Testimony of Dallas Salisbury
Appendix L	Testimony of Jamie Cowen
Appendix M	State of Maine v. MSEA et al., Decision of the Maine Supreme Judicial Court

Appendix A

Authorizing Legislation

APPROVED

APR 17 '87

BY GOVERNOR

CHAPTER

68

PUBLIC LAW

STATE OF MAINE

IN THE YEAR OF OUR LORD
NINETEEN HUNDRED AND EIGHTY-SEVEN

S.P. 372 - L.D. 1107

AN ACT Making Additional Appropriations from the General Fund and Allocations from Other Funds for the Expenditures of State Government for the Fiscal Year Ending June 30, 1987.

Sec. 9. Committee to Study the Retirement System. There is established a committee to study the retirement system which shall consist of 6 members to be appointed as follows: Three members to be appointed jointly by the President of the Senate and the Speaker of the House; and 3 members appointed by the Governor, one of whom shall be designated by the Governor to serve as the committee chairman.

All appointments shall be made no later than 30 days following the effective date of this Act. The Executive Director of the Legislative Council shall be notified by all appointing authorities once their selections have been finalized.

The first meeting of the committee shall be convened by the chairman of the Legislative Council.

1. Compensation. The legislative members of the committee shall receive the legislative per diem rate, as defined in the Maine Revised Statutes, Title 3, section 2. Legislators shall not be paid a per diem when they attend meetings of the committee while the Legislature is in session or in conjunction with serving on another board for which they receive compensation. All members of the committee shall be reimbursed for expenses upon application to the Executive Director of the Legislative Council.

2. Duties and responsibilities. The committee shall review all aspects of the Maine State Retirement System, to insure its present and future fiscal soundness, including, but not limited to:

A. The present and alternate systems or methods of funding and contributions;

B. The present and future investment methods and incomes, including investment management, reporting and policies;

C. The present and future expenses and costs of the system, including operating expenses, commissions, salaries and indirect costs;

D. The present and future benefit plans and payment methods;

E. The anticipated unfunded liability of the system, or other financial obligations that have not been presently met; and

F. All other aspects of the laws, operations and procedures of the system that relate to its financial stability and fiscal soundness.

3. Staff. The committee may contract for those professionals it requires to assist it. In addition, the Legislative Council shall provide staff for the committee.

4. First meeting. The chairman of the committee to study the retirement system shall call the first meeting of the committee as soon as possible following the effective date of this Act.

5. Report. The committee shall report its findings and recommendations, including any implementing legislation, to the joint standing committee of the Legislature having jurisdiction over retirement at the Second Regular Session of the 113th Legislature.

Committee to Study Retirement System	
All Other	75,000

Provides funds for a study of the Maine State Retirement System. This appropriation shall carry forward until June 30, 1988.

Appendix B

Schedule of Meetings

APPENDIX B

SCHEDULE OF MEETINGS

May 26*	Tuesday	Organizational: Establish Schedule and other Procedures
June 29	Monday	Introduction to the System
July 10	Friday	Interview and Selection of Consulting Actuary Other Testimony
July 24**	Friday	Actuarial Terms MSRS Administration
August 7	Friday	Principles of Pension Systems Investment Performance Credit Rating Participating Local Districts
August 21	Friday	Plan Design Issues Credit Rating Retire Health Insurance
September 4	Friday	Review of Findings and Development of Proposals
September 18	Friday	Review of Findings and Recommendations (cont.)
October 16	Friday	Review of Findings and Recommendations (cont.)
November 13	Friday	Review of Findings and Recommendations (cont.)
December 18	Friday	Circulate Preliminary Draft
January 29*	Friday	Final Committee Meeting

All meetings were held at the Portland Jetport Conference Room except as noted below.

* May 26 and January 29 meetings were held at the State House in Augusta

** July 24 meeting was held at the MSRS Conference Room in Augusta

Appendix C

Persons Testifying before the Committee

APPENDIX C

PERSONS TESTIFYING BEFORE THE COMMITTEE
(Listed Cronologically)

NAME	DATE	AFFLLIATION
Claude Perrier	June 29	MSRS (Exec.Dir.)
Fred Kenny	June 29	MSRS (Bd.of Trustees)
Fred Bibber	June 29	MSRS (Bd. of Trustees)
Eugene Kalwarski	June 29	Milliman & Robertson
Cathy Idleberg	June 29	Gov. Finance Officer Assoc.
Roberta Weil	June 29	Former MSRS Exec.Dir.
William Blodgett	June 29	Former MSRS Exec.Dir.
Phil Merrill	June 29	Exec. Dir.,Me. State Employees Assoc.
Gerald Tabenken	June 29	MSRS (Bd. of Trustees)

Representatives of four actuarial consulting firms presented proposals for providing consulting services to MSRS on 7/10/87

Johnson & Higgins:
Ken Davidson
Ronald Sonkin
Edward Friend

The Wyatt Company:
Kenneth Steiner
Richard Hubbard

Mercer, Meidinger and Hansen
Barry Gilman
Herbert Crehan

T,P, F, & C
Wayne R. Foster
Benjamin Haas

Christopher Lockwood	July 10	Maine Municipal Assoc.
Sgt. Larry Gross	July 10	Me.State Police
Maj. Larry Cummings	July 10	Game Warden
Peter Herring	July 10	VP, State Troopers Assoc.
Milton Wright	July 10	Maine Teachers Assoc.
Paula Gaudet	July 10	MSRS (Bd.of Trustees)
Rep. Jean Dellert	July 10	Maine State Legislature
Kenneth Steiner	July 24	The Wyatt Company
Claude Perrier	July 24	MSRS, Exec.Dir.
Mark D. Abrahams	July 24	Peat, Marwick
Gary E. Whitcomb	July 24	Peat, Marwick
David Peppard	July 24	Game Warden
Prof. Herman Leonard	August 7	Harvard, Kennedy School of Government
Steven Rappaport	August 7	Prudential Bache
Fred Settelmeyer	August 7	The Boston Safe Deposit & Trust Company, Inc.
Dallas Salisbury	August 21	Employee Benefit Research Institute
Claire Cohen	August 21	Moody Investment, Co.
Thomas Bleakney	August 21	Milliman & Robertson
Jamie Cowen	Sept.18	Government Retirement & Benefits, Inc.

Appendix D

Committee Budget and Expenditures

Appendix D

COMMITTEE TO STUDY THE RETIREMENT SYSTEM
Budget and Expenditures

FUNDS ORGINALLY BUDGETED		**$75,000.00**
EXPENDITURES: (Processed through 2/15/88)		
Committee Meetings:		
Member and Staff Travel	$ 2,954.37	
Catering	537.98	
Secretarial Services:		
Downing & Peters	3,158.50	
Other	420.43	
Other Expenses:		
Postage	191.81	
Consulting Services:		
The Wyatt Company	$35,000.00	
Windham Group (Prof. Leonard)	4,227.00	
GRB, Inc. (J. Cowen)	5,000.00	
Peat Marwick	6,300.00	
Milliman & Robertson	12,841.04	
Total Expenditures	70,631.13	
Balance (as of 2/15/88)		**$4,368.87**
ESTIMATED COST OF OTHER COMMITMENTS:		
Cost of Report (400 copies/color)	3,800.00	
Other Miscellaneous Expenses	568.87	
Total Additional Commitments	4,368.87	
ESTIMATED FINAL BALANCE		**$ 0.00**

Appendix E

Comparison of State Retirement Plans

10: RETIREMENT SYSTEMS

Participation in a state employee retirement system is mandatory in all fifty states. Thirty-seven states reported that their standard pension plan requires a contribution from the employee. Some states have optional contributory and non-contributory plans. Of those reporting contributory plans with set contribution rates, the average percent of salary paid by the employee comes to 5.35%. The state contributes a higher percentage of salary in all but five instances, averaging 9.71%. Only the state of Massachusetts reports that it makes no contribution toward retirement.

Twelve states report that as of January 1, 1987 there was a mandatory retirement age of 70. Several states have removed this limitation and all states are expected to do so to comply with the recent federal amendments to the Age Discrimination in Employment Act.

The average number of years of service required before an employee is fully vested in a retirement system is 7.57 years. In one-half of the states, employees vest after 10 years.

Many states require that an employee reach a certain age before retiring with full benefits. In other states, the employee must accrue a specified number of years of service before retirement. Several states provide for a variety of combinations between years of service and age to be able to receive full retirement benefits. While this survey does not report on the availability of early retirement with partial benefits, several respondents indicated that such an option was available to their employees.

A variety of computations were reported for calculating retirement benefits. Most followed the formula of a certain percentage (averaging 1.76%) multiplied by an employee's total number of years of service then multiplied by the employee's average final compensation. In most cases average final compensation is based on three or five years of highest compensation. Thus, if a state employee works for thirty years and retires, he or she would receive an average 52.8% of salary as a retirement benefit.

Forty-three states report that most state employees do participate in the Social Security system. The seven states not in the Social Security system are Alaska, Colorado, Louisiana, Maine, Massachusetts, Nevada and Ohio. Of these states where employees receive both a state pension and Social Security benefits, eleven have integrated plans. The states of Connecticut, Delaware, Hawaii, New York and Vermont more recently established plans which are integrated with Social Security.

Most states provide some form of cost of living adjustment for retired state workers. Sixteen states indicated that such increases are determined on an ad hoc basis. That is, in those states there is no established procedure for determining an adjustment. Sixteen states tie their cost of living increases to changes in the Consumer Price Index.

TABLE 10

RETIREMENT

State	Contribution Rate-% Salary: state	Contribution Rate-% Salary: employee	mandatory retirement age	full vesting	Normal Full Benefit Requirements: minimum age	Normal Full Benefit Requirements: year service	AFC: Average Final Compensation — benefit formula	employees in social security	integrated plan	cost of living adjust.
Alabama	7.59%	5.00%	none	10yrs	none	30yrs	2.0125% x yrs x AFC (3 yrs)	yes	no	ad hoc
Alaska	11.30%	6.75%	none	5yrs	60 and	5yrs	2.00% x yrs x AFC (3 yrs)	no	no	yes.
Arizona	5.53%(1)	5.53%(1)	70	5yrs	60 or	25yrs(2)	2.00% x yrs x AFC (3 yrs)	yes	no	ad hoc
Arkansas	12.00%	0.00%	70	10yrs	none	30yrs	1.625% x yrs x AFC (less 1.25%) (3)	yes	yes	yes
California(4)	15.45%	5.00%	none	5yrs	50	5yrs	2.00% x yrs x AFC (3yrs)(5)	yes	yes	CPI, 2% max.
Colorado	12.20%	8.00%	70	5yrs	55 and	30yrs	2.50% x yrs x AFC (3 yrs)(6)	no	no	CPI
Connecticut(7)	7.00%	5.00%	70	10yrs	55	25yrs	2.00% x yrs x AFC (3 yrs)	yes	no	CPI
Delaware(8)	12.70%	3.00%	none	10yrs	n/a	25yrs	1.66% x yrs x AFC (5 yrs)	yes	no	ad hoc
Florida	13.14%	0.00%	none	10yrs	62	30yrs	1.65% x yrs x AFC (5 yrs)	yes	no	CPI, 3% max.
Georgia	17.86%	0.50%	none	10yrs	65	34yrs	1.50% x yrs x AFC (2 yrs)(9)	yes	no	CPI
Hawaii(10)	15.90%	7.80%	none	5yrs	55	5yrs	2.00% x yrs x AFC (3yrs)	yes	no	2.5%
Idaho	8.89%	5.34%	none	5yrs	60	30yrs	1.67% x yrs x AFC (5 yrs)	yes	no	survey
Illinois	5.80%	4.00%	none	8yrs	60 or	35yrs	-------------------------(11)	yes	yes	ad hoc
Indiana	varies	0.00%	none	10yrs	65	10yrs	1.10% x yrs x AFC (5 yrs)	yes	yes	ad hoc
Iowa	5.75%	3.70%	none	4yrs	62 or	30yrs	1.25% x yrs x AFC (5 yrs)	yes	no	--- .
Kansas	3.30%	4.00%	none	10yrs	65	n/a	1.25% x yrs x AFC (5 yrs) (12)	yes	no	ad hoc
Kentucky	7.45%	5.00%	none	5yrs	65 or	30yrs	1.85% x yrs x AFC (5 yrs)	yes	no	ad hoc
Louisiana	9.20%	7.00%	70	10yrs	none	30yrs	2.50% x yrs x AFC (3 yrs)	no	no	CPI
Maine	20.00%	6.50%	none	10yrs	60 and	25yrs	2.00% x yrs x AFC (3 yrs)	no	no	CPI, 4% max.
Maryland	5.16%	0.00%	70	5yrs	62 or	30yrs	-------------------------(13)	yes	yes	CPI
Massachusetts	0.00%	5%-8%(14)	none	6yrs	55	n/a	-------------------------(15)	no(16)	no	CPI
Michigan	varies	0.00%	none	10yrs	55 and	30yrs	1.50% x yrs x AFC (5yrs)	yes	no	---
Minnesota	3.90%	3.73%	70	10yrs	62	10yrs	(1.00% 1st 10 yrs + 1.5% x yrs over 10) x AFC	yes	yes	ad hoc
Mississippi	8.75%	6.00%	70	10yrs	55 and	30yrs	1.50% x yrs x AFC (5 yrs)	yes	no	ad hoc
Missouri	10.00%	0.00%	70	10yrs	60 and	15yrs	1.33% x yrs x AFC (3yrs)	yes	no	ad hoc
Montana	6.417%	6.00%	none	5yrs	60	30yrs	1.67% x yrs x AFC (3yrs)	yes	no	ad hoc
Nebraska	----(17)	----(17)	70	5yrs	60	30yrs	no formula, cash on annuities	yes	no	none
Nevada	9.00%(18)	9.00%(18)	none	10yrs	55	30yrs	2.50% x yrs x AFC (3yrs)	no	no	---
New Hampshire	varies	4.60%	none	10yrs	60	n/a	1.67% x yrs x AFC (3yrs)	yes	yes	---
New Jersey	varies	varies	none	10yrs	60	n/a	1.67% x yrs x AFC (3yrs)	yes	no	CPI, 60%

TABLE 10 - Continued

RETIREMENT

State	Contribution Rate-% Salary: state	Contribution Rate-% Salary: employee	mandatory retirement age	full vesting	Normal Full Benefit Requirements: minimum age		Normal Full Benefit Requirements: year service	AFC: Average Final Compensation: benefit formula	employees in social security	integrated plan	cost of living adjust.
New Mexico	11.48%	3.83%	none	5yrs	none		25yrs	2.00% x yrs x AFC (3yrs)	yes	no	ad hoc
New York(19)	14.00%	0.00%	none	10yrs	55		n/a	1.66% x yrs x AFC (3yrs)	yes	no	ad hoc
North Carolina	10.25%	6.00%	none	5yrs	65	or	30yrs	1.58% x yrs x AFC (4yrs)	yes	no	none
North Dakota	9.12%	0.00%	none	10yrs	65		n/a	1.30% x yrs x AFC (5yrs)	yes	no	ad hoc
Ohio	13.71%	8.50%	none	5yrs	any		30yrs	2.10% x yrs x AFC (3yrs)	no	no	3%
Oklahoma	14.00%	2.00%	none	10yrs	58		30yrs	2.00% x yrs x AFC (10yrs)	yes	no	---
Oregon	17.23%	0.00%	none	5yrs	58		n/a	1.67% x yrs x AFC (3yrs)	yes	no	CPI
Pennsylvania	12.78%	6.25%(20)	none	10yrs	60	or	35yrs	2.00% x yrs x AFC (3yrs)	yes	no	ad hoc
Rhode Island	5.50%	6.50%	70	10yrs	55		38yrs	-------------------------(21)	yes	no	---
South Carolina	-----(22)	7.10%	70	5yrs	65		30yrs	-------------------------(23)	yes	no	---
South Dakota	5.00%	5.00%	none	5yrs	65		20yrs	1.00% x yrs x AFC	yes	yes	---
Tennessee	10.00%	0.00%	none	10yrs	60	or	30yrs	-------------------------(24)	yes	yes	CPI
Texas	7.40%	6.00%	none	10yrs	55	and	30yrs	(1.5% x 1st 10 yrs + 2% x yrs over 10) x AFC (3yrs)	yes	yes	---
Utah	6.00%	0.00%(25)	none	4yrs	none		30yrs(26)	-------------------------(27)	none	no	CPI, 4% max.
Vermont	varies	0.00%	none	10yrs	62 and		20yrs	1.67% x yrs x AFC (5yrs)	yes	no(28)	CPI
Virginia	12.84%	0.00%	none	5yrs	55	and	30yrs	1.50% x yrs x AFC (3yrs)	yes	no	CPI
Washington	9.27%(29)	6.00%(29)	none	5yrs	60	and	30yrs	2.00% x yrs x AFC (2yrs)	yes	no	CPI
West Virginia	9.50%	4.50%	none	5yrs	60(30)		30yrs	2.00% x yrs x AFC (3yrs)	yes	no	none
Wisconsin(31)	7.20%	6.00%	none	immed	65(32)	or	30yrs	1.60% x yrs x AFC (3yrs)	yes	yes	none
Wyoming	7.50%	3.75%	none	4yrs	50	and	4yrs	2.00% x yrs x AFC (3yrs)	yes	no	ad hoc

NOTES FOR TABLE 10: RETIREMENT

1. Arizona: Contribution rate is adjusted each July 1 to assure fund solvency.

2. Arizona: Or any combination of age plus service equal to 85 points.

3. Arkansas: 1.25% subtracted is for primary Social Security benefits.

4. California: Different plans available for public safety workers.

5. California: Benefit formula shown applies to retirees at age 60.

6. Colorado: Benefit formula as shown applies to yrs of service up to 20 yrs; for 20-40 yrs service the percentage changes to 1%. Max. benefit: 70% of salary.

7. Connecticut: A second plan in effect which is integrated with Social Security requires employee contributions of 2% of salary subject to S.S. taxes, and 5% of salary above wage base. A third plan for new hires also integrated with S.S. requires no employee contributions, allows retirement at age 65 and pays a smaller benefit.

8. Delaware: A second plan in effect is integrated with Social Security. Benefits under this plan cannot exceed 75% of AFC.

9. Georgia: For employees hired before 7/1/82: Percent factor (base 1.18% + .03 for each add'l yr to max. of 2.2%) x yrs x AFC (2 yrs) less $140.00.

10. Hawaii: New contributory plan in effect 1/1/85. New hires must join, others have option. Under this plan the minimum retirement age is 55 yrs with 30 yrs of service or 62 yrs with 10 yrs of service. Vesting after 10 yrs. This plan is integrated with Social Security.

11. Illinois: Benefit formula is (1% x 1st 10 yrs + 1.1% x 2nd 10 yrs + 1.3% x 3rd 10 yrs less 1.5% x yrs over 30) x AFC.

12. Kansas: For service prior to 7/1/82, benefit formula is 1.4% x yrs x AFC (5yrs).

13. Maryland: Benefit formula for plan in effect 1/1/80 is 0.8% up to integration level plus 1.5% above level x yrs x AFC (3 yrs).

14. Massachusetts: 5%, 7% or 8% depending on date of hire.

15. Massachusetts: P.A.Y.: Percent for age x Average 3 yr salary x Years of service.

16. Massachusetts: Medicare for persons hired after 4/1/86.

17. Nebraska: Employee contributes 3.6% of first $24,000 and 4.8% on amount over $24,000. State contributes 5.62% on first $24,000 and 7.5% on amount over $24,000.

18. Nevada: Half of the workforce on contributory plan and half on full employer paid plan (17.0% employer contribution).

19. New York: Four different tiers are available depending on date employee joined the system with different requirements and benefit formulas. Figures shown are for the non-contributory plan for Tier I. Tier III plan is integrated with Social Security.

20. Pennsylvania: 5% for those hired before 7/22/83.

21. Rhode Island: Benefit formula is 1.7% x 1st 10 yrs + 1.9% x 2nd 10 yrs + 2.4% x yrs over 20) x AFC (3 yrs). Maximum benefit is 80% of AFC.

22. South Carolina: 4% of 1st $4,800 and 6% of salary over $4,800.

23. South Carolina: Benefit formula: (1.25% of 1st $4,800 x AFC (12 consecutive quarters) + 1.65% of AFC over $4,800) x yrs service.

24. Tennessee: Benefit formula: (1.5% x yrs service x AFC (5 yrs) up to Social Security max) + (1.75% x yrs service x AFC above maximum.)

25. Utah: Non-contributory plan offered in July 1986. Employee pays 6% for contributory plan.

26. Utah: Or 65 and 4 yrs, 62 and 10 yrs or 60 and 20 yrs.

27. Utah: Benefit formula: (1.1% x yrs service prior to 1967 + 1.25 x yrs (1967-1975) + 2% x 4 yrs service after 1975) x AFC. AFC is 5 yrs for contributory plan and 3 yrs for non-contributory plan.

28. Vermont: A more recent retirement plan is integrated with Social Security.

29. Washington: For employees hired after 10/1/77, state pays 8.43% and employees pay 4.83%.

30. West Virginia: Or 55 with 25 yrs of service.

31. Wisconsin: General employees.

32. Wisconsin: 65 with less than 30 yrs; 62 with at least 30 yrs.

MAINE STATE RETIREMENT SYSTEM

EARLY RETIREMENT REDUCTION FACTORS FOR SELECTED STATES

(Assuming 25 Years of Service)

State	60	55	50
Maine	1.00	.88	.78
Arizona	1.00	.60	.35
California	1.00	.73	N/A
Colorado	1.00	.40	N/A
Florida	.90	.65	.40
Illinois	1.00	.70	N/A
Iowa	.70	.70	N/A
Kansas	.82	N/A	N/A
Maryland	1.00	.70	.40
Massachusetts	.80	.60	N/A
Mississippi	.85	N/A	N/A
New York (Tier III)	.87	.70	N/A
North Carolina	1.00	.70	.55
Oklahoma	.87	.53	N/A
Oregon	1.00	.60	N/A
Pennsylvania	1.00	.72	?
South Carolina	.75	N/A	N/A
Tennessee	1.00	.76	N/A
Texas	1.00	.87	N/A
Utah	.90	N/A	N/A
Virginia	.70	.40	N/A
Washington	1.00	1.00	N/A
West Virginia	1.00	.53	N/A
Wisconsin	.94	?	N/A
Average	.88 (.88)	.64 (.53)	.50 (.10)

Source 1981 Wyatt PERS Benefit Survey. N/A denotes early retirement not available. ( ) denotes average assuming N/A = 0

MAINE STATE RETIREMENT SYSTEM
EARLY RETIREMENT REDUCTION FACTORS FOR SELECTED STATES
(Assuming 30 Years of Service)

State	60	55	50
Maine	1.00	.88	.78
Arizona	1.00	.60	.35
California	1.00	.73	N/A
Colorado	1.00	1.00	N/A
Florida	.90	.65	.40
Illinois	1.00	.70	N/A
Iowa	1.00	1.00	1.00
Kansas	.82	N/A	N/A
Maryland	1.00	1.00	1.00
Massachusetts	.80	.60	N/A
Mississippi	1.00	1.00	1.00
New York (Tier III)	.87	.70	N/A
North Carolina	1.00	1.00	1.00
Ohio	1.00	1.00	1.00
Oklahoma	1.00	.53	N/A
Oregon	1.00	.60	N/A
Pennsylvania	1.00	.72	?
South Carolina	1.00	1.00	1.00
Tennessee	1.00	1.00	1.00
Texas	1.00	1.00	N/A
Utah	1.00	1.00	1.00
Virginia	1.00	.40	N/A
Washington	1.00	1.00	1.00
West Virginia	1.00	.53	N/A
Wisconsin	.94	?	N/A
Average	.97 (.97)	.81 (.78)	.88 (.44)

Source 1981 Wyatt PERS Benefit Survey. N/A denotes early retirement not available. ( ) denotes average assuming N/A = 0

Appendix F

Alternative Benefits Designs

THE Wyatt COMPANY

Actuaries and Consultants

Employee Benefits | Compensation Programs | Employee Communications | Administrative Systems | Risk Management | International Services

Wellesley Office Park 80 William Street Wellesley Hills, Massachusetts 02181 (617) 237-3900

September 11, 1987

Mr. Robert Monks
Chairperson of MSRS Study Commission
3050 K Street, N.W.
Suite 300
Washington, D.C. 20006

Dear Bob:

As requested, enclosed are two tables which illustrate the impact on system benefits and system contribution requirements of the changes we discussed (which are outlined below).

System Changes

Effective July 1, 1988, all future employees who become members of MSRS would become participants in the following plans:

- The OASDI portion of Social Security
- MSRS (as modified for new employees)
- The MSRS Thrift Plan

Social Security

As employees covered by Social Security, the new employees would be required to contribute the OASDI rate (they are already required to contribute the HI rate). For 1990 and thereafter, the OASDI rate is scheduled to be 6.2% of pay up to the Social Security Taxable Wage Base, as compared with the 6.5% MSRS participants currently pay.

MSRS (as modified for new hires)

MSRS would be modified for employees (other than special group employees) hired after June 30, 1988 to provide the following benefits with respect to such employees:

- A normal retirement benefit equal to 1% of final three year average pay for each year of service.
- Normal retirement at age 65. Actuarially reduced benefits payable upon commencement of benefits after age 55.
- Retirement Equity Act death benefits.
- Continuation of service credit for disability (with disability conditioned upon satisfying Social Security eligibility).

- No post retirement cost of living protection.
- 5-year "cliff" vesting
- No employee contributions.

MSRS Thrift Plan

- Employees would be eligible to contribute up to 10% of their pay to the plan. The first 4% of pay would be considered "basic" contributions and the next 6% of pay would be considered "voluntary" contributions.
- The State would contribute $.50 for each $1.00 of basic contributions.

Funding Changes

The state will continue to fund on an actuarial basis with state contributions equal to the State's normal cost plus 30-year "rolling" amortization of the unfunded actuarial liability.

Spendable Income Analysis

The attached spendable income analysis chart shows the benefits provided to a new employee retiring at age 65 with 35 years in the System. The total benefit comes from three sources: Social Security, MSRS and the Thrift Plan. For this chart, we have assumed that the hypothetical employees contribute 4% per year for 35 years. What we have shown is just the employer-provided portion of the Thrift Plan benefit. If the employee-provided benefit is added (at 4% per year), it would add slightly more than 20% of pay on top of the Thrift Plan line, based on the assumptions we have used to develop these charts in the past (as summarized in our benefit design report).

State Contribution Requirement

The second table illustrates future total state contribution requirements for state employees and teachers based on the July 1, 1986 actuarial valuation results. Please note: these results do not reflect recent favorable investment performance, nor do they reflect the lower retirement age assumption. These changes can be reflected, but we have chosen to illustrate the cost impact of the changes discussed above using the latest available actuarial valuation results.

We estimate that the State contribution requirement for the revised MSRS defined benefit portion of the new program would be about 4.5% of new entrant pay. The employer cost for the OASDI portion of Social Security would be about 6.2% of pay (assuming everyone earns less than the Taxable Wage Base) and the Thrift Plan might cost 1.5% of pay, for total "employer normal cost" for the new program of about 12.2% of pay, as compared with new entrant MSRS normal cost of about 7.1% of pay for regular State employees and Teachers. Thus, all things being equal, the proposed program would increase the State's cost by about 5% of pay for each newly hired employee.

As the table shows, if the rolling 30-year amortization approach is followed, the past service cost will be decreased from about 13.2% currently to 9.3% for 1988. Because the amortization approach would involve a fresh 30-year period each year, the unfunded liability would never be fully amortized, but the contribution to fund it would be expected to represent a decreasing percentage of total payroll of all active MSRS participants (both old and new). At the same time, if we assume a 5% turnover rate for old employees, the normal cost of the system will increase each year as more new entrants (with higher normal cost) are hired. The net impact of the decreasing past service cost and the increasing normal cost would be to provide fairly level State contribution requirements, ultimately decreasing somewhat below the levels in the first 10 years, provided all assumptions are realized.

Please call Rick or me if you have any questions regarding this letter or the chart. There are many changes that could be examined (such as alternative benefit designs, or alternative amortization approaches), and we would be happy to explore various alternatives with the Commission.

Sincerely,

THE WYATT COMPANY

Ken Steiner

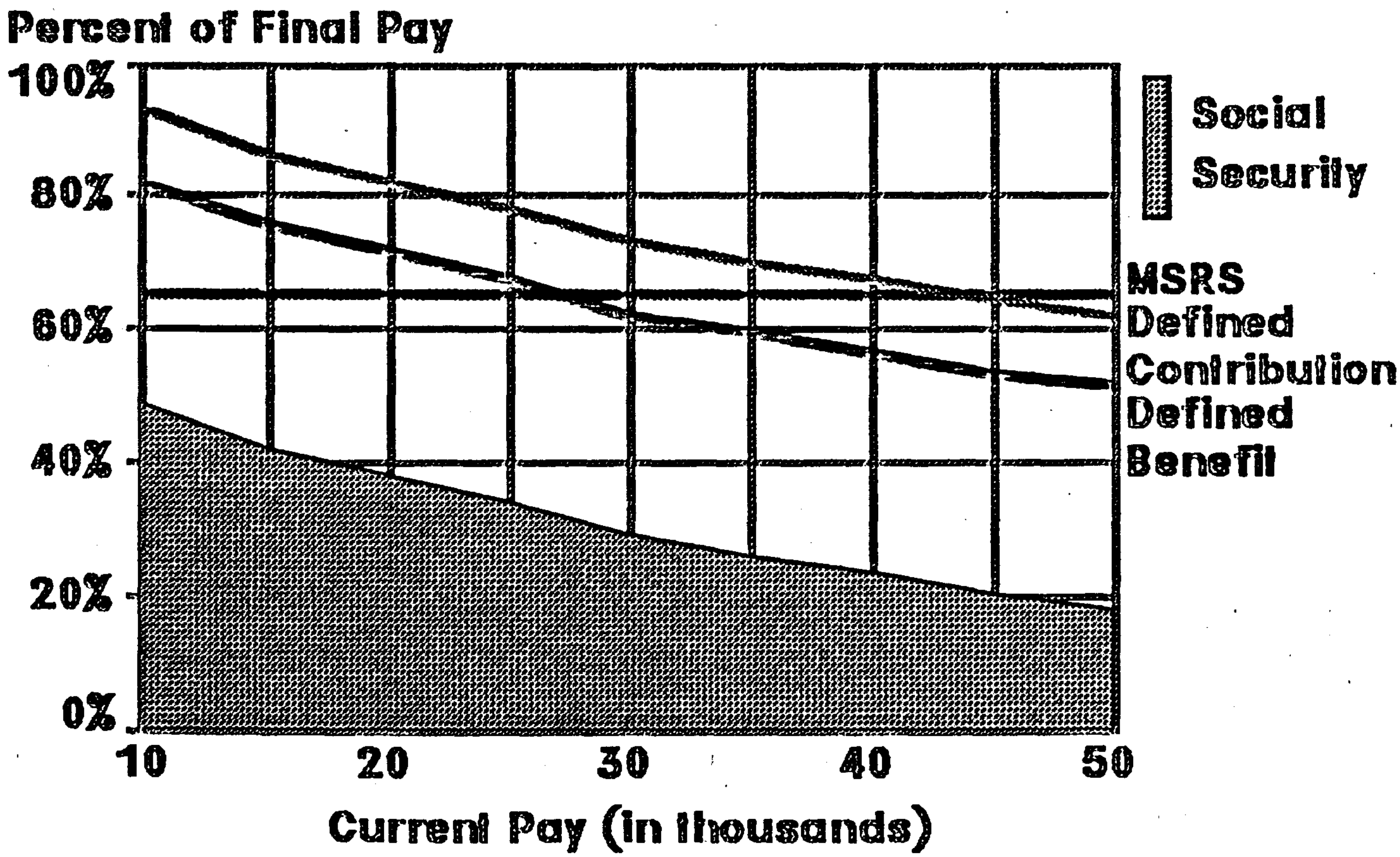
Kenneth A. Steiner

KAS/cam
Enclosure

cc: Richard Hubbard

MAINE STATE RETIREMENT SYSTEM

SINGLE EMPLOYEE RETIRING AT AGE 65
WITH 35 YEARS OF SERVICE



PROJECTED STATE CONTRIBUTION REQUIREMENTS FOR
ALTERNATIVE "THREE PLAN PROGRAM" FOR NEW ENTRANTS

Year	% New Entrants	% Old Participants	Normal Cost Rate 1/	Past Service Cost Rate 2/	Total Contribution Rate
1988	0 %	100 %	7.1 %	9.3 %	16.4 %
1989	5 %	95 %	7.4 %	9.1 %	16.5 %
1990	10 %	90 %	7.6 %	8.9 %	16.5 %
1991	14 %	86 %	7.8 %	8.7 %	16.5 %
1992	19 %	81 %	8.1 %	8.5 %	16.6 %
1993	23 %	77 %	8.3 %	8.3 %	16.6 %
1994	26 %	74 %	8.4 %	8.1 %	16.5 %
1995	30 %	70 %	8.6 %	7.9 %	16.5 %
1996	34 %	66 %	8.8 %	7.7 %	16.5 %
1997	37 %	63 %	9.0 %	7.6 %	16.6 %
1998	40 %	60 %	9.1 %	7.4 %	16.5 %

1/ Percentage of total payroll for regular state employees and teachers. Determined by applying .122 to the percentage of new entrants and .071 to the percentage of old participants.

2/ Percentage of total payroll for regular state employees and teachers (both old and new).

MILLIMAN & ROBERTSON, INC.
CONSULTING ACTUARIES

SUITE 3600
1301 FIFTH AVENUE SEATTLE, WASHINGTON 98101-2646
206/624-7940
TELECOPIER: 206/340-1380

ALLAN D. AFFLECK, F.S.A.
DAVID V. AXENE, F.S.A.
RICHARD L. BERGSTROM, F.S.A.
JAMES M. BERRY, F.S.A.
THOMAS P. BLEAKNEY, F.S.A.
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JOSEPH D. SINTOV, F.S.A.
STEVEN O. SOMMER, F.S.A.
DENNIS L. STANLEY, F.S.A.
KAREN I. STEFFEN, F.S.A.
RICHARD A. WINKENWERDER, F.S.A.

WENDELL MILLIMAN, F.S.A. (1976)
STUART A. ROBERTSON, F.S.A.
CHAIRMAN EMERITUS

September 10, 1987

Mr. Robert A. Monks
3050 K Street N.W., Suite 300
Washington, D.C. 20007

Re: Possible Alternative Program

Dear Bob:

At your August 21 meeting, I presented a suggestion for a possible alternative program to the existing schedule of benefits under the Maine State Retirement System.

As we discussed, a key element of the new program is that it would be designed to accompany Social Security coverage for all new employees. If you believe that universal Social Security coverage is inevitable, this program could be adopted either to accompany voluntary entry into Social Security, or for implementation when and if Social Security should become mandatory.

In brief, the program has the following basic features:

- A 1.5% benefit formula, rather than the current 2%
- A retirement age equal to the Social Security retirement age - age 65 for employees born before 1938, age 67 for those born after 1959, and phased in for those born in the mid-years.
- No COLA
- No employee contributions.

We have made some crude estimates of the cost of this kind of program, based upon the actuarial valuation of the System as of July 1, 1986. I must emphasize the word "crude." Estimating the cost of any benefit program is difficult without an expensive computer run. Estimation is even more difficult when the

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BACON & WOODROW IN THE UNITED KINGDOM
ECKLER PARTNERS LTD. IN CANADA

retirement age is to be changed, such as is the case in the suggested program. Because of that, the estimates in this letter are subject to significant improvement if a more thorough actuarial procedure is needed to evaluate the suggestion.

The following table summarizes the cost of the current program and the estimated cost of its possible replacement, expressed as percentages of payroll.

		Current	Alternative
1.	Employer normal cost	5.5%	4.5%
2.	Amortization payment (level percent, 25 years)	11.0	11.5
3.	Death, disability	1.9	1.5
4.	Total	18.4%	17.5%

As I indicated at the meeting, the alternative program's cost should be substantially less than that of the existing program. We have now estimated its normal cost at about 45% of the current program's total normal cost. This is not readily apparent from the table. What is missing is the employee contributions. After allowing for refunds, the current 6.5% employee rate is about the same as an employer's rate of 4.5%. Thus, the total current effective normal cost, calculated on this basis, is about 10% of pay.

Another way of looking at this is that maintaining all or part of the existing employee contributions would significantly reduce the employer cost of the alternative program. For example, a 3% member contribution would have the effect of reducing employer contributions by about 2% of pay, for a total rate of about 15.5%.

The costs in the table above reflect the actuarial assumptions used in the 1986 valuation. One key assumption is the average age at retirement. For the 1986 valuation, we changed the assumed average age at retirement from age 65 to about age 62. However, we are concerned that even this change may not be drastic enough. If it should turn out that an average retirement age of, say, 60 is more appropriate, all of the projected current costs will increase, as will the amortization payment under the alternative program. However, the alternative program's normal cost would remain as shown in the table above. Thus, reduction in the average assumed retirement age below age 62 would cause the alternative program to be somewhat more attractive, relative to the current program, than the table indicates.

All of our calculations are based upon a 1.5% formula. A 1% benefit percentage would free up 1.5% in normal contribution, which might be used for a form of thrift plan. However, a 1% formula might generate pressures for improvement when employees start retiring from the new plan. Two reasons:

- Many employees may choose not to join the thrift plan; for them, the actual benefit received in retirement may be inadequate, or perceived to be.

- Even for those who join the thrift plan, in years like the early 1970's in which inflation causes salaries to go up rapidly while investment returns are poor, the total benefits relative to final salaries may be substantially less than anticipated.

Either of these two occurrences, but particularly the latter, may generate pressure upon the legislature to improve the defined benefit portion of the program. Similar poor experience in public employee systems led to shifts from defined contribution to improved defined benefit plans in the 1930's and 1940's. Employees enjoyed the advantages of the defined contribution benefits when investments were favorable, and the taxpayers picked up the difference in the improved defined benefit plans when investments were not.

Although the alternative program has lower normal costs than the current plan, the amortization payment is greater. The reason for this shift is somewhat technical. We set the total employer normal cost rate - including that for present employees - as that of the new plan. This technique has a stabilizing effect on long-term costs, since the normal cost rate will not change as "old plan" members are replaced by "new plan" members. Because the anticipated employer normal cost is lower under the new plan, however, a small addition is made to the unfunded actuarial reserve to fund the anticipated differences in the normal cost rates. Thus the increase in the amortization payment.

A heavy portion of the current plan's cost is driven by the unfunded actuarial reserve for existing benefits. We have assumed that there is nothing that can be done about this unfunded amount, with the possible exception of voluntary transfers of employees to the new and less expensive program. Since transfers would also require participation in Social Security, we have assumed that no transfers would occur.

We have estimated that the costs of the death and disability programs would decline slightly. This reflects the increasing effect of Social Security benefits offsetting the System's disability benefits.

Once more I wish to emphasize, Bob, that all of these numbers are estimates, and should be used for the purpose of determining the general cost characteristics of a possible new plan, rather than rates which could be adopted in an actuarial valuation. If matters should progress sufficiently to bring this or a similar plan into serious consideration, we would strongly recommend that a more elaborate analysis be made to firm up these figures. If such a determination should show higher costs than these estimates, and the Committee's decision is a close one, this could alter your recommendations. Conversely, if a more refined calculation should come up with somewhat lower numbers and your Committee is on the fence but negative, perhaps this could cause the decision to tip the other direction. Naturally, I hope that the Committee's recommendations are not too dependent upon the precision of these costs.

I am sending a copy of this letter to Claude Perrier for his information.

Sincerely,

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

TPB/mhr

cc: Mr. Eugene M. Kalwarski
Mr. Claude R. Perrier

2cor939
04 36 MON 01

THE Wyatt COMPANY

Actuaries and Consultants

Employee Benefits | Compensation Programs | Employee Communications | Administrative Systems | Risk Management | International Services

Wellesley Office Park 80 William Street Wellesley Hills Massachusetts 02181 (617) 237-3900

September 16, 1987

Mr. Robert Monks
Chairperson of MSRS Study Commission
Institutional Shareholder Services, Inc.
3050 K Street, N.W.
Suite 300
Washington, D.C. 20006

Dear Bob:

We received your telecopy of Mr. Bleakney's letter of September 10, 1987, and we have the following comments:

1. While Tom indicates that his new program is designed to accompany Social Security coverage, he has not included in his cost analysis the State's cost of the OASDI portion of Social Security, which we indicated is scheduled to be 6.2% of pay up to the Taxable Wage Base ($43,800 in 1987) for years after 1989. If this cost is added to his new program (assuming, for simplicity purposes, that everyone earns less than the Taxable Wage Base), it brings the total employer normal cost to 12.2% of payroll – the same percentage we developed for the plan described in our letter to you dated September 11, 1987.

2. Tom has indicated that a 1.5% formula would have a normal cost of 6.0% of pay (including 1.5% for disability and death) and that a 1% formula would reduce System normal cost by 1.5%, or to about 4.5%, the same figure we developed! The only difference in our approaches is that we suggested a 1% defined benefit formula with 1.5% of pay spent on a Thrift Plan. We agree, however, that quite a few employees may not participate and therefore 1.5% of pay may be an overstatement of the cost of a Thrift Plan for MSRS.

   You will note from our Spendable Income Analysis that a 1% of final average pay benefit (together with Social Security) is expected to replace 80% of final pay at the $10,000 pay level for a participant retiring with 35 years of service. A 1.5% benefit would provide close to 100% of final pay.

3. Tom seems to have modified the plan he presented at our August 21 meeting somewhat. At that time, he mentioned a cost of living adjustment limited to 3% or so, 5 year vesting, indexed benefits to terminated vested employees and a Thrift Plan.

In summary, we are in basic agreement with Tom's numbers with the important caveat that he has left out a pretty sizable piece – that is the cost of Social Security. The unavoidable fact remains that while the current normal cost for hiring an MSRS employee is 7.4% (or possibly higher due to use of assumptions about which Milliman and Robertson appears to be uncomfortable), the normal cost for Tom's program would be about 12.2%, or 65% higher than currently anticipated.

Please call Rick or me if you have any questions.

Sincerely,

THE WYATT COMPANY

Ken Steiner

Kenneth A. Steiner

KAS/cam

Appendix G

Audit Proposal of Peat Marwick

KPMG Peat Marwick

Certified Public Accountants

Peat Marwick Main & Co.
P.O. Box 507
Three Canal Plaza
Portland, ME 04112

Telephone 207 774 5871

Telecopier 207 774 1793

August 6, 1987

Mr. Robert A.G. Monks, Chairman
Committee to Study the Retirement System
Institutional Shareholders Services, Inc.
3050 K Street N.W. Suite 300
Washington, D.C. 20007

Dear Mr. Monks:

At your request, we have drafted a workplan to conduct an audit of the benefit calculations of Maine State Retirement System (M.S.R.S.). The Committee to Study the Retirement System (Committee) has expressed concern as a result of previous testimony that the record keeping policies and procedures of M.S.R.S. are not in proper order. Since an independent outside audit of M.S.R.S. has never been performed, the Committee has no comfort regarding the accuracy of individual benefit calculations or that proper records are being maintained. As such, you have requested Peat Marwick to prepare for the Committee a workplan that would address the concerns noted above.

WORKPLAN

Task 1 - Review Current M.S.R.S. Benefit Calculation Process

We will meet with appropriate M.S.R.S. staff to review the current M.S.R.S. benefit calculation process. A consultant from our employee benefit/actuarial consulting group will review the current calculation methodology and confirm that the calculation process meets M.S.R.S. plan specifications.

Task 2 - Develop Detailed Compliance Audit Workplan

From the information developed in Task 1, we will develop a detailed compliance audit workplan that will become the basis for the audit of the M.S.R.S. benefit calculation process. We will review this detailed workplan with the Executive Director, Benefits Manager and other appropriate M.S.R.S. staff before proceeding with the audit.

Task 3 - Conduct A Statistical Sample of Active Benefit Recipients

Currently M.S.R.S. has approximately 22,000 active recipients of benefits. We will perform a random, statistical sample of the active recipients of benefits to conduct our audit. We will use our System 2190 EDP audit software that is currently in place at the State of Maine Bureau of Data Processing. This software has been used in a similar capacity in support of the annual quadrennial audit of the State of Maine. We expect to extract a sample size that will provide us with a 95% confidence level that the sample selected has the same attributes as the population as a whole (total active benefit recipients).

Task 4 - Conduct Review of Selected Sample Files

Based upon the statistical sample we will review each selected file for the compliance items determined in Task 2. We will also recalculate the benefits calculation based upon information present in the selected files. All discrepancies and errors will be documented.

Task 5 - Report Findings

We will prepare a comprehensive report to the Executive Director, Benefits Manager and the Board of Trustees. The report will include a detailed description of the work performed and the results of the audit. Also, recommendations for improvement will be included.

STAFFING, TIMING AND FEES

We will staff this engagement with a project team that is familiar with M.S.R.S. operations and has conducted similar audits for other governmental entities. Mr. George Lambert, Partner in Charge of Audit of our Portland office, will act as client partner. Mr. Lambert will act as liaison between the engagement team and M.S.R.S. staff and the Board of Trustees. Mr. Mark Abrahams, Partner in Charge of our New England governmental management consulting practice, will serve as engagement partner. Mr. Abrahams will be responsible for the successful completion of the project. Mrs. Denise Taaffe, senior manager of our Portland office governmental audit practice, will serve as technical advisor to the project. I will serve as engagement manager and be responsible for all on-site work. Resumes for the above as enclosed. We will use other qualified staff as necessary.

Since we are aware of the Committees deep concern over the above issues. We are prepared to begin the engagement immediately. This is facilitated by the fact that the System 2190 software is currently in place on the Bureau of Data Processing System and that we have staff on site at M.S.R.S. We would expect the engagement to take four to six weeks to complete.

Based upon the approval of the Committee, Executive Director and the Board of Trustees of the workplan above we would be glad to provide an estimate of professional fees if M.S.R.S. decides to proceed.

* * * * *

Mr. Monks, we appreciate the opportunity to serve the Committee and look forward to working with you and the M.S.R.S. staff on this important project. If you have any questions please contact me at 774-5871.

Sincerely yours,

Gary E. Whitcomb
Senior Manager

Appendix H

MSRS and Department of Administration

MAINE STATE RETIREMENT SYSTEM
STATE HOUSE STATION 46 - AUGUSTA 04333

October 2, 1987

COPY

Charles Morrison, Commissioner
Department of Administration
State House Station #74

Dear Chip:

The Governor has commissioned a Task Force to study the Maine State Retirement System (MSRS) and make recommendations, if warranted, for its improvement. An issue raised during the deliberations of the Task Force has been the extent to which the Retirement System is subject to the Department of Administration. At present, my organization interfaces with the Bureaus of Human Resources, Data Processing, Purchasing, Public Improvements and the Office of Information Services.

Testimony provided to the Task Force indicates that the MSRS is required by statute to administer all personnel activities through the Bureau of Human Resources. However, it appears that similar legislation is absent regarding the remaining functions in the Department of Administration. Accordingly, this situation implies that the Board of Trustees has complete discretion in administering these functions without involvement of the respective Bureaus.

I raise this issue with you in an effort to elicit your comments and present them to the Task Force at its next meeting (October 16).

I would also ask your opinion regarding the issue of administering the personnel function. As indicated earlier, we are by statute subject to the rules and regulations of the Bureau of Human Resources. However, the Task Force is considering a recommendation that the Retirement System itself administer all personnel activities, subject to the State's master contract. This is in response to a number of concerns that have been raised during testimony. The intent of this recommendation is to provide the Retirement System with a more responsive and efficient system in administering its personnel requirements, which in part, are unique.

Again, I consider your comments to be extremely important regarding the aforementioned matters and look forward to receiving them. Certainly, if you have any questions regarding my request, please feel free to call.

Yours truly

Claude Perrier

Claude R. Perrier
Executive Director

CRP/lmc

cc: Mr. Robert Monks
Governor John McKernan

COPY

John R. McKernan, Jr.
Governor

Charles A. Morrison
Commissioner

DEPARTMENT OF ADMINISTRATION

Telephone (207) 289-4505

October 13, 1987

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STATE RETIREMENT SYSTEM

Claude R. Perrier,
Executive Director
Maine State Retirement System
Station #46
Augusta, Maine 04333

Dear Claude:

I am replying to your two letters of October 2nd. First, George Viles will represent me at the meeting on October 26th because I will be away from Augusta on that day.

On the other issue of separation of MSRS from State government administrative procedures, I do not believe possible (or wise) for several reasons. First, MSRS does not have an independent charter like FAME, MSHA, MTA, the University, etc. It is also not organized under an independent constitutional office. Therefore, its administrative procedures and operational requirements are driven the same as other executive agencies. To do otherwise would require a major policy decision by the Legislature.

Second, it would not be possible to have two separate systems governed by the same labor contract. Precedents set under one would have ramifications for the other.

Finally, MSRS was established in its current manner so it could take advantage of certain economies of scale. As I have discussed with you, I will pledge my cooperation to ensure that you get the administrative support you need. The new watchword of the Department of Administration is Customer Service and I will do all I can to see that we provide needed services in an effective and timely manner.

I'd be most happy to discuss these issues with you at your convenience.

Sincerely,

Charles A. Morrison
Commissioner

CAM/p

Appendix I

Allocation of Administrative Costs

MAINE STATE RETIREMENT SYSTEM

Date: July 22, 1987

To: Claude Perrier, Executive Director

From: Gus Webber, Financial Manager

Subject: Participating District Administrative Costs

The following is an estimate of administrative cost allocations of Participating Local Districts:

Personal Services (Includes Benefits)	- MSRS divisional employess time working on PD's. Actual time for Technicians and Clerk-Typists that work directly on PD's and estimated time for others working on PD and other MSRS members.
Actuarial Costs	- Actual amount paid by MSRS for actuarial costs applicable to PD's valuations. (Annual & Special)
MSA Payroll	- Amount based on percent of retired PD members to total members receiving retirement benefits.
Data Processing	- Data Processing costs, less MSA costs allocated above, based on 25% for PD's.
Rent	- The PD's portion of MSRS building rental expense based on $11.00 per square foot - 25% for PD
Capital Equipment	- 25% of total purchased in fiscal 87 - Using three year life.
Regular Operating Expenses	- Estimated Total $633,595 - 25% PD

Administrative Expense	Amount	Percent of Total Admin Expense
Personal Services	$372,238	30.5%
Actuarial Costs	87,269	47.9%
MSA Costs	61,792	29.0%
Data Processing	62,435	25.0%
Rent	18,962	25.0%
Capital Equipment	12,500	25.0%
Regular Operating	158,400	25.0%
TOTALS	$773,596	29.5% (Net percentage of total Administrative Costs)
Amount Received	395,575	(Fiscal 1987)
Difference	$378,021	

Appendix J

Drafts of Proposed Legislation

(EMERGENCY)
SECOND REGULAR SESSION

ONE HUNDRED AND THIRTEENTH LEGISLATURE

Legislative Document **No. 0**

STATE OF MAINE

IN THE YEAR OF OUR LORD
NINETEEN HUNDRED AND EIGHTY-EIGHT

AN ACT to Improve the Services Provided to the Members and Retirees of the Maine State Retirement System.

Emergency preamble. Whereas, Acts of the Legislature do not become effective until 90 days after adjournment unless enacted as emergencies; and

Whereas, the Committee to Study the Retirement System has recommended that the Maine State Retirement

System improve the level of services provided to members and retirees of the retirement system; and

Whereas, failure to authorize this expenditure for the automation of the retirement system will prevent the retirement system from overcoming a serious obstacle to improving service; and

Whereas, any delay in implementation will continue the decline in the quantity and quality of services provided to members and retirees; and

Whereas, in the judgment of the Legislature, these facts create an emergency within the meaning of the Constitution of Maine and require the following legislation as immediately necessary for the preservation of the public peace, health and safety; now, therefore,

Be it enacted by the People of the State of Maine as follows:

Allocation. The following funds are allocated from the Retirement Allowance Fund of the Maine State Retirement System to carry out the purposes of this Act.

	1987-88
MAINE STATE RETIREMENT SYSTEM, BOARD OF TRUSTEES OF THE	
Retirement System - Administration	
All Other	$ 400,000
Capital Expenditures	800,000
Total	$1,200,000

Allocates additional funds to the Expense Fund to automate the data storage and retrieval systems of the Maine State

Retirement System. These funds shall not lapse, but shall carry forward until June 30, 1989.

Emergency clause. In view of the emergency cited in the preamble, this Act shall take effect when approved.

FISCAL NOTE

This bill will reduce the amount of funds being invested in the Retirement Allowance Fund by $1,200,000. This will increase the unfunded liability of the Maine State Retirement System by approximately the same amount. The recognition of this unfunded liability will occur during the 1988 valuation of the system. Consequently, rates will be affected in fiscal year 1989-90.

The increase in rates will be allocated according to value of assets among participating local district plans, the teachers' retirement plan and state employee plan. The estimated additional cost to the State is approximately $36,000 in 1990 and increasing at 6% per year thereafter. This will increase contribution rates by less than 0.01% of payroll.

STATEMENT OF FACT

The Committee to Study the Retirement System has recommended that the Maine State Retirement System proceed as quickly as possible with plans to automate the data storage and retrieval systems. Every delay in implementing automation of the retirement system further erodes the ability of the system to deliver the quality of services members and retirees of the system deserve. This bill authorizes expenditures of funds from the Retirement Allowance Fund for this purpose.

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SECOND REGULAR SESSION

ONE HUNDRED AND THIRTEENTH LEGISLATURE

Legislative Document **No. 0**

STATE OF MAINE

IN THE YEAR OF OUR LORD
NINETEEN HUNDRED AND EIGHTY-EIGHT

AN ACT to Make Changes in the Administration of the Maine State Retirement System.

Be it enacted by the People of the State of Maine as follows:

Sec. 1. 2 MRSA §6, sub-§4, as repealed and replaced by PL 1987, c. 402, Pt. A, §3, is amended to read:

4. Range 88. The salaries of the following state officials and employees shall be within salary range 88:

State Purchasing Agent;

Director, Arts and Humanities Bureau;

Director, State Museum Bureau;

Director of the Bureau of Parks and Recreation;

State Director of Alcoholic Beverages;

~~Executive Director, Retirement System;~~

Director of Public Lands;

State Librarian;

Director of Employee Relations;

Director, Bureau of Air Quality Control;

Director, Bureau of Land Quality Control;

Director, Bureau of Water Quality Control; and

Director, Bureau of Oil and Hazardous Materials Control.

Sec. 2. 2 MRSA §6-D is enacted to read:

§6-D. Salaries of certain employees of the Maine State Retirement System

Notwithstanding Title 5, section 17105, subsection 3, paragraph C, the salaries of certain employees of the Maine State Retirement System shall be subject to this section.

1. Executive director. The salary of the

executive director shall be established by the Board of Trustees of the Maine State Retirement System and may not exceed the maximum rate of salary which may be received by a state employee.

2. Associate directors. The salaries of the associate directors shall be established by the Board of Trustees of the Maine State Retirement System and may not exceed the maximum rate of salary which may be received by a state employee.

Sec. 3. 5 MRSA §17102, sub-§1, ¶¶D and E, as enacted by PL 1985, c. 801, §§5 and 7, are amended to read:

D. ~~Three~~ Four persons appointed by the Governor and subject to review by the joint standing committee of the Legislature having jurisdiction over aging, veterans and retirement and to confirmation by the Legislature:

(1) At least ~~2~~ 3 shall be qualified through training or experience in the field of investments, accounting, banking, insurance or law; and

(2) One of whom shall be selected from a list or lists of ~~3~~ nominees submitted by the Maine Retired Teachers' Association, retired state employees, retired participating local district employees or by a committee comprised of representatives of those groups; and

E. A person who is a member of the retirement system through a participating local district and who shall be appointed by the governing body of the Maine Municipal Association~~; and~~.

Sec. 4. 5 MRSA 17102, sub-§1, ¶F, as enacted by PL 1985, c. 801, §§5 and 7, is repealed.

Sec. 5. Transition provision. Members of the Board of Trustees of the Maine State Retirement System who have been appointed to terms extending beyond the effective date of this Act shall continue to serve for their appointed terms of office and shall serve until their successors are appointed and qualified.

Sec. 6. Allocation. The following funds are allocated from the Expense Fund of the Maine State Retirement System to carry out the purposes of this Act.

	1988-89
MAINE STATE RETIREMENT SYSTEM, BOARD OF TRUSTEES OF THE	
Retirement System - Administration	
Positions	(2)
Personal Services	$150,000
Allocates funds for 2 new associate director positions and the potential salary upgrade of the executive director.	

FISCAL NOTE

This bill allocates an additional $150,000 in funds to be used by the Board of Trustees of the Maine State Retirement System to hire 2 new associate directors and to fund the potential increase in the executive director's salary.

The additional allocation will not affect contribution rates in fiscal year 1988-89. However, contribution rates beginning in fiscal year 1989-90 will increase by less than 0.02% of salaries to fund these increased administrative costs.

STATEMENT OF FACT

This bill implements some of the recommendations of the Committee to Study the Retirement System. It adds 2 associate director positions within the office of the executive director. These positions shall be unclassified, and the salaries set by the Board of Trustees of the Maine State Retirement System. However, the salaries are limited to those ranges provided for state employees.

In addition, this bill adjusts the selection process of the Board of Trustees of the Maine State Retirement System so that the retiree member selected by the board members would be selected by the Governor to represent the taxpayers. This more equitably balances the representation of taxpayers with the constituency groups. The remaining retiree member would be selected by the Governor from a list or lists representing all retirees of the system, not just from lists of retired teachers.

4893022588

(EMERGENCY)

SECOND REGULAR SESSION

ONE HUNDRED AND THIRTEENTH LEGISLATURE

Legislative Document **No. 0**

STATE OF MAINE

IN THE YEAR OF OUR LORD
NINETEEN HUNDRED AND EIGHTY-EIGHT

AN ACT to Establish Disability Retirement Benefits for Members of the Maine State Retirement System.

Emergency preamble. Whereas, Acts of the Legislature do not become effective until 90 days after adjournment unless enacted as emergencies; and

Whereas, the principal addition of this legislation is the provision for rehabilitation services to recipients of disability retirement benefits from the Maine State Retirement System; and

Whereas, this rehabilitation encouraging return to active service is in the best interest of both recipients of disability retirement benefits and employers; and

Whereas, in the judgment of the Legislature, these facts create an emergency within the meaning of the Constitution of Maine and require the following legislation as immediately necessary for the preservation of the public peace, health and safety; now, therefore,

Be it enacted by the People of the State of Maine as follows:

Sec. 1. 5 MRSA §17106, sub-§3, ¶¶C and D, as enacted by PL 1985, c. 801, §§5 and 7, are amended to read:

C. Assist the executive director in determining if a disability review of a recipient of a disability allowance is warranted; ~~and~~

D. Inform the executive director and board in writing of its view as to the existence of a disability entitling an applicant to benefits under chapter 423, subchapter V, ~~article~~ articles 3 or 3-A, or chapter 425, subchapter V, ~~article~~ articles 3~~.~~ or 3-A; and

Sec. 2. 5 MRSA §17106, sub-§3, ¶E is enacted to read:

E. Make recommendations to the executive director and board to determine if rehabilitation services should be provided to a person who is the recipient of a disability retirement benefit under chapter 423, subchapter V, article 3-A, or chapter 425, subchapter V, article 3-A.

Sec. 3. 5 MRSA §17152, as enacted by PL 1985, c. 801, §§5 and 7, is amended to read:

§17152. Funds

All of the assets of the retirement system shall be credited according to the purpose for which they are held among ~~5~~ 7 funds, namely:

1. Members' Contribution Fund. The Members' Contribution Fund;

2. Retirement Allowance Fund. The Retirement Allowance Fund;

3. Expense Fund. The Expense Fund;

4. Survivors' Benefit Fund. The Survivors' Benefit Fund; ~~and~~

5. State Retiree Health Insurance Fund. The State Retiree Health Insurance Fund~~.~~;

6. State Retired Teachers' Health Insurance Fund. The State Retired Teachers' Health Insurance Fund; and

7. Disability Retirement Benefit Fund. The Disability Retirement Benefit Fund.

Sec. 4. 5 MRSA §17251, as enacted by PL 1985, c. 801, §§5 and 7, is amended to read:

§17251. Establishment

The Retirement Allowance Fund is established in which shall be accumulated all reserves required for the payment of benefits under this Part, other than reserves in the Members' Contribution Fund ~~and~~, the Survivors' Benefit Fund and the Disability Retirement Benefit Fund.

Sec. 5. 5 MRSA c. 421, sub-c. IV, art. 8 is enacted to read:

ARTICLE 8. DISABILITY RETIREMENT BENEFIT FUND

§17421. Establishment

The Disability Retirement Benefit Fund is established in which shall be accumulated all reserves required for the payment of disability retirement benefits and other costs as set forth in chapter 423, articles 3 and 3-A and chapter 425, subchapter V, articles 3 and 3-A. The fund shall include an account for the accumulated contributions of former members who are recipients of disability retirement benefits under this article.

§17422. Disability contribution

For each member, the State and those participating local districts which have elected disability retirement benefits under chapter 425, article 3 or 3-A shall pay annually into the Disability Retirement Benefit Fund an amount equal to a certain percentage of the annual earnable compensation of the member, to be known as the "disability contribution."

§17423. Disability contribution rate

The percentage rate of the disability contribution, described in section 17422, shall be fixed on the basis of the liabilities established by chapter 423, subchapter V, articles 3 and 3-A and chapter 425, subchapter V, articles 3 and 3-A. There shall be one percentage rate applicable to all employers whose employees are covered by chapter 423, subchapter V, article 3-A and chapter 425, subchapter V, article 3-A.

Sec. 6. 5 MRSA §17755, as enacted by PL 1985, c. 801, §§5 and 7, is amended to read:

§17755. Disability retirement service credit

A beneficiary shall receive service credit for the purpose of determining benefits under this Part for the period following termination of service for which he receives disability retirement benefits under subchapter V, ~~article~~ articles 3 and 3-A.

Sec. 7. 5 MRSA §17901-A is enacted to read:

§17901-A. Applicability

This article applies to all disabilities which occur before July 1, 1988. All disabilities which occur after June 30, 1988 are subject to article 3-A.

Sec. 8. 5 MRSA c. 423, sub-c. V, art. 3-A is enacted to read:

ARTICLE 3-A. DISABILITY RETIREMENT BENEFITS AFTER JUNE 30, 1988

§17921. Definitions

As used in this article, unless the context otherwise indicates, the following terms have the following meanings.

1. Disabled. "Disabled" means that the member is mentally or physically incapacitated under the following conditions:

A. Which incapacity can be expected to be permanent;

B. To the extent that it is impossible to perform the duties of the member's employment position;

C. After the incapacity has continued for 2 years, the incapacity must render the member unable to engage in any substantially gainful activity for which the member is qualified by training, education or experience; and

D. So that the incapacity will be revealed by examinations or tests conducted in accordance with section 17926.

§17922. Applicability

This article applies to all disabilities which occur after June 30, 1988.

§17923. Statement of health

1. Statement required. Any person who becomes a member of the retirement system on or after July 1, 1988, shall submit a statement of that person's health to the executive director on forms prescribed by the executive director.

2. Additional information. If the executive director determines that additional information is necessary to determine the extent of any preexisting disability of the member, the executive director may require that the member undergo medical and, when appropriate, psychological examinations or tests with the results submitted as evidence of the member's health. Any examinations or tests under this subsection are governed by section 17926.

3. Limitation on use. The statement of health or the results of examinations or tests may be used only to determine eligibility for a disability retirement benefit under section 17924, subsection 2.

4. Sanction. Any member who is required to submit a statement of health under this section and who does not submit the statement before applying for disability retirement benefits is not eligible to receive those benefits unless that member establishes to the satisfaction of the executive director that the member meets the requirements of section 17924, subsection 2.

§17924. Qualification for benefit

1. Qualification. Except as provided in subsection 2, a member qualifies for a disability retirement benefit if disabled:

A. While in service; and

B. Before reaching the normal retirement age.

2. Exception. A member with fewer than 5 years of continuous creditable service immediately preceding that member's application for a disability retirement benefit is not eligible for that benefit if the

disability is the result of a physical or mental condition which existed before the member's latest membership in the retirement system, unless the disability is a result of, or has been substantially aggravated by, an injury or accident received in the line of duty.

§17925. Application

In order to receive a benefit under this article:

1. Written application. The member must apply in writing to the executive director in the format specified by the executive director.

A. The executive director shall submit the application and all pertinent medical and psychological information to the medical board for review as required by section 17106, subsection 3.

B. As required by section 17106, the medical board shall make a recommendation as to whether or not the member should be provided vocational rehabilitation services;

2. Workers' compensation. If the incapacity upon which the application is based is a result of an injury or accident received in the line of duty, the application must include proof that the member has made application for benefits under the workers' compensation laws; and

3. Approval. The written application must be approved by the executive director upon finding that the member has met the requirements of section 17924.

§17926. Examinations or tests

Any examinations or tests recommended by the medical board in accordance with section 17106 or required by the executive director under section 17921, subsection 1, paragraph D; section 17923, subsection 2; section 17924; section 17929, subsection 2, paragraph B; or section 17933, subsection 3, paragraph A are governed as follows.

1. Agreed upon physician. The examinations or tests shall be conducted by a qualified physician and, when appropriate, a qualified psychologist mutually agreed upon by the executive director and the member claiming to be disabled.

2. Agreed upon place. The examinations or tests shall be conducted at a place mutually agreed upon by the executive director and the member claiming to be disabled.

3. Costs. The costs incurred under subsections 1 and 2 shall be paid by the retirement system.

§17927. Rehabilitation

Upon recommendations from the medical board, rehabilitation services shall be provided to any person who is the recipient of a disability retirement benefit under this article. Services shall be provided by private and public rehabilitation counselors, governmental agencies and others approved by the executive director as qualified to provide rehabilitation services. The executive director shall consider a rehabilitation counselor's rate of successfully placing rehabilitated employees in jobs relative to the placement rates of other counselors in the State as fundamental in deciding whether to approve the counselor as qualified.

1. Rehabilitation plan. If rehabilitation is feasible and recommended, the retirement system shall designate a rehabilitation provider to evaluate the person and develop a rehabilitation plan.

2. Costs. The executive director may contract with rehabilitation providers to develop and carry out approved rehabilitation plans.

A. Except as provided in paragraph B, the executive director may pay these providers from funds accumulated in the Disability Retirement Benefit Fund.

B. If the person is entitled to other benefits to meet the cost of vocational rehabilitation services, that person must first apply for and use those benefits to the extent available to pay for the goods and services provided.

3. Approval of rehabilitation plan. The executive director shall approve any rehabilitation plan the executive director finds to be in the person's best interest and consistent with the purposes of this article. The person and the executive director shall indicate in writing their approval of and agreement to the submitted rehabilitation plan. The person shall approve the plan within 30 days or, within that time period, submit to the executive director the name of an alternate provider for the executive director's consideration. If the rehabilitation plan includes return to employment with the employer for whom the person worked before becoming disabled, the employer shall also indicate in writing approval of the plan.

4. Decline of rehabilitation. If, after recommendation by the medical board, a person declines use of the rehabilitation services offered or refuses to agree to a rehabilitation plan approved by the executive director, the disability retirement benefit payments shall cease at the end of the month following the decline or refusal.

A. The executive director shall notify the person in writing of the decision to discontinue the disability retirement benefit.

B. The decision shall be subject to appeal under section 17451.

5. Return to service. If the rehabilitation plan includes return to employment with the person's former employer, that person shall be reemployed in accordance with the plan. If the plan does not include reemployment with the former employer, the executive director shall notify the former employer, in writing, that the person has completed the rehabilitation plan and is ready to return to

employment. The former employer shall reemploy the person in the first available position for which that person is qualified, taking into consideration that person's training, education and experience, including that person's rehabilitation plan.

6. Other employment under system. If the former employer has not reemployed the person before the expiration of 3 months, the executive director shall inform all other employers whose employees are covered by this article and chapter 425, subchapter V, article 3-A, of the availability of the person and solicit their assistance in finding employment for that person.

§17928. Computation of benefit

When a member qualified under section 17924 retires, after approval for disability retirement by the executive director in accordance with section 17925, the member shall receive a disability retirement benefit equal to 66 2/3% of that member's average final compensation.

§17929. Payment of benefit

1. Beginning. Payment of disability retirement benefits shall begin on the first day of the month following the date of termination of active service of the member, but not more than 6 months before the date of receipt by the executive director of the written application, by or on behalf of the member, for disability retirement, unless it is shown that:

A. It was not reasonably possible to file the application for disability retirement benefits within the 6-month period; and

B. The application was made as soon as was reasonably possible.

2. Cessation. Payment of disability retirement benefits shall continue as long as a person is disabled, except that:

A. The disability retirement benefit ceases and a service retirement benefit begins:

(1) On the 10th anniversary of the person's normal retirement age, as defined in section 17001, subsection 23; or

(2) When the service retirement benefit of a person equals or exceeds the amount of the disability retirement benefit, if that occurs before the date in subparagraph (1).

(a) When calculating the person's service retirement benefit, the average final compensation shall be the average final compensation at the time that person terminated from active service before receiving disability retirement benefits adjusted by the same percentage adjustments, if any, that were applied to the disability retirement benefits under section 17806.

(b) The person shall receive service credit for the purpose of determining benefits under this Part for the period following termination of service for which that person receives disability retirement benefits under this article; and

B. After the disability has continued for 2 years, the disability must render the person unable to engage in any substantially gainful activity for which the person is qualified by training, education or experience.

(1) The executive director may require, once each year, that the person undergo examinations or tests, conducted in accordance with section 17926, to determine the person's disability.

(2) If the person refuses to submit to the examinations or tests under subparagraph (1), the disability retirement benefit shall be

discontinued until that person withdraws the refusal.

(3) If the person's refusal under subparagraph (2) continues for one year, all rights to any further benefits under this article shall cease.

(4) If it is determined, on the basis of the examinations or tests under subparagraph (1), that the disability of a person no longer exists, the payment of the disability retirement benefit shall cease.

§17930. Reduction in amount of benefit

1. Definition. As used in this section, unless the context otherwise indicates, "adjusted final compensation" means the present rate of pay of an employee in the position in which the person was employed immediately before termination and becoming a recipient of a disability retirement benefit.

2. Compensation from employment not covered by this article. If any person who is the recipient of a disability retirement benefit is reemployed by an employer whose employees are not covered by this article and if the total of the person's monthly disability retirement benefit for any year and the person's total earnable compensation for that year exceeds the person's average final compensation at the time that person became a recipient of a disability retirement benefit, increased or decreased by the same percentage adjustments as have been granted by section 17806:

A. The excess shall be deducted from the disability or service retirement benefits during the next calendar year, the deductions to be prorated on a monthly basis in an equitable manner prescribed by the board over the year or part of the year for which the benefits are received;

B. The person shall reimburse the retirement system for any excess payments not deducted under paragraph A. If the retirement benefit payments are eliminated by this subsection, the disability shall be deemed to no longer exist, the payments of the disability retirement benefit shall be discontinued and, except as provided in paragraph D, all of the person's rights to benefits under this article shall cease;

C. If, during the first 5 years of reemployment, the person again becomes disabled, terminates employment and is not covered by any other disability program, the retirement system shall resume paying the disability retirement benefit payable prior to the reemployment with all applicable cost-of-living adjustments. The executive director shall require examinations or tests to determine whether the person is disabled as described in section 17921; and

D. At any time before the elimination of disability retirement benefit payments by this subsection, the person may request that benefit payments be terminated and the executive director shall terminate benefit payments at the end of the month in which the request is received.

3. Compensation from employment covered by this article. If any person who is the recipient of a disability retirement benefit is reemployed by that person's prior employer or any other employer whose employees are covered by this article and if the total of the person's disability benefit for any year and the person's total earnable compensation for that year exceeds the adjusted final compensation:

A. The disability or service retirement benefits will be reduced during the next calendar year by the amount that the total compensation exceeds the adjusted final compensation;

B. The deductions shall be prorated on a monthly basis in an equitable manner prescribed by the board over the year or part of the year during which the benefits are received;

C. The person shall reimburse the retirement system for any excess payments not deducted under paragraph A;

D. If the retirement benefit payments are eliminated by this subsection:

(1) The person shall again become a member of the retirement system and begin contributing at the current rate; and

(2) When the person again retires, the person shall receive benefits computed on the basis of that person's entire creditable service and in accordance with the law in effect at that time;

E. If, during the first 5 years of reemployment, the person again becomes disabled and terminates employment, the retirement system shall resume paying the disability retirement benefit payable prior to the reemployment with all applicable cost-of-living adjustments, or, if greater, a disability retirement benefit based upon the person's current average final compensation. The executive director shall require examinations or tests to determine whether the person is disabled as described in section 17921; and

F. At any time before the elimination of disability retirement benefit payments by this subsection, the person may request that benefit payments be terminated and the executive director shall terminate benefit payments at the end of the month in which the request is received.

4. Disability payments under other laws. The reduction of disability retirement benefits because of disability benefits received under other laws is governed as follows.

A. The amount of any disability retirement benefit payable under this article shall be reduced by any amount received by the person for the same disability under either or both of the following:

(1) The workers' compensation or similar laws, except amounts which may be paid or payable under Title 39, section 56 or 56-A; or

(2) The United States Social Security Act, if the employment for which creditable service with the employer is allowed was also covered under that Act at the date of disability retirement.

B. The reduction in the disability retirement benefit shall be the amount necessary to make the total of the initial disability retirement benefit, not including adjustments under section 17806, plus the offset amounts of workers' compensation and social security benefits, as limited under paragraph A, equal to 80% of average final compensation.

C. The disability retirement benefit may not be reduced below the amount of the retirement benefit which is the actuarial equivalent of the member's accumulated contributions at the time of retirement.

D. Lump-sum settlements of benefits that would reduce the disability retirement benefit under this subsection shall be prorated on a monthly basis in an equitable manner prescribed by the board.

(1) These prorated lump-sum settlements may not include any part of the lump-sum settlement attributable to rehabilitation, attorneys' fees, physicians', nurses', hospital, medical, surgical or related fees or charges or any amount paid or payable under Title 39, section 56 or 56-A.

(2) These prorated lump-sum settlements shall reduce the disability retirement benefit in the same manner and amount as monthly benefits under this subsection.

E. Any dispute about amounts paid or payable under workers' compensation or about the amount of the lump-sum settlement and its proration shall be determined on petition by a single member of the Workers' Compensation Commission in accordance with Title 39. These determinations may be appealed under Title 39, section 103-B.

§17931. Statement of compensation

1. Requirement. The executive director shall require each person who is the recipient of a disability retirement benefit to submit, each calendar year, a statement of compensation received from any gainful occupation during that year.

2. Failure to submit statement. Failure to submit the statement under subsection 1 shall result in the following:

A. If the person fails to submit the statement required under subsection 1 within 30 days of receipt of the executive director's request for the statement, the disability retirement benefit shall be discontinued until the statement is submitted; or

B. If the person fails to submit the statement required under subsection 1, within one year of receipt of the executive director's request for the statement, all rights to further benefits shall cease.

§17932. Voluntary return to service

1. Right to reinstatement. If a person who is the recipient of a disability retirement benefit decides that the person is no longer incapacitated and is able to perform the duties of that person's employment position, the employer for whom the person last worked before becoming disabled shall reinstate the person to the first available position for which the person is qualified and which is consistent with the person's prior work experience. If a collective

bargaining agreement applies to such a position, the employer may offer only a position which the person could claim by virtue of the seniority accumulated at the time of the disability.

2. Dispute over mental or physical capacity. If there is a dispute between the person and the former employer over the person's mental or physical capacity to perform a specific job, at the option of the person that dispute shall be resolved by the majority of 3 physicians, one appointed and reimbursed by the person, one appointed and reimbursed by the employer and one appointed by the executive director and reimbursed by the retirement system.

3. Termination or reduction in benefits. At any time before the elimination of disability retirement benefit payments under section 17930, subsection 3, the person may request that benefit payments be terminated and the executive director shall terminate benefit payments at the end of the month in which the request is received.

4. Reinstatement of benefits. If, during the first 5 years of reinstatement, the person again becomes disabled and terminates employment, the retirement system shall resume paying the disability retirement benefit payable before the reinstatement with all applicable cost-of-living adjustments, or, if greater, a disability retirement benefit based upon the person's current average final compensation. The executive director may require examinations or tests to determine whether the person is disabled under section 17921.

§17933. Service retirement

1. Average final compensation. The service retirement benefit of a person who returns to employment with that person's former employer or any other employer whose employees are covered by this article or chapter 425, subchapter V, article 3-A, after having been the recipient of a disability retirement benefit, will be computed in its entirety using the average final compensation as defined by

section 17001, subsection 4, on the date of that person's termination from service immediately before becoming the recipient of a service retirement benefit.

2. Costs of benefits. The cost of benefits based upon service credits earned before and during disability shall be charged to the Disability Retirement Benefit Fund. The cost of benefits based upon service credits earned after becoming reemployed shall be charged to the account of the employer through whom the service credits were earned.

3. Special plans. The service credits earned after return to employment by a person who was employed under a special plan before becoming the recipient of a disability retirement benefit may be credited toward completing the service requirements for retirement under that special plan. As used in this section, unless the context otherwise indicates, "special plan" means any of the retirement programs in section 17851, subsections 4 to 11 or section 18453, subsections 2 to 9.

A. The executive director may require, once each year, that the member undergo examinations or tests, conducted in accordance with section 17926, to determine that the member is still disabled to the extent that it is impossible to perform the duties of that member's former employment position.

B. If the member refuses to submit to the examinations or tests under paragraph A, the service credits earned after that date shall be based upon the plan applicable to the position in which the member is currently employed.

C. If it is determined, on the basis of the examinations or tests under paragraph A, that the member is no longer disabled to the extent that it is impossible to perform the duties of the former employment position, the member shall:

(1) Return to employment in a position covered by the same special plan, or a comparable special plan, that covered the

former employment position; or

(2) Remain in the current employment position and have the service credits earned thereafter based upon the plan applicable to the position in which the member is currently employed.

Sec. 9. 5 MRSA §18355, as enacted by PL 1985, c. 801, §§5 and 7, is amended to read:

§18355. Disability retirement service credit

A beneficiary shall receive service credit for the purpose of determining benefits under this Part for the period following termination of service for which he receives disability retirement benefits under subchapter V, ~~article~~ articles 3 and 3-A.

Sec. 10. 5 MRSA §18501-A is enacted to read:

§18501-A. Applicability

This article applies to all disabilities which occur before July 1, 1988. All disabilities which occur after June 30, 1988 are subject to article 3-A.

Sec. 11. 5 MRSA c. 425, sub-c. V, art. 3-A is enacted to read:

ARTICLE 3-A. DISABILITY RETIREMENT BENEFITS AFTER JUNE 30, 1988

§18521. Definitions

As used in this article, unless the context otherwise indicates, the following terms have the following meanings.

1. Disabled. "Disabled" means that the member is mentally or physically incapacitated under the following conditions:

A. Which incapacity can be expected to be permanent;

B. To the extent that it is impossible to perform the duties of the member's employment position;

C. After the incapacity has continued for 2 years, the incapacity must render the member unable to engage in any substantially gainful activity for which the member is qualified by training, education or experience; and

D. So that the incapacity will be revealed by examinations or tests conducted in accordance with section 18526.

§18522. Applicability

This article applies to all disabilities which occur after June 30, 1988.

§18523. Statement of health

1. Statement required. Any person who becomes a member of the retirement system on or after July 1, 1988, shall submit a statement of health to the executive director on forms prescribed by the executive director.

2. Additional information. If the executive director determines that additional information is necessary to determine the extent of any preexisting disability of the member, the executive director may require that the member undergo medical and, when appropriate, psychological examinations or tests with the results submitted as evidence of the member's health. Any examinations or tests under this subsection are governed by section 18526.

3. Limitation on use. The statement of health or the results of examinations or tests may be used only to determine eligibility for a disability retirement benefit under section 18524, subsection 2.

4. Sanction. Any member who is required to submit a statement of health under this section and who does not submit the statement before applying for

disability retirement benefits is not eligible to receive those benefits unless that member establishes to the satisfaction of the executive director that that member meets the requirements of section 18524, subsection 2.

§18524. Qualification for benefit

1. Qualification. Except as provided in subsection 2, a member qualifies for a disability retirement benefit if disabled:

A. While in service; and

B. Before reaching the normal retirement age.

2. Exception. A member with fewer than 5 years of continuous creditable service immediately preceding an application for a disability retirement benefit is not eligible for that benefit if the disability is the result of a physical or mental condition which existed before the member's latest membership in the retirement system, unless the disability is a result of, or has been substantially aggravated by, an injury or accident received in the line of duty.

§18525. Application

In order to receive a benefit under this article:

1. Written application. The member must apply in writing to the executive director in the format specified by the executive director;

A. The executive director shall submit the application and all pertinent medical and psychological information to the medical board for review as requird by section 17106, subsection 3.

B. As required by section 17106, the medical board shall make a recommendation as to whether or not the member should be provided vocational rehabilitation services;

2. Workers' compensation. If the incapacity upon

which the application is based is a result of an injury or accident received in the line of duty, the application must include proof that the member has made application for benefits under the workers' compensation laws; and

3. Approval. The written application must be approved by the executive director upon finding that the member has met the requirements of section 18524.

§18526. Examinations or tests

Any examinations or tests, recommended by the medical board in accordance with section 17106 or required by the executive director, under section 18521, subsection 1, paragraph D; section 18523, subsection 2; section 18524; section 18529, subsection 2, paragraph B; or section 18533, subsection 3, paragraph A are governed as follows.

1. Agreed upon physician. The examinations or tests shall be conducted by a qualified physician and, when appropriate, a qualified psychologist mutually agreed upon by the executive director and the member claiming to be disabled.

2. Agreed upon place. The examinations or tests shall be conducted at a place mutually agreed upon by the executive director and the member claiming to be disabled.

3. Costs. The costs incurred under subsections 1 and 2 shall be paid by the retirement system.

§18527. Rehabilitation

Upon recommendations from the medical board, rehabilitation services shall be provided to any person who is the recipient of a disability retirement benefit under this article. Services shall be provided by private and public rehabilitation counselors, governmental agencies and others approved by the executive director as qualified to provide rehabilitation services. The executive director shall consider a rehabilitation counselor's rate of successfully placing rehabilitated employees in jobs relative to the placement rates of other counselors in the State as fundamental in deciding whether to approve the counselor as qualified.

1. Rehabilitation plan. If rehabilitation is recommended, the retirement system shall designate a rehabilitation provider to evaluate the person and develop a rehabilitation plan.

2. Costs. The executive director may contract with rehabilitation providers to develop and carry out approved rehabilitation plans.

A. Except as provided in paragraph B, the executive director may pay these providers from funds accumulated in the Disability Retirement Benefit Fund.

B. If the person is entitled to other benefits to meet the cost of vocational rehabilitation services, that person must first apply for and use those benefits to the extent available to pay for the goods and services provided.

3. Approval of rehabilitation plan. The executive director shall approve any rehabilitation plan found to be in the person's best interest and consistent with the purposes of this article. The person and the executive director shall indicate in writing their approval of and agreement to the submitted rehabilitation plan. The person shall approve the plan within 30 days or, within that time period, submit to the executive director the name of an alternate provider for the executive director's consideration. If the rehabilitation plan includes return to employment with the employer for whom the person worked before becoming disabled, the employer shall also indicate in writing approval of the plan.

4. Decline of rehabilitation. If, after recommendation by the medical board, a person declines use of the rehabilitation services offered or refuses to agree to a rehabilitation plan approved by the executive director, the disability retirement benefit

payments shall cease at the end of the month following the decline or refusal.

A. The executive director shall notify the person in writing of the decision to discontinue the disability retirement benefit.

B. The decision shall be subject to appeal under section 17451.

5. Return to service. If the rehabilitation plan includes return to employment with the person's former employer, that person shall be reemployed in accordance with the plan. If the plan does not include reemployment with the former employer, the executive director shall notify the former employer, in writing, that the person has completed the rehabilitation plan and is ready to return to employment. The former employer shall reemploy the person in the first available position for which that person is qualified, taking into consideration training, education and experience, including that person's rehabilitation plan.

6. Other employment under system. If the former employer has not reemployed the person before the expiration of 3 months, the executive director shall inform all other employers whose employees are covered by this article and chapter 423, subchapter V, article 3-A, of the availability of the person and solicit their assistance in finding employment for that person.

§18528. Computation of benefit

When a member qualified under section 18524 retires, after approval for disability retirement by the executive director in accordance with section 18525, the member shall receive a disability retirement benefit equal to 66 2/3% of that member's average final compensation.

§18529. Payment of benefit

1. Beginning. Payment of disability retirement benefits shall begin on the first day of the month

following the date of termination of active service of the member, but not more than 6 months before the date of receipt by the executive director of the written application, by or on behalf of the member, for disability retirement, unless it is shown that:

A. It was not reasonably possible to file the application for disability retirement benefits within the 6-month period; and

B. The application was made as soon as was reasonably possible.

2. Cessation. Payment of disability retirement benefits shall continue as long as a person is disabled, except that:

A. The disability retirement benefit ceases and a service retirement benefit begins:

(1) On the 10th anniversary of the person's normal retirement age, as defined in section 17001, subsection 23; or

(2) When the service retirement benefit of a person equals or exceeds the amount of the disability retirement benefit, if that occurs before the date in subparagraph (1).

(a) When calculating the person's service retirement benefit, the average final compensation shall be the average final compensation at the time that person terminated from active service before receiving disability retirement benefits adjusted by the same percentage adjustments, if any, that were applied to the disability retirement benefits under section 18407.

(b) The person shall receive service credit for the purpose of determining benefits under this Part for the period following termination of service for which that person receives disability retirement benefits under this article; and

B. After the disability has continued for 2 years, the disability must render the person unable to engage in any substantially gainful activity for which the person is qualified by training, education or experience.

(1) The executive director may require, once each year, that the person undergo examinations or tests, conducted in accordance with section 18526, to determine the person's disability.

(2) If the person refuses to submit to the examinations or tests under subparagraph (1), the disability retirement benefit shall be discontinued until that person withdraws the refusal.

(3) If the person's refusal under subparagraph (2) continues for one year, all rights to any further benefits under this article shall cease.

(4) If it is determined, on the basis of the examinations or tests under subparagraph (1), that the disability of a person no longer exists, the payment of the disability retirement benefit shall cease.

§18530. Reduction in amount of benefit

1. Definition. As used in this section, unless the context otherwise indicates, "adjusted final compensation" means the present rate of pay of the employee in the position in which the person was employed immediately before termination and becoming a recipient of a disability retirement benefit.

2. Compensation from employment not covered by this article. If any person who is the recipient of a disability retirement benefit is remployed by an employer whose employees are not covered by this

article and if the total of the person's monthly disability retirement benefit for any year and the person's total earnable compensation for that year exceeds the person's average final compensation at the time that person became a recipient of a disability retirement benefit, increased or decreased by the same percentage adjustments as have been granted by section 17806:

A. The excess shall be deducted from the disability or service retirement benefits during the next calendar year, the deductions to be prorated on a monthly basis in an equitable manner prescribed by the board over the year or part of the year for which the benefits are received;

B. The person shall reimburse the retirement system for any excess payments not deducted under paragraph A. If the retirement benefit payments are eliminated by this subsection, the disability shall be deemed to no longer exist, the payments of the disability retirement benefit shall be discontinued and, except as provided in paragraph D, all of the person's rights to benefits under this article shall cease;

C. If, during the first 5 years of reemployment, the person again becomes disabled, terminates employment and is not covered by any other disability program, the retirement system shall resume paying the disability retirement benefit payable prior to the reemployment with all applicable cost-of-living adjustments. The executive director shall require examinations or tests to determine whether the person is disabled as described in section 18521; and

D. At any time before the elimination of disability retirement benefit payments by this subsection, the person may request that benefit payments be terminated and the executive director shall terminate benefit payments at the end of the month in which the request is received.

3. Compensation from employment covered by this

article. If any person who is the recipient of a disability retirement benefit is reemployed by that person's prior employer or any other employer whose employees are covered by this article and if the total of the person's disability benefit for any year and the person's total earnable compensation for that year exceeds the adjusted final compensation:

A. The disability or service retirement benefits will be reduced during the next calendar year by the amount that the total compensation exceeds the adjusted final compensation;

B. The deductions shall be prorated on a monthly basis in an equitable manner prescribed by the board over the year or part of the year during which the benefits are received;

C. The person shall reimburse the retirement system for any excess payments not deducted under paragraph A;

D. If the retirement benefit payments are eliminated by this subsection:

(1) The person shall again become a member of the retirement system and begin contributing at the current rate; and

(2) When the person again retires, the person shall receive benefits computed on the basis of that person's entire creditable service and in accordance with the law in effect at that time;

E. If, during the first 5 years of reemployment, the person again becomes disabled and terminates employment, the retirement system shall resume paying the disability retirement benefit payable prior to the reemployment with all applicable cost-of-living adjustments, or, if greater, a disability retirement benefit based upon the person's current average final conmpensation. The executive director shall require examinations or tests to determine whether the person is disabled as described in section 18521; and

F. At any time before the elimination of disability retirement benefit payments by this subsection, the person may request that benefit payments be terminated and the executive director shall terminate benefit payments at the end of the month in which the request is received.

4. Disability payments under other laws. The reduction of disability retirement benefits because of disability benefits received under other laws is governed as follows.

A. The amount of any disability retirement benefit payable under this article shall be reduced by any amount received by the person for the same disability under either or both of the following:

(1) The workers' compensation or similar laws, except amounts which may be paid or payable under Title 39, section 56 or 56-A; or

(2) The United States Social Security Act, if the employment for which creditable service with the employer is allowed was also covered under that Act at the date of disability retirement.

B. The reduction in the disability retirement benefit shall be the amount necessary to make the total of the initial disability retirement benefit, not including adjustments under section 17806, plus the offset amounts of workers' compensation and social security benefits, as limited under paragraph A, equal to 80% of average final compensation.

C. The disability retirement benefit may not be reduced below the amount of the retirement benefit which is the actuarial equivalent of the member's accumulated contributions at the time of retirement.

D. Lump-sum settlements of benefits that would reduce the disability retirement benefit under this subsection shall be prorated on a monthly basis in an equitable manner prescribed by the board.

(1) These prorated lump-sum settlements may not include any part of the lump-sum settlement attributable to rehabilitation, attorneys' fees, physicians', nurses', hospital, medical, surgical or related fees or charges or any amount paid or payable under Title 39, section 56 or 56-A.

(2) These prorated lump-sum settlements shall reduce the disability retirement benefit in the same manner and amount as monthly benefits under this subsection.

E. Any dispute about amounts paid or payable under workers' compensation or about the amount of the lump-sum settlement and its proration shall be determined on petition by a single member of the Workers' Compensation Commission in accordance with Title 39. These determinations may be appealed under Title 39, section 103-B.

§18531. Statement of compensation

1. Requirement. The executive director shall require each person who is the recipient of a disability retirement benefit to submit, each calendar year, a statement of compensation received from any gainful occupation during that year.

2. Failure to submit statement. Failure to submit the statement under subsection 1 shall result in the following:

A. If the person fails to submit the statement required under subsection 1 within 30 days of receipt of the executive director's request for the statement, the disability retirement benefit shall be discontinued until the statement is submitted; or

B. If the person fails to submit the statement required under subsection 1, within one year of receipt of the executive director's request for the statement, all rights to further benefits shall cease.

§18532. Voluntary return to service

1. Right to reinstatement. If a person who is the recipient of a disability retirement benefit decides that the person is no longer incapacitated and is able to perform the duties of that person's employment position, the employer for whom the person last worked before becoming disabled shall reinstate the person to the first available position for which the person is qualified and which is consistent with the person's prior work experience. If a collective bargaining agreement applies to such a position, the employer may offer only a position which the person could claim by virtue of the seniority accumulated at the time of the disability.

2. Dispute over mental or physical capacity. If there is a dispute between the person and the former employer over the person's mental or physical capacity to perform a specific job, at the option of the person that dispute shall be resolved by the majority of 3 physicians, one appointed and reimbursed by the person, one appointed and reimbursed by the employer and one appointed by the executive director and reimbursed by the retirement system.

3. Termination or reduction in benefits. At any time before the elimination of disability retirement benefit payments under section 18530, subsection 3, the person may request that benefit payments be terminated and the executive director shall terminate benefit payments at the end of the month in which the request is received.

4. Reinstatement of benefits. If, during the first 5 years of reinstatement, the person again becomes disabled and terminates employment, the retirement system shall resume paying the disability

retirement benefit payable before the reinstatement with all applicable cost-of-living adjustments, or, if greater, a disability retirement benefit based upon the person's current average final compensation. The executive director may require examinations or tests to determine whether the person is disabled under section 18521.

§18533. Service retirement

1. Average final compensation. The service retirement benefit of a person who returns to employment with that person's former employer or any other employer whose employees are covered by this article or chapter 423, subchapter V, article 3-A, after having been the recipient of a disability retirement benefit, will be computed in its entirety using the average final compensation as defined by section 17001, subsection 4, on the date of that person's termination from service immediately before his becoming the recipient of a service retirement benefit.

2. Costs of benefits. The cost of benefits based upon service credits earned before and during disability shall be charged to the Disability Retirement Benefit Fund. The cost of benefits based upon service credits earned after becoming reemployed shall be charged to the account of the employer through whom the service credits were earned.

3. Special plans. The service credits earned after return to employment by a person who was employed under a special plan before becoming the recipient of a disability retirement benefit may be credited toward completing the service requirements for retirement under that special plan. As used in this section, unless the context otherwise indicates, "special plan" means any of the retirement programs in section 17851, subsections 4 to 11 or section 18453, subsections 2 to 9.

A. The executive director may require, once each year, that the member undergo examinations or tests, conducted in accordance with section 18526, to determine that the member is still disabled to the extent that it is impossible to perform the duties of that member's former employment position.

B. If the member refuses to submit to the examinations or tests under paragraph A, the service credits earned thereafter shall be based upon the plan applicable to the position in which the member is currently employed.

C. If it is determined, on the basis of the examinations or tests under paragraph A, that the member is no longer disabled to the extent that it is impossible to perform the duties of the former employment position, the member shall:

(1) Return to employment in a position covered by the same special plan, or a comparable special plan, that covered the former employment position; or

(2) Remain in the current employment position and have the service credits earned thereafter based upon the plan applicable to the position in which the member is currently employed.

Emergency clause. In view of the emergency cited in the preamble, this Act shall take effect when approved.

STATEMENT OF FACT

This bill establishes a new disability retirement plan for members of the Maine State Retirement System. This new plan will be applicable to state employees, teachers and employees of participating local districts which have adopted as part of their retirement plan the disability retirement plan set forth in the Maine Revised Statutes, Title 5, chapter 425, subchapter V, article 3. Subsequent to its enactment, other participating local districts may adopt this new plan.

The principal difference between the existing disability retirement plan and the plan contained in this bill is that under this plan the Maine State Retirement System may provide rehabilitation sevices to recipients of disability retirement benefits upon recommendation of the Maine State Retirement System's medical board. Any person who returns to employment with his previous employer or any other employer whose employees are covered by this plan would have no reduction in disability retirement benefits until combined earnings on his new job and disability retirement benefit exceed the amount he would have been earning had he continued to be employed on his previous job. A person who becomes employed by an employer whose employees are not covered by this plan would have his earnings limited to the difference between his average final compensation, plus cost-of-living adjustments, and his disability retirement benefit.

Sections 1 and 2 of the bill add to the duties of the Maine State Retirement System's medical board to include duties relating to the new disability plan.

Section 3 adds the Disability Retirement Benefit Fund to the list of funds administered by the Maine State Retirement System and corrects an error in prior legislation when a new fund was created, but not added to this list.

Section 4 amends a section relating to the Retirement Allowance Fund recognizing the establishment of the Disability Retirement Benefit Fund.

Section 5 establishes the Disability Retirement Benefit Fund from which all benefits under this plan will be paid. The State, as the employer of state employees and teachers and participating local districts whose employees are covered by this plan, will make contributions to the fund based upon actuarial valuations, including all members of the retirement system covered by this plan, hence there will be one rate applicable to all employers.

Sections 6 and 9 amend 2 sections in the present law to provide for continuation of service credits for persons who are recipients of disability retirement benefits under this plan in the same manner as persons receiving benefits under the present plan receive service credits.

Sections 7 and 10 provide that all disabilities which occur before the effective date of this bill are subject to the present disability retirement plan and all disabilities which occur on and after the effective date of this bill are subject to this plan.

Sections 8 and 11 contain the statutory language for the new disability retirement plan. Section 8 pertains to state employees and teachers and section 11 pertains to participating local district employees. The principal differences between the present disability retirement plan and this plan were discussed in the opening paragraph. There are several other areas where this plan differs from the present plan. If a person who is the recipient of a disability retirement benefit has his benefit discontinued because of his becoming reemployed, he is entitled to have his benefit payments resumed if he again becomes disabled within 5 years of becoming reemployed. A person who is reemployed by any employer whose employees are covered by this plan will have complete portability between his predisability employment and his post-disability employment. A person who was under a special plan, such as police or fire fighter, before becoming disabled will receive credit toward retirement under that special plan upon becoming reemployed in any position covered by this plan.

Because it is expected that the rehabilitation provision in this bill will encourage return to active service of disability recipients from the Maine State Retirement System, there will be a reduction in the long-term costs of disability retirement. An estimate of the reduction of contribution rates cannot be determined.

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Appendix K

Testimony of Dallas Salisbury

EBRI

Presentation of Dallas Salisbury*

Before

Committee To Study The Maine State Retirement System

August 21, 1987

*Dallas Salisbury is President of the Employee Benefit Research Institute, a non-profit, non-partisan, public policy research organization located in Washington, DC. EBRI is the only organization of its type in the world, and enjoys support from business, labor, the general public, and government organizations, including many state and local retirement systems.

EMPLOYEE BENEFIT RESEARCH INSTITUTE
2121 K Street, NW/Suite 860/Washington, DC 20037-2121/Telephone (202) 659-0670

INTRODUCTION

It is a pleasure to join you today to provide a perspective on the Maine State Retirement System, and on the overall system of retiree support provided by the State of Maine and its subdivisions.

First, let me note certain trends in employee benefits design that may prove relevant to your review.

Second, I will review with you a table that provides an overview of where Maine sits relative to other systems.

Then, I will conclude with some comments on future developments that you may wish to factor into your review.

TRENDS

1. Employers are increasingly viewing benefits as part of a total compensation package, taking cash compensation into consideration when determining how much should be spent on benefits. Employers don't want to pay both higher cash and higher benefits.

2. Employers are focusing more on the total ultimate cost of a benefit promise, rather than today's cost. This, for example is why there is a movement towards more provision of retirement income through defined contribution pension plans. And, we are now beginning to see employers provide a retiree health cash account, rather than the promise to provide insurance.

3. Employers are moving away from setting their benefits by industry, such as by what other governments provide, and are moving to compete with the economy in which they find themselves. Maine government, for example, competes with Maine employers, not the California government, when filling most jobs.

4. Employers are designing around government universal benefit programs in order to avoid benefit duplication and to hold down costs. Most public retirees, for example, end up with social security even if their public employer wasn't a part of the system. And, Medicare serves to reduce employer benefit cost significantly.

5. Employers are beginning to believe the demographic studies showing that (a) we are facing a period ahead when there will not be enough workers; (b) a period during which life spans will continue to extend with direct cost increase effects for defined benefit plans and retiree health programs; and, (c) a period during which the number of non-retired workers and taxpayers available to support each retiree will shrink dramatically. As a result, they are beginning to redesign programs to encourage workers to work longer, cutting back on inflation adjustments, redefining disability to be an inability to do all jobs rather than the present job, and increasing the cost for employees.

6. Employers are also moving to consolidate employee benefit programs so that all employees have the same benefits, allowing easier mobility of employees, a greater ability to comply with federal tax requirements, and a far more efficient and less costly administrative process. Maine, for example, could have one set of public employee programs, not many varying jurisdictional programs.

7. Employees are moving in many of these directions as well, showing a preference for cash based benefits that allow them mobility and the ability to take benefits with them. This frequently means a preference for government program participation (Social Security and Medicare) and defined contribution plans.

8. Employees and employers are showing some preference to have a portion of employee benefits tied to the employer. For example, investment of 10% of a pension plan's assets in the stock of the company. For Maine, this might equate to 10% of pension assets being invested in the State of Maine.

These trends are not all inclusive, but they do provide a picture of the activity now taking place as public and private sector employers and employees seek to react to a changing world and changing demographics.

COMPARISONS

Maine can be compared against a number of different standards, and Table One seeks to provide basic information for that purpose. The State might also wish to commission a study of the employee benefits provided by Maine private employers. This could serve to establish the most relevant competetive standard for designing benefits for Maine public employees. The United States Bureau of Labor Statistics (BLS) conducted a survey effort in March of 1987 on public employers that will be available in 1988 and will allow some expansion of comparisons to other public employers and, to private employers as well.

The Maine system of employee benefits, as shown by Table One, is comparatively generous.

1. Maine spends more for its pension plans than nearly all other employers when considering total expense, even if adjusted for Social Security. When looking only at normal cost (7.4%), one must consider that the presence of post retirement automatic indexation up to 4% guarantees a much higher ultimate cost for these current benefit accruals which helps explain the large post service expense.

2. Maine is less generous on vesting than other systems, except when workers hit age 60, and some would argue that Maine will have to move to five year vesting for those under age 60 to conform to the requirements of the tax

reform act of 1986. This would add further cost to the system. The presence of a minimum benefit plus indexation make the age 60 vesting, and the prospect of five year vesting, more expensive for Maine than would be true for other employers.

3. Maine provides for full unreduced pension benefits on a more generous basis than nearly all private employers, while being less generous than many public systems.

4. Maine is more generous than nearly all other public and private sector employers, however, when it comes to the small amount of actuarial reduction required for early retirement. The 55 year old retiree in the Maine system would face a reduction of only 13%, while the 55 year old retiree from the federal government would have a reduction of 35%, and, by federal law, many future private sector retirees a reduction of 60%. When the presence of automatic post retirement indexation is added onto this nearly full benefit a reason for high cost system becomes quite clear. Particularly, if the retirement age assumption is higher than the actual age of retirement.

5. Maine also has a very generous benefit formula to begin with, at 2% per year of service on a final average pay basis, which, when combined with other plan features increases costs. Even though this formula might be justified on the basis of no Social Security coverage, if Maine is like most government units, most Maine retirees <u>do</u> end up with a Social Security benefit in addition to the Maine pension.

6. Maine is one of the few States that has not opted into the social security system. The present legislative study will indicate the relative advantages and disadvantages of this, but one advantage that can be

highlighted would be the ability to reduce the basic Maine system benefit <u>and</u> to rely on social security indexation and provide a Maine pension benefit with less indexation than today.

7. Maine promises a retiree health benefit that is standard for many state and local government units, but far more expensive than either the federal government or private employers are willing to promise. Were TRA 86 interpreted to require public employers like Maine to move to 5 year pension vesting, the aggregate cost of this benefit would become higher. The Maine benefit is made even more generous by the full payment by the employer. Coverage of state and local employees by Medicare will have the effect of saving Maine a great deal of money, since the benefit promise is so generous. Maine has a lower expense than it might because workers leave Maine employment, withdraw their pension contributions, and thus forfeit a right to both a Maine pension and the retiree health benefit. Should Maine experience what others are now experiencing, however, fewer workers will do this in the future in order to preserve the benefits.

8. Finally, Maine provides the most expensive possible form of disability benefit for the first 5 years, far in excess of what most employers provide.

Maine system covered employees have a generous employee benefit package. Far more generous than employees of the federal government, and more so than most private employees nationally <u>or</u> in Maine.

CONCLUSION

Maine clearly faces tough decisions in the employee benefits area. Demographics and economics make higher costs for present programs a certainty. The totally unfunded retiree health promise, when considered with the pension plan that includes benefit indexation and nearly full early retirement benefits, argues for providing the maximum possible funding for the pension plan and consideration by the state of advance funding the retiree health promise. Without these actions, or reduction in the level of benefits being promised, Maine will face higher and escalating costs in the decades ahead. This means either reduced spending in other areas, lower wages and salaries, or higher taxes. Ideally, today's workers and taxpayers should pay for the benefits being accrued today, rather than being paid for by future workers and taxpayers.

Appendix L

Testimony of Jamie Cowen

GRB
Government Retirement & Benefits, Inc
5400 Eisenhower Avenue
Alexandria, VA 22304 (703) 461-910[illegible]

COMMITTEE TO STUDY THE

MAINE STATE RETIREMENT SYSTEM

SEPTEMBER 18, 1987

PRESENTED BY

JAMIE COWEN, PARTNER

My name is Jamie Cowen. I am a partner with Government Retirement & Benefits, Inc. of Alexandria, Virginia. Previously, I served as Chief Counsel to the U.S. Senate Subcommittee on Civil Service and was the primary architect of a new retirement system established for the Federal government, which became effective on January 1, 1987.

Today, I am here at the Commission's request to discuss the issues the State will face in considering a redesign of its present retirement systems. It took over five years to research, design and successfully pass the new federal system. There were enormous economic, budget, and particularly political obstacles to the successful enactment of the implementing legislation. I believe our experiences with the federal system can prove useful to the State in its consideration of retirement reform.

Maine's current situation is comparable to the federal climate approximately six years ago. Maine's retirement system (MSRS), including the participating districts, have a significant unfunded liability which approximately equals the annual Maine budget. The unfunded liabilities of the federal civilian and military systems appproximate the annual federal budget, $1 trillion, which, by the way, is <u>not</u> reflected in the National debt. In other words, it is unaccounted-for debt. Unfunded liabilities are common among public systems due to the fact that legislatures can punt the cost of benefit enhancements to the future. Naturally, as the pension plans mature, as they have in Maine, the costs rapidly increase and force either higher taxes or the rechanneling of budgetary outlays to fund old promises.

Because of the new amortization schedule to pay off the unfunded liability adopted by Maine coupled with new cost estimates, Maine is now setting aside approximately 20% of annual payroll to fund its retirement system. The federal government faces the same problem. Unfunded liabilities grew so quickly that to adequately finance it, current expenditures rose rapidly in the 70's and 80's. In 1970, federal outlays for civilian retirement were $2.75 billion. In 1980, they were $15 billion. This year they will be $28 billion.

The result of this was tremendous taxpayer outrage (enhanced by political propaganda) at perceived overly generous benefits received by federal employees. Pressures mounted to reduce benefits.

In 1981, Senator Ted Stevens (R-Alaska), Chairman of the Civil Service Subcommittee, responded by directing the staff to design a new program for the Federal Government. The goals were to reduce costs, to structure the plan around private sector models, to base the system on Social Security (the Federal Government was not under Social Security at the time), to fully fund the new plan and to subject a portion of the employees' benefits to the risks and rewards of the economy. The result was the enactment of Public Law 99-335 on June 6, 1986, the Federal Employees' Retirement System Act of 1986. The final product fully accomplished the goals we originally established. It was reported out of Committee with a 17-0 vote, and all but one Senator served as co-sponsors. It passed the U.S. Senate 96-1. The legislation was never voted upon in the House of Representatives.

To reach the President's desk, however, took tremendous time and effort on the part of many individuals, years of educating the various interested parties, deliberate design strategy to fulfill the goals we established yet meet the needs of the interest groups and finally extensive negotiation. In order for the State to seriously consider an extensive reform, the State must be prepared to devote years to the task. But planning must begin now.

A Retirement System is not Designed in a Vaccuum

There are unlimited ways to design a retirement program. But retirement programs affect workforce demographics, alter local economics, reallocate budget priorities. In other words, a public retirement system should never be designed in a vaccuum. Often, public entities look to other such entities to gather ideas for design. This is totally fruitless. When we began the design of the new federal plan, we deliberately ignored the structure of the current one. This ultimately proved to be a good decision, but made our task more difficult. The only true value of a current plan is to gain information on how plans impact related matters.

The structure of the old federal program is similar to the Maine system. It is a defined benefit plan which pays a monthly benefit at a certain age determined by one's high-3 average pay and his length of service. The actual formula pays a benefit just under 2% per year of service but permits unreduced benefits at age 55 with 30 years of service. Systems such as these are excellent for individuals who commit themselves to 25-30 year government careers and then escape at their earliest opportunity. But they have signficant drawbacks.

These systems deter recruitment for most young people. The economies of Maine, as well as the United States, are undergoing major transformations. The old industrial economy is being replaced by a highly technical service economy, making government type service jobs more available in the private economy. According to the Maine State Planning Office's publication, "The Maine Economy: A Forecast to 1995", the service sector created the most jobs in the State over the last five years and will continue to do so in the future. Whereas, in the past, certain occupations could only be found in the government, these same occupations are now increasingly utilized in private industry. Where individuals were once locked into government careers by their very occupation, those same occupations are now available on the outside.

Additionally, society, in general, is much more mobile than many years ago. Few individuals come to work for an employer with the intention of making it a career. Thus, it is imperative that portability be built into a new system. A retirement plan such as Maine's or the Federal Government's precludes recruitment of the brighter young people coming out of colleges. In fact, the same Maine planning publication noted that there is emigration from Maine of those aged 18-24. These are the new recruits that the State must contain if it is to provide new impetus to the state economy. An attractive retirement plan could induce some of these individuals to stay and join the government. Regardless, to attract the ones who do stay, a system that at least doesn't penalize short careers is a necessity.

The other anomaly is that both the state and federal systems encourage early retirement in the 50's. These individuals do not actually retire, but often move to other jobs to qualify for Social

Security and possibly another pension while receiving the state or federal pensions. The average retirement age of a state employee is less than even the federal government, much less the average in private industry. The ones departing at these ages are often the senior careerists who are at the peak of their careers. The loss of senior talent due to subsidized early retirement can be astounding and expensive.

Finally, as society becomes more complex, it equally becomes more interrelated. Again, the Planning Office's publication noted the changing Maine economy and recommended public policy assistance. This is also obviously true at the federal level. We felt it imperative that employees be able to move in and out of the public sector without penalty to gain wider experience in the changing economy. A non-portable retirement plan can stagnate a workforce and actually keep it behind recent developments in various product areas. Enhanced portability in the retirement plan was a must at the federal level. It is a must at the state level.

Clearly, budget constraints played a major role in the development of the federal plan, and they will in the development of a new state plan. The most important consideration in the cost of a new plan is "truth in budgeting." The temptation will always exist for politicians to design a cadillac plan and fund it at the sub-compact level. The problem of such an approach is why this Commission sits here today. Current taxpayers <u>must</u> pay for the benefits that current employees are accruing today, using the most up-to-date and dynamic actuarial projections. When a large unfunded liability exists, it must be amortized overtime. Typically, such liabilities are amortized over 30-40 year periods. The new federal plan chose a 30-year amortization schedule.

Also, I would suggest using conservative economic assumptions. I am not an actuary, but the projected long-term yield on investments of the MSRS seems high and the overall cost of the system seems surprisingly low. We used a 6% interest factor at the federal level with price and wage growth fairly consistent with the state projections. MSRS is using 8% interest growth. A difference of 1% in the interest component can affect the normal cost projection by 25%. Typically, long-term real rates of return average 2-3%. MSRS is using a long-term real rate of 3 1/2-4%. If the long-term rate is too high, unfunded liabilities are again the result.

When costs are not adequately financed, future taxpayers are forced to pay not only for their generation but for that of the prior generation. If taxes are not increased, then alternatively other pressing governmental programs or priorities must be trimmed to pay for old debt. Then, often there is a taxpayer revolt, resulting in reduced benefits for the employees.

In designing a reasonably good retirement plan, there should be at least an implicit acceptance that the plan will be costly. Good benefits are not free. But the State must see such a cost as an economic necessity and a social responsibility. Typically, public employers compensate their employees with sparse salaries and rich retirements. This should change somewhat. The State is in the marketplace for employees. Because of increasing competition for quality employees, especially in light of Maine's changing economy, the State must be reasonably competitive in terms of current compensation. However, the State bears a social responsibility as the governing body to ensure that its employees are adequately provided for in retirement.

Ideally, retirement income should be able to maintain one's pre-retirement standard of living into retirement. For low income employees, this often means benefits that approximate 80% of pre-retirement salaries. For higher income employees, benefits equal to 60% of salaries are normally adequate. In the design of the federal plan, both these factors - cost and benefit adequacy - played a major role. The new federal plan was designed to cost 10% less than the older one, but in many cases benefit adequacy was greater in the new one. This resulted from redistributing the value of overly generous features existent in the old plan into a wider spectrum of benefits to a broader class of individuals in the new one. For example, early retirements and cost-of-living adjustments are the most expensive features of the old federal plan. In the new plan the subsidy for early retirement was cut substantially. However, benefits for those who stayed later increased. Also benefits to the "inners and outers" were increased as well.

Additionally, some of the responsibility for retirement income adequacy was shifted to the employees, particularly those at the middle and higher income levels. Retirement experts have traditionally stated that retirement income should come from three sources - the public source such as Social Security, the employer through an employer pension plan and personal savings. Savings rates in this country are deplorably low. If it wasn't for the existence of large employer-sponsored pension funds, capital formation would have come to a stand-still. Individuals must be encouraged to save for their benefit as well as for the national and state economy. The new federal plan accomplished this by creating a typical private sector thrift/savings plan where an employee is encouraged to contribute to it by an employer match.

Prior to tackling retirement redesign, there must be determinations made as to what the new plan is designed to accomplish. Whatever is established will impact demographics of the workforce, the compensation structure of the state economy generally, future state budget priorities and the health of the Maine economy overall. It is best to decide what the impacts should be and design the pension plan accordingly.

Understanding the Constituencies

The ultimately successful passage of the federal plan was due to the recognition by the most important parties to the necessity of such a plan. Without that realization or something akin to it, successful passage is dubious.

A. Employee Organizations

Clearly, the most important constituency of the new plan are the employees to be covered by it. At the federal level these were new employees, most of whom were not yet hired. To digress for a moment, I strongly urge that a new plan be designed for new employees only, particularly if the system is to be Social Security based. Old employees can be given the option to transfer, but should not be mandatorily covered. The two systems are likely to be very different and could unintentionally reduce certain individuals' benefits.

Since new employees do not yet exist as a constituency, the closest group to them are current employees and their representatives. This is undoubtedly the most vital group, but inevitably the hardest to win. Employee organizations rarely favor change unless the result is a clear benefit enhancement. Attempts to establish a completely new retirement system can quickly lead to a bloodbath even though it can be often shown the new system is superior to the old. Senator Stevens, a recognized friend of federal employees, introduced his first reform bill in 1982. His whole thrust was to design a system that would be less susceptible to political attack. Every union and employee organization vehemently opposed it. The primary opposition was to Social Security coverage, upon which the new system was based.

Irrespective that most union members will fare better under a Social Security based system (since Social Security benefits are tilted to lower wage earners), public sector unions will usually oppose Social Security coverage. Their reasoning is somewhat sound. One, as long as all benefits flow only from the state, the unions have a major role to play in the benefit levels and structure. Social Security coverage removes control of a substantial benefit from union reach. The problem is union leadership often worsens the case for Social Security coverage by exaggerating to the membership the weaknesses of the Social Security System. Coverage, in and of itself, normally results in overall benefit increases to union members, however.

Two, the unions' strength lies in numbers. If two distinct systems are established, the unions' strength is diluted because it has to represent two separate interest groups which could conceivably divide the union itself. One way to resolve that is to design the new plan to cover all employees, including current ones. But integrating Social Security with MSRS as currently designed to afford current employees identical benefits is nearly impossible.

At the federal level the driving impetus behind the establishment of a new plan was separate legislation mandating Social Security coverage of new federal employees. This action was part of the Social Security reform package of 1983. The federal unions spent in excess of $6 million to defeat the coverage measure which many in the union leadership admitted was a lost cause. Without a similar situation facing state employees, it is unlikely that the state unions will embrace a Social Security based plan.

Unions traditionally favor defined benefit plans over defined contribution ones for at least two reasons. One, defined benefit plans place the risk of financing a promised benefit on the employer. The union is normally involved in influencing the benefit amount which it feels is adequate without concerning itself with the benefits financing, at least not until serious financing problems arise. A defined contribution plan places risk on the employee. Unions traditionally favor security and certainly over risk and reward.

Two, a defined contribution plan, even when coupled with a benefit plan such as a thrift plan, is provided to enhance portability. Unions tend to discount the importance of portability since they usually represent and benefit by career employees as opposed to transient ones.

The federal experience proved, however, that unions will accept a thrift plan as long as the more valuable piece is a defined benefit plan. When presented in an appropriate manner, union membership will pressure the leadership into accepting such a plan. The opportunity to control one's retirement investments in a limited fashion and to have access to it when he separates is attractive to individual employees.

However, the most serious problem we faced in the legislative design was that the employee organizations showed little concern for the new plan except as to potential precedent-setting differences with the old plan. Recall at the time of legislative consideration, the unions do not represent the employees to be covered by the new plan. They represent the employees in the old plan. Their primary concern is to not only ensure the old plan is not changed in the process, but that the new plan does not establish precedents to alter the old plan. Serious controversy surrounded the issues of early retirement and cost of living adjustments. They had to be changed to pay for the inclusion of the Thrift plan. But the unions insisted on consistency with the old plan to avoid a precedent. Compromises were finally worked out.

B. Government Structure

The administrative structure of MSRS is similar to the federal system. Participating in MSRS are various local government entities. They are separate and distinct plans, some of which, as I understand, are subject to Social Security and yet they cover various local government employees. As I have read from previous testimony and

Commission deliberations, there is interest in merging them into one plan.

We had a similar problem at the federal level. There are approximately 60 federal retirement systems. The largest two are the Civil Service Retirement System covering approximately two million employees and the military retirement system covering another two million uniformed personnel. There are also separate systems covering foreign service employees, Federal Reserve Board employees, employees of the Central Intelligence Agency, service employees of Defense Department installations, etc.

Serious consideration was given to merging all the plans into one plan. However, except for some limited successes, the idea was rejected. Designing a public retirement system involves politics. A good plan is not the only consideration. A plan that must be adopted by the legislature must also be designed to limit the number of Committees who hold jurisdiction over the plan. Otherwise, if the legislation ever survives, it becomes encumbered with extraneous provisions. When we designed the federal plan, we wrote it in a way that it would be referred to our Committee. We worked with other Committees to assist them in designing parallel plans for their employees and ultimately the Foreign Service and CIA joined our legislation when it reached the Senate floor. But the primary plan was progressing with or without the other plans.

Additionally, some of those localities may resist attempts to merge since they lose authority. We found this often at the federal level and had to concede in some areas. The one unifying factor may be mandatory Social Security coverage. This would force the non-covered plans to change and assist in unifying the plans. One other possible approach is to maintain separate plans, but increase portability among them. We did this in a few instances.

C. Taxpayers

The taxpayers as an interest group play almost no role since no group represents them. However, in every politician's mind is how will the voters (taxpayers) respond. Public employees' compensation will always stir controversy. By public employment's very nature it becomes everyone's business. Public employees' compensation, including retirement benefits, will always appear better than that of the average non-public employee because government work is predominantly white-collar, whereas, the economy as a whole is more mixed. Thus, the "taxpayer" will continue to criticize whatever public employees receive.

Similar to Maine's experience, the federal retirement system has been subjected to tremendous public scrutiny due to its unfunded liabilities and perceived overly generous benefits. Again, I stress "truth-in-budgeting." If a system is adequately costed out, a commitment is made to fully fund it, and the system financing is revised periodically as assumptions change, a large unfunded liability is unlikely to occur.

The so-called overly generous benefits could be more accurately described as unique benefits. Most taxpayers "suffer" under Social Security taxes. Maine state or federal employes do not. But they do make retirement contributions comparable to the level of Social Security taxes. Most taxpayers working for a company do not receive automatic cost-of-living adjustments on their employer's pension. Maine state and federal employees do. However, state and federal employees do not receive Social Security benefits which are fully adjusted for changes in the cost-of-living as a result of their primary employment which private employees do. Private employees can rarely receive full pension benefits before age 62. Maine state and federal employees can retire in their 50's with close to full benefits. On the other hand, Maine state and federal employees do not have thrift plans, stock options and profit-sharing plans which often enable private sector employees to retire in their 50's. The average retirement ages in all three sectors are not dramatically different. The average retirement age for regular state employees is 60.5. The average federal age is 61.1, and the average private sector age 61.9.

The point I'm making is public employment compensation will always come under attack. What makes it an easier target is the uniqueness of some of its benefits. The same benefit values could be redistributed such as eliminating pension cost-of-living adjustments but adopting Social Security which already has COLAs resulting in a plan more acceptable to the taxpayer.

D. The Legislature

Public employee benefits that are not negotiable are political. One can design the greatest plan in the world, but if it is not politically feasible, it is doomed from the start. What makes it feasible is a recognition by the major players that something is seriously wrong with current plan. I emphasize the word, "recognition." Based on my cursory analysis, I am not persuaded that the major parties will recognize this fact with respect to MSRS. Obviously, everyone will agree that costs are rising dramatically. But there are always gimmicks to resolve that.

Ultimately, the legislature will play the major role in the plan's development. The legislature represents its constituents, particularly its voting constituents. State and local government employees constitute approximately 11% of employment in the State. Federal employees constitute approximately 2.5% of employment in the nation. Even with the far smaller proportion of federal employees involved, than in the State, Senator Stevens would not move the federal legislation until the employee organizations saw a need for it. That is, in part, why it took five years. That is also why we had almost complete unanimity in the legislation's passsage.

The key to the successful enactment of a new plan is to involve key legislators from the beginning. Although employee organizations will rarely propose major reforms such as this, key legislators, particularly those close to employee organizations, can influence them in due time.

Before specific proposals are made, there must be education of all parties. The problems must be discussed openly and possible solutions aired. The involvement of all parties can sometimes narrow the issues and make a legislative initiative possible. In the federal experience after Senator Stevens introduced his measure, which died at the end of the Congress, and after Social Security coverage became a fait accompli, our Committee held five public forums where experts from the public and private sectors presented papers and discussed issues ranging from Social Security integration to defined benefit versus defined contribution plans to investments, etc. Congressional staff, employee organizations and other experts were invited to discuss these measures. The result was by the time we were ready to again present a plan design, all the parties were talking the same language and had come to very similar conclusions.

The new plan design was submitted to a bi-partisan Committee staff working group which made changes. Great amounts of strategy were discussed. Employee organizations were then involved directly. More marginal changes were made. The legislation passed the Committee with a unanimous vote and the employee groups reticently supported the legislation.

Do not expect rabid support from employee organizations. But the legislators do not need that if they perceive there is a problem and if they can be assured that employee groups will not scalp them for moving the legislation.

E. The Governor

Presumably, the Governor has the broadest perspective of any party. He represents everyone. As the chief executive officer, a new plan will affect his employees and will determine in large part what type of workforce he directs. On the other hand, he is the chief budget officer recommending and administering how limited state funds are spent for his constituents. Obviously, he must be involved from the beginning.

If done right he should be able to weave together a plan that is acceptable to his two largest constituencies - his employees and the taxpayers. But the key to success will be fair handedness and openness. If employee organizations spot a ruse, and they normally will, the plan is dead.

Unfortunately, the federal experience does not lend itself to a good example. The Reagan Administration is perceived as very anti-federal employee. Anything proposed by them is uniformly rejected by employee organizations, notwithstanding its merits, because of their anti-employee rhetoric. Fortunately, for the plan's political success, the executive branch surprisingly played no role in the development of the plan. However, their expertise in personnel matters was sorely missed.

This experience is unlikely to recur at the State level. Hence, the involvement of the Governor at early stages is imperative. However, he must wear the two hats of his constituents if the plan is to be successful. He should solicit views from employee organizations prior to any public discussion of a new plan.

Structuring A New Plan

When we first designed the new federal plan, we assumed Social Security as the base. It was inevitable that Social Security eventually would be extended to cover the federal workforce. At the time the three largest uncovered groups were federal employees, state and local government employees who had not elected coverage and non-profit organizations. As a result of the Social Security Amendments of 1983, new federal employees and non-profit organizations were covered and state and local government employees currently covered could not elect out.

Additionally, Senator Stevens felt strongly that to protect the federal retirement system from further erosion, its basic structure must be patterned after private plans. Social Security coverage was a must for political reasons. The State is at a similar cross-roads. If a new plan is to be designed, it would be short-sighted to ignore Social Security.

With my experience on Capitol Hill and my continuing connections to it, I strongly believe that new state and local government employees will be covered by Social Security within the next three years. The 1983 amendments foreclosed state elections to opt out of coverage. Last year Congress mandated that new state and local government employees be subject to the Medicare component of Social Security. This year the House Ways and Means Committee included a provision in its tax bill to cover all state and local government employees under Medicare. The final step is mandatory Social Security coverage.

Everyone knows that to reduce the federal budget deficit, which must be and will be done, that revenues must increase. There are three ways to raise revenues to the government, i.e., raise taxes, apply user fees to free federal functions and extend the coverage of revenue measures, such as Social Security. The political fallout from extending Social Security taxes to more uncovered groups and thus reducing the deficit is far less than raising taxes on the general populace. The impetus to extend such coverage will not be to rescue Social Security - it doesn't need it anyway - but rather to reduce the short term federal budget deficit.

The advantages to employees of Social Security coverage greatly outweigh the disadvantages. One, prior to the 1983 amendments, non-covered employees who later worked for short periods under covered employment received proportionately greater Social Security benefits than those who worked full careers under Social Security. This became known as a windfall benefit. Maine state employees, like federal employees, could retire from their employer in their 50's and work for a short period under Social Security covered employment to receive a substantial Social Security benefit. Hence, this created an incentive to both remain uncovered through their major employer, receive a good pension and then retire early to earn sufficient Social Security coverage to be additionally eligible for a relatively rich Social Security benefit.

The 1983 amendments applied a penalty to any earned Social Security benefits where one received a government pension outside of Social Security. For Maine state employees effected by this, which will be most of them, their normal Social Security benefit will be reduced by 1/4 to 1/2. This is a severe penalty, thus eliminating the major financial advantage to remaining uncovered.

In addition, in a two-wage earner family where one was subject to Social Security and the other worked for the government, previously the government employee could draw additional Social Security benefits as a consequence of being a spouse to a Social Security wage earner. However, again this was changed to often completely eliminate the receipt of such a spouse benefit. Thus, again there is no advantage to remain in a non-covered government position.

Two, Social Security is in part a social insurance program which redistributes income away from higher wage earners to lower ones. Those at lower income levels, under $20 or $25,000, will often find their total retirement income higher under a Social Security based system. For example, note in Table 1, how Social Security benefits are tilted to lower wage earners. In Table 2, note how if the Maine retirement benefit is cut in half when added to Social Security, the lower wage earners do better than under the current system. Since employee organizations tend to represent lower wage earners, a Social Security based system can provide greater benefits to the bulk of its membership.

Three, as previously mentioned, one of the great criticisms of the federal plan was its full cost-of-living protection. Private industry argues that its plans are not automatically adjusted for inflation. But Social Security is adjusted which serves as the base for all private plans. A General Accounting Office study we used in the development of the federal plan concluded that when Social Security cost-of-living adjustments were added to the ad hoc adjustments granted by private firms, the average annual adjustment for total benefits was between 60-70% of inflation.

Cost-of-living adjustments account for almost 40% of federal retirement costs. By shifting the primary burden of indexation onto Social Security, employees still remain protected but at a lower cost to the plan. The new federal plan provides for no adjustments until age 62. At age 62 and beyond, the adjustment equals the change in the Consumer Price Index minus 1%.

Compare the following adjustments over the last 10 years to both Social Security benefits and the MSRS:

	Social Security	MSRS
1977	5.9%	10.88%
1978	5.0 %	4%
1979	9.9%	4%
1980	14.3%	4%
1981	11.2%	6%
1982	7.4%	4%
1983	3.5%	4%
1984	3.5%	4%
1985	3.1%	3.7%
1986	1.3%	1.7%

If we assumed a Social Security beneficiary was receiving $4800/yr. or $400/mo. in 1976, cost-of-living increases would have raised that to $8958/yr. or $747/mo. in 1986. A MSRS retiree receiving $4800/yr. in 1976 would find his benefit at $7528/yr. now or $627/mo. Because of the 4% cap on MSRS cost-of-living adjustments, Social Security clearly accords greater inflation protection.

Four, probably the most significant advantage of Social Security is its portability. Portability was a major premise of the new federal plan. As I previously discussed, the changing demographics of our society necessitate increased retirement portability. Options to withdraw one's contributions at separation thereby forfeiting a future benefit or leaving the money in the system to receive a badly eroded benefit in the future are unreasonable and unfair. Social Security coverage accords one significant portability. Almost all jobs today are covered by Social Security. Even wages received early in a career influence the eventual Social Security benefit because wages are indexed to current dollars at time of retirement. Thus, transferring among different jobs does not reduce the value of the eventual benefit.

Five, for a married couple, where one spouse has not worked or worked only intermittently, the Social Security benefit paid to the wage earner can be increased by an additional 50% through payment of a spouse benefit. No employer pension plans pay anything like that. In fact, most comparative retirement analyses done for the State will normally ignore this potential benefit. Table 3 shows a revised Maine plan where a Social Security spouse benefit is payable. Note only salaried positions in excess of $50,000 actually received greater benefits through the current system.

Six, survivor benefits are much richer under Social Security than either MSRS or the federal plan. There are, however, holes in survivor protection from Social Security which should be supplemented by the employer's plan. This is what we did in the federal plan. Still, a better benefit can be provided for less cost.

Seven, disability benefits are generous for those totally disabled. MSRS disability benefits are overly generous. The cost of these benefits can be redistributed to provide a less generous disability benefit to one who is occupationally disabled but not eligible for Social Security disability.

The only real disadvantages of Social Security coverage are that its expensive - approximately 6% of payroll for the state and the employee - and control of the State plan is now partially removed from the State. While these factors cannot be ignored, the advantages of coverage significantly outweigh them. Some would argue for a new state plan designed like Social Security but still remaining separate from it. This lacks merit. The Social Security system is very complicated to administer. MSRS adoption of such an approach would probably cost more than current Social Security costs and many of the political and demographic advantages of coverage would still be lacking.

A fundamental decision must be made with regard to Social Security coverage. We proposed it. We were criticized. We were correct. We are now acclaimed.

The second major structuring issue is how will the employer pension plan be designed. The choices are a defined benefit plan such as MSRS or a defined contribution plan or a combination of both. A defined contribution plan specifies the employer contribute fixed amount to employee accounts and the employee receives at retirement whatever exists in the account. Thrift plans and profit sharing plans are forms of defined contribution plans.

Interestingly, this was a major issue at the federal level. Senator Stevens preferred a straight defined contribution plan which was the design of the 1982 legislation. The main problem with such an approach is that it is bound to generate substantial union opposition. The main advantages of such a plan are its complete portability and its fixed costs.

We discovered while portability is desirable, there should also be some incentive to remain with an employer for a full career. A defined benefit plan clearly rewards a career person over a short-timer. The combination of this fact plus almost certain union opposition moved us toward a combination approach. The fact that most private plans use a combination of a defined benefit/contribution plan sealed the fate of the federal plan.

Possibly, a more significant issue is whether the defined benefit plan reverses the tilt of the Social Security formula. Typically, private plans offset the redistribution of Social Security benefits by providing a larger pension benefit to higher wage earners. Note in Table 4 how the combination of Social Security and an offset pension plan flattens total retirement income on a percentage of salary basis across the income stream. The final result is a plan close to MSRS. But Table 5 reveals how this is done. Note how more of the state's plan is tilted toward the higher incomes.

We experienced the same dilemma at the federal level. The current system because of its flat benefit structure treats everyone alike. Private plans incorporating an offset approach essentially accomplishe the same thing. As a major employer the federal system had to be competitive with private industry for higher wage earners.

But in light of public policy, how could the Federal Government propose a plan for its employees that explicitly reversed the deliberate tilt of the federal Social Security System? Additionally, offset plans are discriminatory on their face against lower wage earners.

The dilemma was solved by maintaining the Social Security tilt in the basic pension but adding greater value to a third tier through a thrift/savings plan. A thrift plan, widely used in private industry, accomplished many of our original goals. It increases portability. It involves the employees in their own retirement planning. It involves the employees directly with the national and possibly state economy, through investments. It fixes the cost of a portion of the employer's pension plan. It provides an incentive for personal savings.

It also potentially flattened the Social Security tilt in total retirement income by employee choice rather than by a plan imposed by the employer. The federal thrift plan is generous. The Federal Government essentially matches an employee's first 5% contribution dollar for dollar. But the thrift plan is generous at the expense of the defined benefit plan. Incentives for early retirement were removed and full inflation protection was pared. These savings were reallocated to the Thrift Plan.

Table 6 is a graph of potential benefits under the new federal plan. Note what happens when all employees contribute the 5% contribution. The tilt still remains with the lower income receiving retirement benefits equal to their pre-retirement salaries. But experience shows that the lower income will not contribute as much as higher income employees nor do they need to.

Table 7 shows varying participation rates increasing on average as incomes increase. Note that the tilt no longer exists. Obviously, these are projected results rather than actual ones. Individuals will determine where they end up, and many will not neatly fit into this scheme: On average, however, it is probably representative of the end result.

The point is we successfully designed a plan which avoided serious political pitfalls that would have resulted from directly compensating higher income employees. However, due to the generous thrift plan matching, higher income employees will be attracted to government service and probably will remain.

Lastly, let me comment on a major transition problem we faced and that the state might face. Because of the different financing schemes of the two federal plans, enactment of the new plan was projected to dramatically increase short-term costs, exacerbating the federal budget deficit. This was resolved by requiring thrift plan contributions to be first held in special government securities and then placed into private investments over time. Investing in non-marketable government securities in the near term caused the deficit to shrink by increasing revenues to the government. A similar approach may be warranted here.

One other interesting point. I noticed in some of the Maine publications that while the state economy is expected to grow over the next few years, the projected growth is uneven and the rate has slowed from previous years. The Maine report urges additional monies be made available for capital formation. The thrift plan could be designed to directly enhance the state economy. Employees as in the federal plan, could be given investment options. One option could be a special state security designated for business enhancement. A set interest rate could be attached to the security, but bonus dividends could be paid as businesses succeed as a result of the available monies. Employment could grow and increased revenues to the state would be the result. Admittedly, it is an unconventional approach, but risk takers reap rewards.

In conclusion, the design and enactment of the federal plan was a long and difficult process. But we succeeded and we succeeded with little controversy. To get to that point took patience, understanding and a great deal of foresight. If it was done at the federal level, it could be done at the state level as well.

TABLE 1 S.S. BENEFITS

AGE 65 W/ 35 YRS. SERVICE

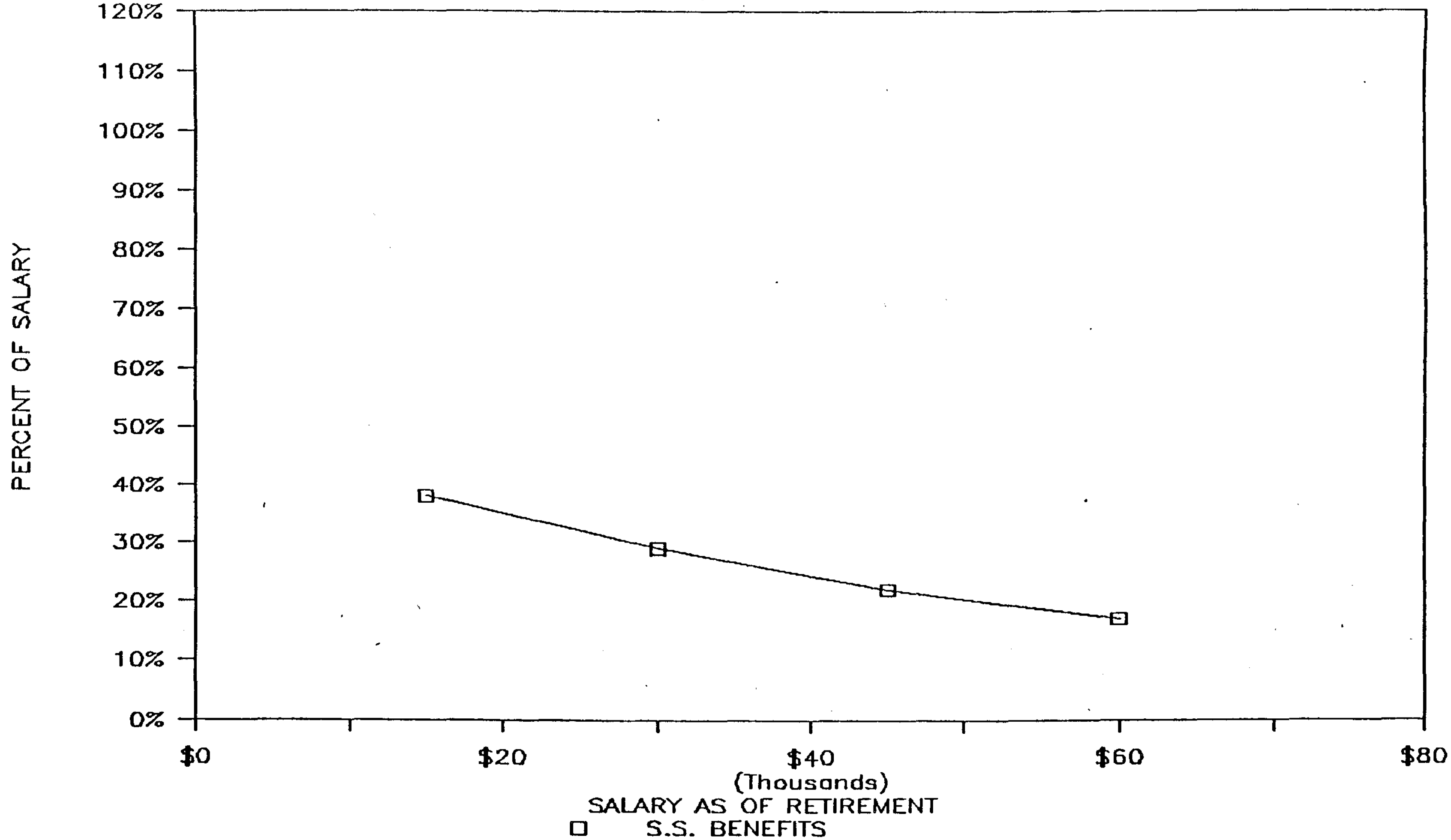
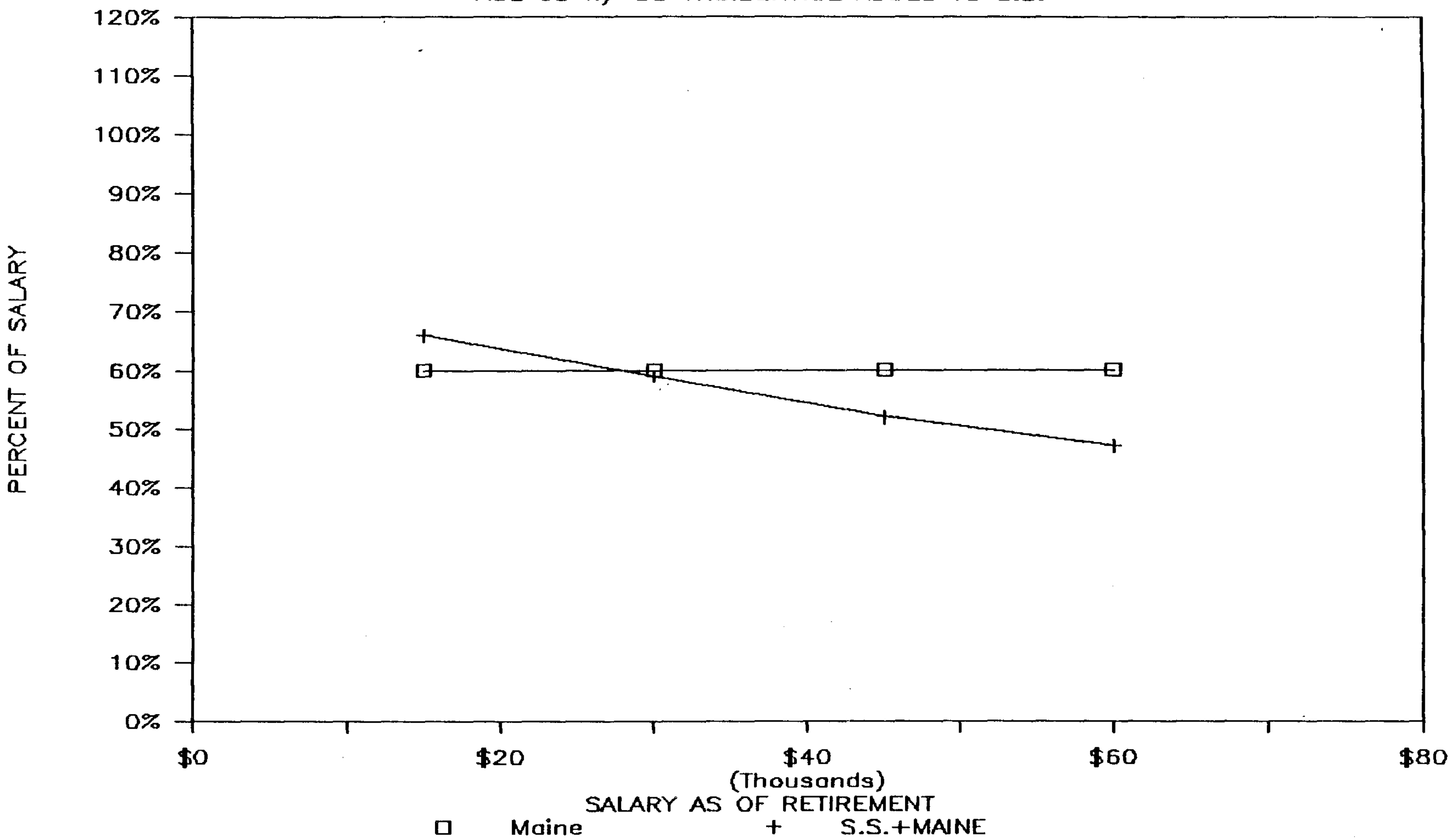


TABLE 2 MAINE BENEFITS REVISED TO 1%/YR

AGE 65 W/ 30 YRS.SERVICE ADDED TO S.S.



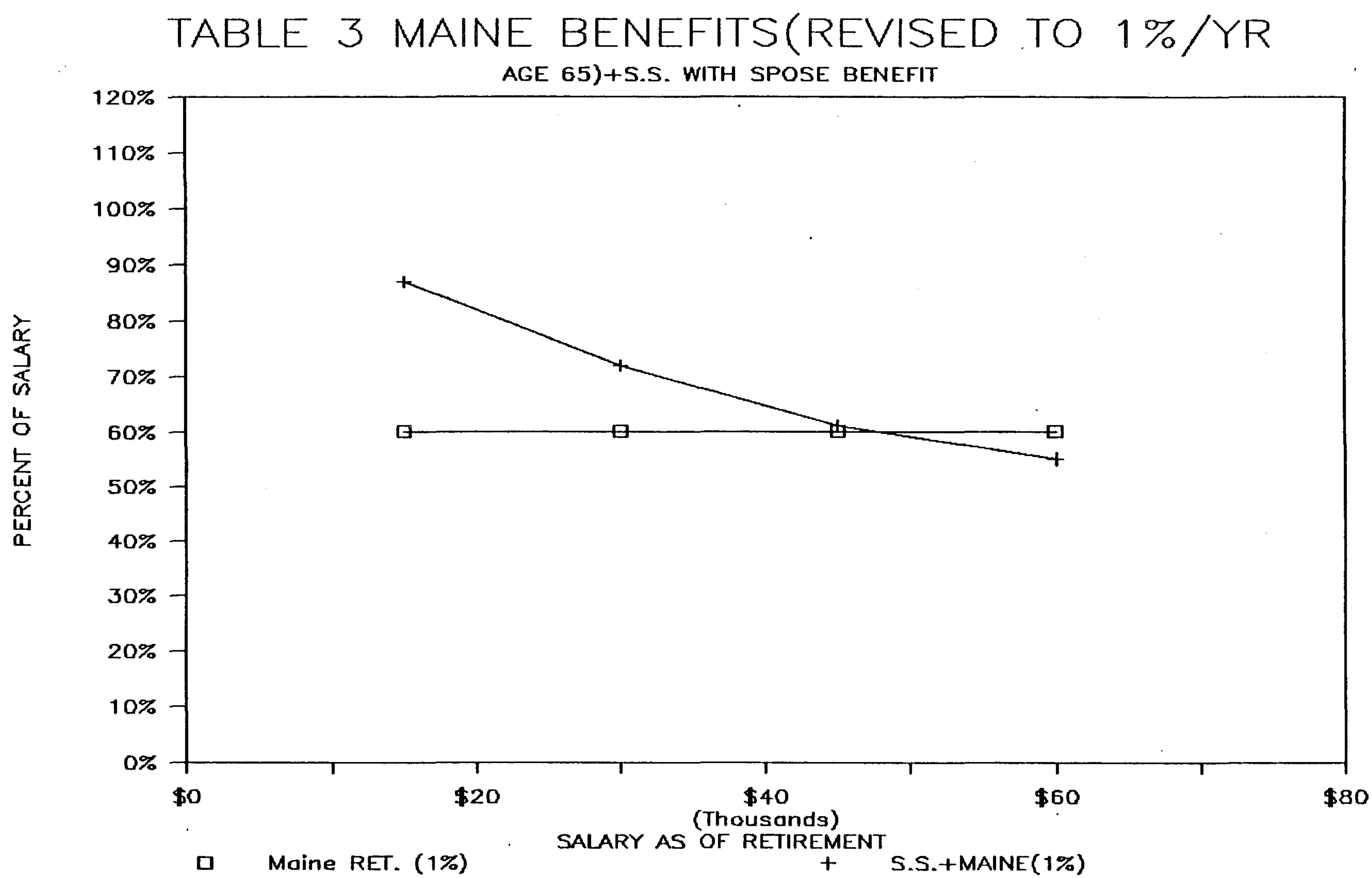


TABLE 3 MAINE BENEFITS(REVISED TO 1%/YR
AGE 65)+S.S. WITH SPOSE BENEFIT
PERCENT OF SALARY
120%
110%
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
$0
$20
$40
$60
$80
(Thousands)
SALARY AS OF RETIREMENT
Maine RET. (1%)
S.S.+MAINE(1%)

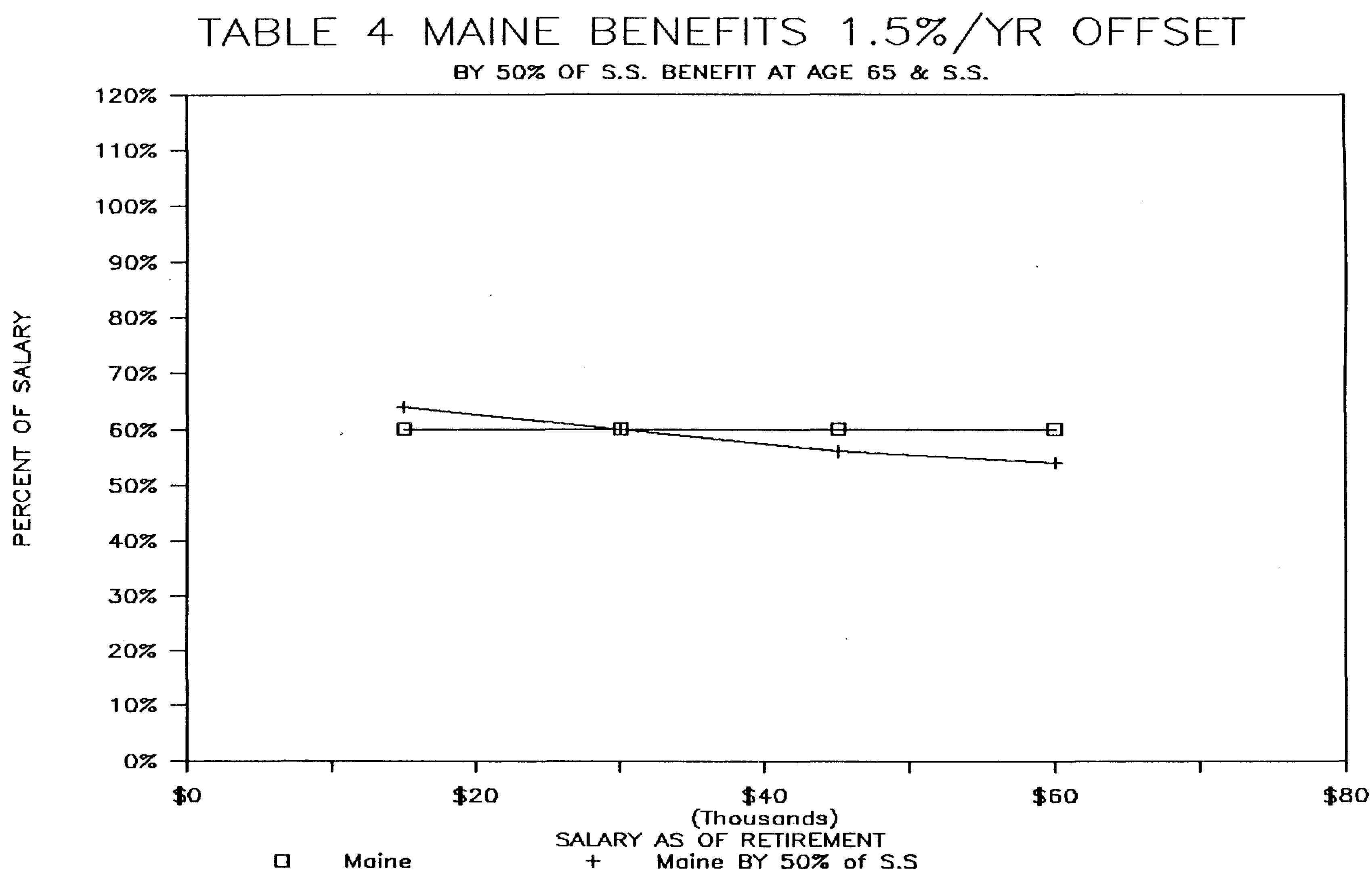


TABLE 4 MAINE BENEFITS 1.5%/YR OFFSET
BY 50% OF S.S. BENEFIT AT AGE 65 & S.S.
PERCENT OF SALARY
120%
110%
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
$0
$20
$40
$60
$80
(Thousands)
SALARY AS OF RETIREMENT
Maine
+ Maine BY 50% of S.S

TABLE 5 MAINE BENEFITS ONLY

OFFSET BY 50% OF S.S.

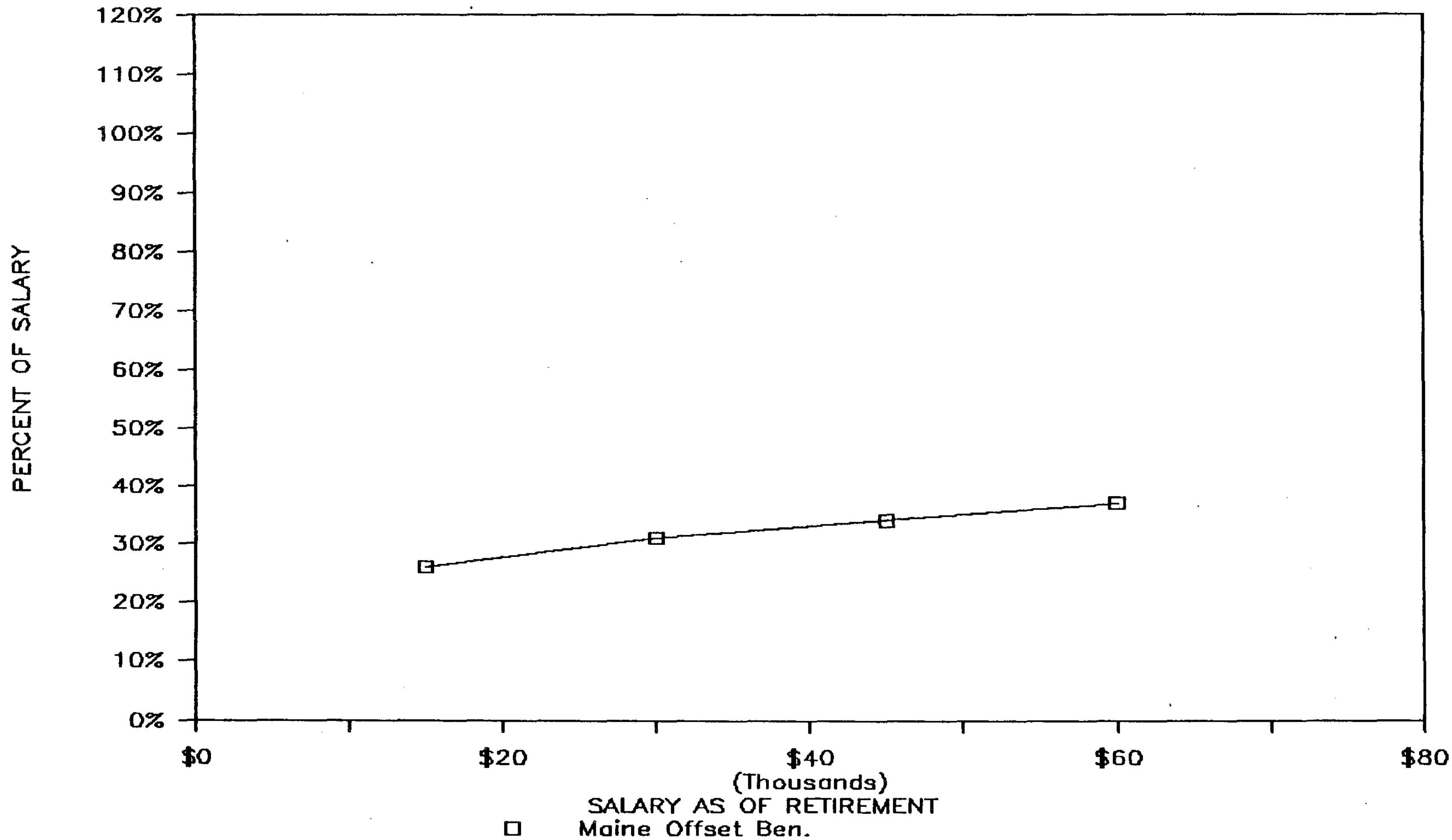


TABLE 6 FEDERAL PLAN AT AGE 65 WITH

30 YRS SERVICE INCLUDING 5% INTO T.S.P.

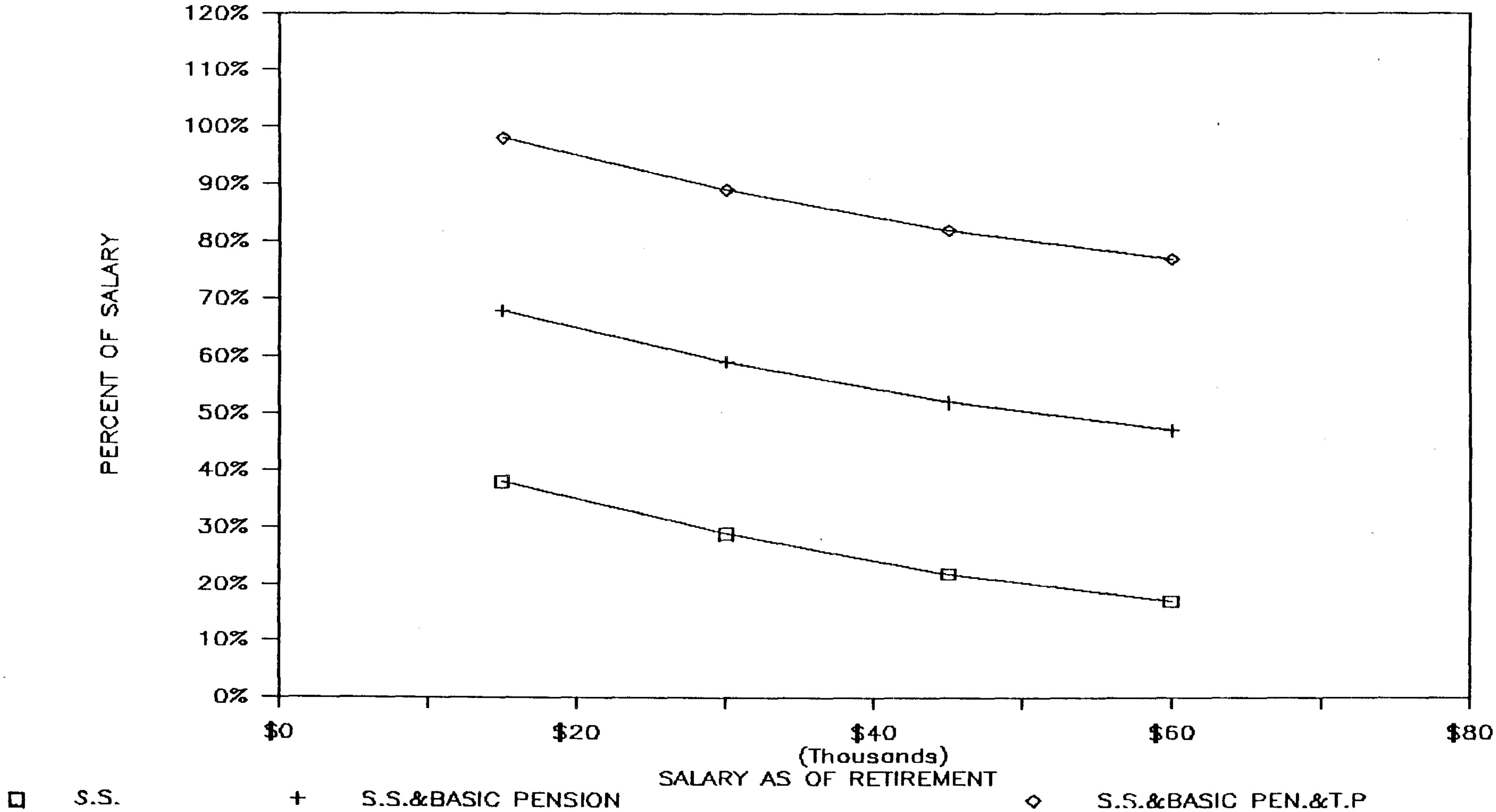
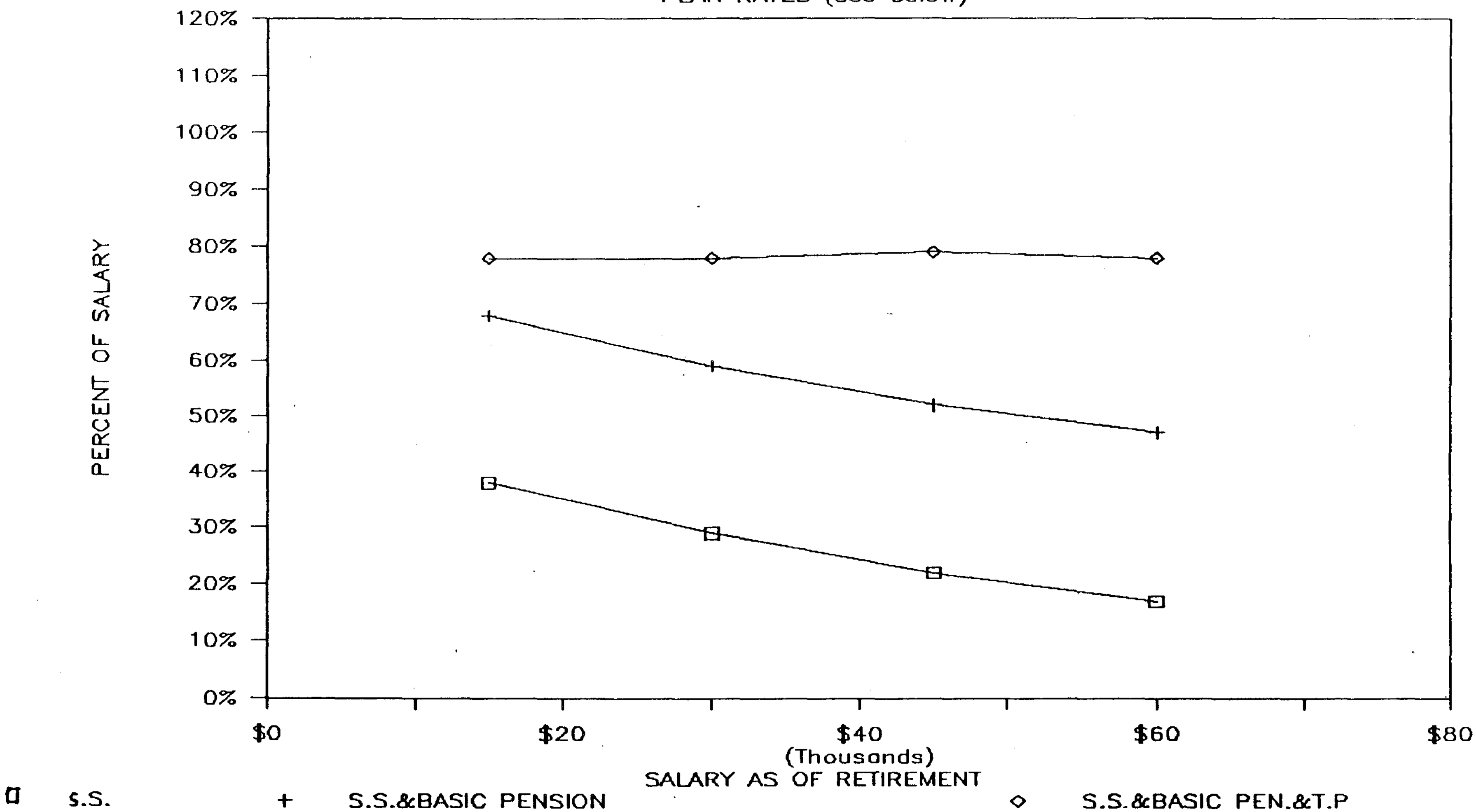


TABLE 7 SAME AS TABLE 6 EXCEPT THRIFT

PLAN RATES (see below)



Assumes	average	$15,000	employee	contributes	1%
"	"	30,000	"	"	3%
"	"	45,000	"	"	4%
"	"	60,000	"	"	5%

Appendix M

State of Maine v. MSEA et al.
Decision of the Maine Supreme Judicial Court

MAINE SUPREME JUDICIAL COURT

Reporter of Decisions
Decision No. 4668
Law Docket No. Ken-87-44

STATE OF MAINE

v.

MAINE STATE EMPLOYEES ASSOCIATION *et al*.

Argued September 2, 1987
Decided February 23, 1988

Before NICHOLS, ROBERTS, WATHEN, GLASSMAN, SCOLNIK, and CLIFFORD, JJ.

GLASSMAN, J.

The Maine State Employees Association (the Union), as the certified bargaining unit for employees employed by the State of Maine, appeals \ judgment of the Superior Court (Kennebec County) vacating the order of the Maine Labor Relations Board (the Board) that the State cease and desist from failing and refusing to negotiate about retirement benefits proposals. The Union challenges the Superior Court's conclusion that by enactment of the retirement law, which sets out by number employee retirement benefits and eligibility requirements, the Legislature removed retirement issues from the ambit of collective bargaining. We affirm the judgment.

I

In December, 1982, the State and the Union began bargaining for collective agreements to succeed those scheduled to expire on June 30, 1983. During negotiations the Union proposed four new retirement benefits standards. The first two proposals sought to amend retirement plans for two groups of employees by creating eligibility for retirement benefits after twenty (20) years of State service, instead of after twenty-five (25) years as then required by 5 M.R.S.A. § 1121 (Supp. 1985).[1] The third proposal sought to change the basis of determining survival benefits from fixed dollar amounts set by 5 M.R.S.A. § 1124(1)(B)(1) to a rate based on the employee's average final compensation and years of State service. The final proposal was to allow the purchase of military service credits after ten (10) years of service instead of fifteen (15) years as required by 5 M.R.S.A. § 1094 (13)(A). The parties held a number of bargaining sessions and then resorted to the impasse resolution procedures set forth in 26 M.R.S.A. § 979-D(2)-(4).

On December 23, 1983, the Union filed a prohibited practice complaint alleging that the State had violated 26 M.R.S.A. § 979-C(1)(A) and (E) (1973)[2] by refusing to bargain about the retirement proposals. The State answered and counterclaimed alleging that it was not obliged to bargain because the proposals were prescribed or controlled by statute and asserting that the

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[1]References herein to the laws governing the Maine State Retirement System are to the 1985-86 Supplement to the Maine Revised Statutes Annotated, on which the Board relied in making its decision.

[2]26 M.R.S.A. §§ 979-C(1)(A) and (E) provide:

> 1. The public employer, its representatives and agents are prohibited from:
>
> > A. Interfering with, restraining or coercing employees in the exercise of rights guaranteed in section 979-B;
> >
> > . . . .
> >
> > E. Refusing to bargain collectively with the bargaining agent of its employees as required by section 979-D.

Union had violated section 979-C(2)(B) by insisting to impasse that the State bargain about the retirement proposals.[3] The precise issue presented to the Board was whether within the meaning of section 979-D(1)(E)(1)[4] the Union's retirement proposals were mandatory or exempt subjects of bargaining. The Board recognized that if the proposals were not mandatory subjects, the Union violated the duty to bargain by insisting on negotiating

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[3] 26 M.R.S.A. § 979-C(2)(B) provides:

> 2. State employees, State employee organizations, their agents, members and bargaining agents are prohibited from:
>
> . . . .
>
> B. Refusing to bargain with the public employer as required by section 979-D.

The State did not seek review by the Superior Court of the Board's implicit denial of the State's counterclaim.

[4] 26 M.R.S.A. § 979-D(1)(E)(1) provides in pertinent part:

> 1. On or after January 1, 1975, it shall be the obligation of the public employer and the bargaining agent to bargain collectively. "Collective bargaining" means . . . their mutual obligation:
>
> . . . .
>
> E.(1) To confer and negotiate in good faith with respect to wages, hours, working conditions and contract grievance arbitration, except that by such obligation neither party shall be compelled to agree to a proposal or be required to make a concession. 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. Such matters appropriate for collective bargaining to the extent they are not prescribed or controlled by public law. . . .

about them to the point of impasse. Alternatively, if the Union's proposals were mandatory subjects, the State violated the statutory duty by failing and refusing to negotiate about them. In determining that the Union's proposals were mandatory subjects of bargaining, the Board primarily relied on the scope of the arbitrator's authority as prescribed by the provisions of 26 M.R.S.A. § 979-D(4)(C)(3)-(4) and § 979-D(4)(D).[5] The Board reasoned that because those sections expressed the clear intent of the Act that the subject of "pensions" could be bargained to impasse, be

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[5]26 M.R.S.A. § 979-D(4)(C)(3) provides:

> C. In reaching a decision . . . the arbitrator shall consider the following factors:
>
> > . . . .
> >
> > (3) The over-all compensation presently received by the employees including direct wage compensation, vacation, holidays and excused time, insurance and pensions, medical and hospitalization benefits, the continuity and stability of employment, and all other benefits received;
> > (4) Such other factors not confined to the foregoing, which are normally and traditionally taken into consideration in the determination of wages, hours and working conditions through voluntary collective bargaining, mediation, fact-finding, arbitration or otherwise between the parties, in the public service or in private employment, including the average consumer price index.

Section 979-D(4)(D) provides:

> D. With respect to controversies over salaries, pensions and insurance, the arbitrator will recommend terms of settlement and may make findings of fact. Such recommendations and findings shall be advisory and shall not be binding upon the parties. The determination of the arbitrator on all other issues shall be final and binding on the parties.

discussed through fact finding and be an issue in interest arbitration, the proposals must be mandatory subjects of bargaining within the meaning of section 979-D(1)(E)(1). Accordingly, the Board ordered the State to cease and desist from failing and refusing to negotiate about the proposals made by the Union.

Pursuant to 26 M.R.S.A. § 979-H(7) (Supp. 1987) and M.R. Civ. P. 80C, the State sought review by the Superior Court of the Board's decision. The Superior Court held that all the Union's proposals related to specific numbers established in the retirement statutes and were, therefore, "prescribed or controlled by public law" within the express preclusion provision of 26 M.R.S.A. § 979-D(1)(E)(1) and were not bargainable. From the court's order vacating the decision of the Board, the Union appeals.

II

The single issue presented by this appeal is whether the Union's proposals are removed from collective bargaining because "prescribed or controlled by public law" as set forth in the statutes governing retirement. When, as here, the review of the Superior Court is confined to the record before the Board, we examine that same record to determine any issue presented on appeal.

In the first instance we notice that this case involves a controversy about negotiations leading to a 1983 collective bargaining agreement which has been superseded by a separate and independent collective bargaining agreement. Further, some of the involved statutes have been recodified and revised. We have previously stated that controversies which are capable of repetition and do not easily lend themselves to final judicial review as they arise may be addressed, even if moot, if the controversy continues between the parties or is highly likely to arise again. See Lynch v. Town of Kittery, 473 A.2d 1277, 1279 (Me. 1984); State v. Gleason, 404 A.2d 573, 578 (Me. 1979). In this case there can be no doubt that the controversy between the State and the Union regarding the bargainability of these issues is either a continuing one or highly likely to arise again. The relatively short time in which bargaining is normally attempted as compared to the relatively long time required for a controversy to be processed by the Board and reviewed by the court makes it unlikely that judicial review can be effected before the controversy becomes moot. Further, there is significant public interest in the resolution of the issue presented. Accordingly, the exception to the mootness rule applies.

We now turn to the specific four proposals of the Union. The Union's first two proposals for institutional employees engaged in prison management and for all law enforcement personnel were as follows:

> (1) Institutional employees in prison management receive 1/2 average final compensation after completing 20 years creditable service and reaching 50 years and contribute at a rate of 7-1/2% of earnable compensation, and that
>
> (2) Law enforcement employees receive 1/2 average final compensation after completing of 20 years creditable service without an age limit and contribute at a rate of 7-1/2% of earnable compensation.

In its claim that negotiation of these two proposals was "prohibited or controlled by public law" the State relied on the provisions of 5 M.R.S.A. §§ 1121 and 1095. Section 1121 provides that a member of the state retirement system may retire at a reduced rate prior to 60 years of age after 25 years of creditable service or at age 60 years. § 1121(1)(A) and (3). Section 1095(1) provides for a member's contribution to retirement at 6-1/2% of earnable compensation "except as hereinafter provided." A percentage rate is then provided as to various types of employment. An explicit exception to a contribution to retirement by a member appears in section 1095(9), which provides:

> When the State pays for the member's mandatory contribution pursuant to a collective bargaining contract, as authorized by section 1062, subsection 2, paragraph G, the percentage rate paid by the State shall be that rate determined by the actuary and approved by the board which provides the same net revenues to the Maine State Retirement System as the applicable mandatory rate paid by the members.

The authorization to negotiate whether the State will pay the member's mandatory contribution appears in the pertinent provisions of section 1062(2)(G):

> Notwithstanding any other provision in this chapter,[6] the State may agree to provide through a collective bargaining contract . . . payment for a member's mandatory contribution to the Maine State Retirement System as set forth in section 1095, in lieu of deducting the contribution from a member's compensation.

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[6]The statutes governing the Maine State Retirement System appeared in Chapter 101, 5 M.R.S.A. §§ 1001-1181 (Supp. 1985). We note that both sections 1095(9) and 1062(2)(G) were added by P.L. 1981, ch. 453.

It is apparent that in considering the retirement rights, benefits and obligations of a member of the state retirement system, chapter 101 must be considered in its entirety. Sections 1121 and 1095, as applicable to and governing the Union's proposals one and two, clearly illustrate that which is and that which is not excluded from collective bargaining by the "prescribed and controlled" exception in section 979-D(1)(E)(1). Section 1121 contains a positive directive as to age and length of creditable service required before a member may retire. Section 1095 mandates the percentage of earnable compensation each member shall contribute to retirement but expressly provides that through collective bargaining negotiations the State can contract to provide payment for a member's contribution. See State v. Maine Labor Relations Board, 413 A.2d 510, 515 (Me. 1980). Accordingly, we agree with the State that the Union's proposals one and two directed toward age and length of creditable service required before a member can retire were excepted from the duty to bargain, as is the percentage of earnable compensation to be contributed by a member as set forth in section 1095. However, whether the contribution is deducted from a member's compensation or paid by the State may be provided through a collective bargaining contract, and accordingly is not excepted from the duty to bargain. See sections 1095(9) and 1062(2)(G).

We apply a similar analysis to the Union's proposal number four that military service credits be available for purchase after ten (10) years of creditable service. The State claimed that 5 M.R.S.A. § 1094(13) providing for purchase after fifteen (15) years of creditable service "prohibited or controlled" this proposal and exempted it from mandatory collective bargaining. The Board noted that because paragraph 2 of section 1094(13) provided, inter alia, "Nothing in this paragraph may be construed to affect in any way the rights of public employees to bargain collectively for terms and conditions of employment," that "the topic of military service credits is appropriate for collective bargaining." We disagree. Paragraph 2 of section 1094(13) was inserted by P.L. 1981, ch. 217, at the same time the Legislature added subsection (9) to section 1095 and subsection G to section 1062(2), setting forth that portion of the retirement system that could be addressed in collective bargaining negotiations. Section 1094(13) not only addresses the length of service required before entitlement to purchase of military service credits, but also requires that a contribution to the retirement fund be made by each veteran for each year of military service claimed equal to the contribution by active members during that same period, as mandated by section 1095(1). It is apparent that the sentence in paragraph 2 of section 1094(13) relied on by the Board must be construed with the other provisions of that section and the other sections of chapter 101. In so doing, it becomes apparent that the only topic falling within the provisions of section 1094(13) not exempted from the duty to bargain is whether the State will pay the member's mandated contribution to the retirement fund.

Finally, we address the third and remaining Union proposal that active employee survivor benefits be based on average final compensation and years of service. The State claimed this proposal was prescribed or controlled by 5 M.R.S.A. § 1124(B)(1) (Supp. 1985). We agree. Section 1124(B)(1) provides a stated monthly allowance for (a) a disabled surviving spouse, (b) a surviving spouse who has the care of a child or children, (c) a surviving child or children, (d) a surviving spouse 60 years of age or over and (e) surviving parent or parents 60 years of age or over. This monthly allowance is unrelated to either the deceased employee's years of state service or the average compensation during state service. The language is mandatory and specific without any reference to collective bargaining.

Thus we have in section 1124(B)(1) a public policy decision of the Legislature recognizing that: (1) benefits to designated beneficiaries are ordinarily restricted to those persons who would most seriously be affected by the death of the employee; (2) an arbitrary figure not based on either length of service or rate of pay is appropriate because general experience discloses that some spouses, children, or parents are more seriously economically affected by the death of that employee than others, an effect that is probably in inverse relationship to the length of service and rate of earnings of that employee; (3) although not eligible for retirement, the deceased employee had made some contribution to the retirement fund.

We hold that within the meaning of 26 M.R.S.A. § 979-D(1)(E)(1) the public law as set forth in the Maine State Retirement System, 5 M.R.S.A. §§ 1001-1181, "prescribed or controlled" the issues contained in the four proposals of the Union and, therefore, the proposals were not subjects of mandatory bargaining. There is nothing in this record to reflect that by its proposals the Union sought through collective bargaining to have the State contract to pay members' contributions to the retirement fund, as authorized by 5 M.R.S.A. § 1062(2)(G). Accordingly, the Superior Court properly held that the Board erred in ordering the State to cease and desist from refusing to negotiate about the proposals of the Union.

The entry is:

Judgment affirmed.

All concurring.

Attorney for Plaintiff:
Sandra S. Carraher, Esq. (orally)
Bureau of Employee Relations
State House Station 79
Augusta, Maine 04333

Attorneys for Defendants:
Eric R. Nelson, Esq. (orally)
Roberta L. deAraujo, Esq.
Maine State Employees Association
65 State Street
Augusta, Maine 04333
Marc P. Ayotte, Esq.
Maine Labor Relations Board
State House Station 90
Augusta, Maine 04333

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