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PUBLIC EMPLOYEE PENSION PLANS

What methods are used in informing legislative bodies concerning problems of public employee retirement plans such as:

- (i) The cost implications of changes in benefits?
- (ii) The adequacy and appropriateness of the rate of funding of costs of such plans?

Toronto Regional Meeting

MR. ROBERT A. WISHART: Public employee retirement plans operate as nonreserve and partial reserve plans or else on the full reserve basis. In the first instance, the government appropriation is set by law at an arbitrary percentage of the employees' payroll or on an estimate of probable annual pension payments during the next 5 or 10 years. Under the nonreserve systems, the true cost of a liberalization in benefits is not evident until it is reflected in the emerging payroll many years after its adoption.

One of the chief arguments for the reserve method is that it acts as a brake on unreasonable demands of employee groups for liberalizing benefits. This is because the legislature moves more circumspectly when an immediate increase in annual appropriations is required to finance the proposed benefit improvement.

New York State adopted the earliest laws for operating retirement systems for public employees on a full reserve basis and has set the pattern for many other states. The provisions of such laws call for annual actuarial valuations in order to determine the normal rate of payment by the government to cover the current service cost, and to obtain the accrued liability payment in accordance with the specific method of funding adopted. Under such state retirement systems, the legislature depends upon the certification of the administration board as to the proper appropriation, which in turn depends on the results of the actuary's valuation.

When adoption of a benefit change is being considered, the administrative board ordinarily secures from its actuary an estimate of the cost. Sometimes an interested employee committee undertakes to have such an estimate prepared and includes the indicated cost in its brief to the legislature. For many years, New York State had a State Pension Commission to which all proposed pension legislation was referred. It served to protect the reserve systems against unsound legislation.

In certain states, including New York, New Jersey and Pennsylvania, the systems for public employees are subject to supervision and periodic examinations of the state insurance department.

In another instance, involving a complete revision of an existing Canadian system, the Royal Commission on Pensions was appointed in Newfoundland in 1958. Two years later it reported on an extensive study of the existing pension plans in that Province together with recommendations to the legislature for their revision and proper financing.

I am of the opinion that public retirement systems should be financed on a full reserve basis. This can and should be accomplished by proper legislation for adequate financing.

Incidentally, such organizations as the National Council on Teacher Retirement of the National Education Association, the National Conference on Public Employees Retirement Systems, and the Municipal Finance Officers Association of the United States and Canada are sources of very good information on public employee retirement plans.

MR. DONALD R. ANDERSON: No prudent employer will undertake pension commitments without consulting an actuary (unless use is being made of actuarially designed pension packages, such as insurance contracts). Government bodies are not exceptions to this rule. If they have ignored the rule, it certainly is not to their credit.

Assuming an actuary is appointed, he will probably deal with the elected body through one of their senior career employees. Successful communications will depend on the ability of this particular person to understand the actuarial aspects of the plan, which will often require considerable planning, patience and organization of ideas on the part of the actuary.

In situations where it is unnecessary that any progress be made on the actuarial deficit, the general level of contributions required to finance a given plan and pay the interest on the deficit can be determined by conventional actuarial methods. Then a long-term projection can be made of the pension fund to show, year by year, the expected amount of contributions, investment income and benefit payments, including a run-off of existing pensioners, and the fund balance. The results of the projection should check with the results of a conventional type actuarial valuation based on the same assumptions.

In communicating the results of an actuarial investigation into a plan of this type, certain general rules should be observed:

- (1) The main body of the report should be, as much as possible, short, free from details and readily comprehensible to a person unfamiliar with the problem. Details should be relegated to an appendix.

- (2) Unless absolutely necessary, do not show an actuarial balance sheet. It may be misunderstood, and it will rarely help the client decide what should be done.
- (3) Arguments in favor of advance funding should emphasize the need for stabilizing the burden of the plan. Long-term projections are extremely valuable in putting across points of this sort.
- (4) The actuary should reach in his own mind tentative conclusions as to attractive solutions to the cost-benefit dilemma and explore these ideas with persons with whom he is dealing before submitting his report.

MR. ROBERT W. WALKER: I think it would be of interest to describe the unique approach to this subject as adopted by Wisconsin.

A Commission known as the Governor's Retirement Study Commission was created by the 1955 State Legislature. Its general purpose was to conduct "a comprehensive study of the broad issues of policy" involved in the public retirement systems in Wisconsin.

Some years prior, there had been established a Joint Survey Committee, including two state Senators, two Assemblymen, one citizen member, and one member each from the Attorney General's Department and Insurance Department. This Joint Survey Committee was created in 1947 and had two prime functions: (a) legislative review and (b) retirement plan review, both related to *any* retirement systems for public employees.

The report of the Governor's Retirement Study Commission pointed out that most retirement legislation is complex and that it was foolish to expect the average legislator or member of the public to understand it. As a result, the report recommended that the Joint Survey Committee should continue to function and that funds be provided to enable it to do so properly. The recommendations were enacted into law in 1957.

A new Governor's Retirement Study Commission was appointed in 1957 as a continuation of the former body. Two major recommendations were made in this report:

- (1) That sufficient funds be provided to permit the Joint Survey Committee to employ a full-time research director. He would conduct continuing research on the retirement programs, serve as executive secretary to the Joint Survey Committee and would obtain Civil Service status, after a probationary period, to insure permanence and continuity.
- (2) That a Retirement Research Council be created and attached to the Joint Survey Committee to function as a part of the Committee during the legislative interims. Its composition would be similar to the Governor's Retirement Commission. Such Council would serve as a coordinating committee for the members of the several systems and would formulate retirement policy recommendations for the legislature.

Where do we stand now? A director has been employed and the whole program is in full swing. A report of the Joint Committee accompanies each bill. An annual report is also published. This report includes, for each and every bill, its purpose, the actuarial effect, the recommendations of the Joint Committee, and the resultant course of the legislation.

MR. DAVIS H. ROENISCH: I would like to make some comments on this topic, with particular reference to Illinois.

Some years ago, its various governmental programs, particularly those for police and firemen, were badly underfinanced and completely uncoordinated. To cure the situation, the State of Illinois set up a Pension Laws Commission, consisting of members of the legislature, to which the proposals of the actuaries of the public retirement systems could be made directly.

During this period, a complex program for integrating the public or municipal programs with the Social Security system was successfully worked out. This year an entirely revised law has been drafted with the blessing of the Pension Laws Commission and should have no difficulty in being enacted into law. The Commission has been instrumental in setting a single pension pattern for the entire state. It has also recommended financing on a current cost basis and linked appropriations to the respective public retirement systems, either as a percentage of payroll or as a multiple of employee contributions.

The Pension Laws Commission produces a report to which their actuary makes a very substantial contribution. Such report includes a section devoted to the "philosophy" of public retirement systems in the state. I think that this serves a very important and useful function because it enables the consulting actuary who is the advisor to a particular public system to know in which directions he can move and expect legislative approval.

Los Angeles Regional Meeting

MR. RALPH R. NELSON: I think sometimes contrasts in methods of handling these things clarify some of the questions, and I have two examples.

In the 1880's the State of California passed its first fire and police retirement system. It provided the usual one-half salary for retirement at age fifty-five, for disability retirement, or to the widow of a policeman or fireman killed in the line of duty. Without paying any attention to the cost of the benefits, they set up the contributions for the communities the law applied to. The contributions consisted of fines and rewards, and

a 2 percent employer contribution if needed. The contributions were wholly inadequate, and the fund went bankrupt.

The other example dates back to 1912 when the United States Government first considered the installation of a retirement plan for public employees. The introductory statement was signed by William Howard Taft and said that each employee would receive a retirement allowance of one-half salary, not to exceed \$600 per year, at age 70. The plan was to be "employee pay all," and there was to be no employer contribution. The employer's sole contribution was to guarantee 4 percent interest on the fund. Their method of determining the cost of the plan was to compare the cost of the benefits with the cost of retaining employees over age 70 in service. One department they looked at had thirty-three people over age 70 who were performing only at 56 percent of their full job, so fell 44 percent short of the normal performance. They concluded that they could retire the 33 people, considering their failure to do a good job, and it would cost them only \$2,060 a year for the payment of these pensions.

For municipalities in California there are very detailed laws. They are detailed to guard against public officials who, if not hedged in with laws, will be very generous in the benefits and require only small employee contributions. There are several hundred public agencies participating in the State Employees Retirement System. They do so simply by entering into a contract with the State.

Many municipalities have individual plans, and their laws prescribe a contribution as a percentage of salary. If the law changes the benefits, it must also change the contribution rate. In all my many years of experience in California and adjacent states, I have known of only one case where there was a material change in benefits without a corresponding change in contribution rate.

There is one system in California which does not have a full reserve system, but maintains a reserve derived only from members' contributions. This is not as dangerous here for the employees as it is in some states, because in California, once a public employer passes a law covering public employees, it is on the risk and cannot get off. Even in this System, every benefit change considered by the legislature is valued, and the legislature always knows what the cost would be on a reserve basis. You never know, however, how long public bodies will follow these practices, and where there is no requirement that contributions be changed if benefits are changed, benefits may some day be granted without considering the cost.

MR. GERALD G. TOY: In Wisconsin a Joint Survey Committee on retirement systems was established by the legislature in 1947.

The law establishing the committee specifies that no bill creating or modifying a public employee retirement system shall be enacted until it has been referred to the J.S.C. and until the committee has submitted a written report on the proposed bill. Each report contains the probable cost of the bill, the effect on actuarial soundness, and the desirability of the proposal related to public policy. The general purpose of the J.S.C. is to preserve the soundness of the various retirement systems.

The committee is presently composed of seven members: four members of the legislature (two senators and two assemblymen), an appointee of the attorney general, a representative of the insurance commissioner, and a public member appointed by the governor.

Each legislative session has seen many pension bills submitted to the committee. It has also reviewed amendments to many bills for reports thereon. For example, in the 1957 session, there were 86 such reports prepared and submitted to the legislature.

In addition to its duties during the legislative session, the J.S.C. has interim duties and is empowered to do the following:

- (i) To make investigations and reports to the legislature on any retirement system for public employees.
- (ii) To hold hearings and examine witnesses.
- (iii) To require officers of public retirement systems to provide financial data as well as investment data regarding their funds.

A full-time research director has been employed to furnish much-needed continuity in the committee's work as well as to draft legislation, conduct continuing research, and serve as the executive secretary of the committee.

In addition, a Retirement Research Council has been created. This Council consists of the J.S.C. and several additional members who provide representation to the groups affected by the retirement systems as well as to the public. The Council assists the J.S.C. in its activities between legislative sessions and formulates retirement policy recommendations to the legislature.

MR. WILLIAM HALL: One method of informing legislative bodies is by means of a special commission appointed for this purpose. The commission may retain an independent actuary or consultant. An example of this method is the Illinois Public Employees Pension Laws Commission. This is a permanent commission composed of five members

of the Illinois House of Representatives appointed by the Speaker of the House, five members of the Senate appointed by the President Pro Tempore, and five persons appointed by the Governor. The appointments are made for two year terms.

The Illinois Commission has comprehensive authority which requires evaluation and analysis of all pension laws and proposals with recommendations for appropriate action.

Another method is through the action of a temporary legislative committee formed for this purpose who may consult with the board of trustees of the particular plan or the board's secretary. If the problems are of sufficient financial importance, the board of trustees will call upon its actuary, if permanently retained, or an independent actuary for a report and recommendations. In some instances the actuary will prepare the initial draft of the proposed legislation. The board of trustees of the plan may sponsor certain changes. A review of the plan with regard to recommendations for changes may be required by law either periodically or in the event of the occurrence of certain events, such as a change in Social Security taxes or benefits. This arrangement may typically occur in state or municipal employee plans.

In publicly owned public utility employee plans, the legislative body may be primarily concerned that the utility's total rate structure can support the cost of the plan along with other operating expenses. Therefore, legislative action may be concerned for the most part with broad control measures, such as limiting total benefits as a percentage of final average compensation or perhaps requiring that employee members must pay at least half the future service cost of the plan. Any changes will be sponsored by the public utility and may require the approval of a majority of the plan members. The legislative body will probably be informed by means of special committee hearings.

The ordinance under which the Employees Retirement System of the City of St. Louis was established formally specifies the procedure to be followed with regard to establishing the initial benefits and costs. The plan was to be designed and proposed by the Director of Personnel of the City of St. Louis and approved by the Civil Service Commission before submission to the Board of Aldermen of the City. However, the Board of Aldermen were only to approve or disapprove the plan as proposed.

In some instances legislative bodies may be informed of retirement plan problems through the lobbying of interested organizations such as a league of municipalities or municipal employees' organizations. Such an organization may even finance an actuarial cost study of certain desired changes.

As a practical matter, the actuary connected with a public plan or familiar with such plans must inform legislative bodies of retirement plan problems by means of reports, discussions, or any other method of making himself heard whenever the need arises.

MR. REINHARD A. HOHAUS: New York State has a history of over forty years of operation of its employees retirement system on an actuarial basis. The actuary of the state system is a Fellow of our body. Annual reports are made which include valuation of assets and liabilities. The amount to pay all the state's obligations to the system for each fiscal year is included in the next year's appropriation bill. The Insurance Department examines the retirement system just as a domestic company is examined.

In addition, and this is very important, there is an Advisory Council on Pensions which is appointed by the Governor with the advice and consent of the Senate. It has the status of a state commission. Its seven members include a lawyer, a banker, a businessman, a CPA, and an actuary.

The Council can, and does, advise and recommend on its own initiative on any phase of the retirement system. It is frequently asked by the Governor for advice on bills regarding benefits, investments, and other matters.

The Advisory Council has a very good record as to the acceptance of its recommendations by the Governor and legislature. An important factor is that elected officials and the legislators are covered under the retirement system. This doubtless gives them a keen interest in the system.

There is a great need for our members to give assistance as a public service in the field of public employee retirement systems. Those of us who are retiring or near retiring can find it a helpful way to carry on some of our activities. The younger men will find it a challenging experience, and will learn a great deal about the operation of government bodies and the political environment.