

MEMORANDUM

To: Subcommittee on HB 1645
Fr: Rep. Neal M. Kurk
Re: Suggested Amendments
Dt: February 21, 2008

HB 1645 should be amended to place the NHRS pension fund on a sound financial basis permanently. We must deal now with the estimated \$2.7 billion unfunded liability. This requires acknowledging:

first, the changing relationship between employee working lives and employee life expectancies. The former have been relatively stable (65 has been the standard retirement age for decades), and the latter have been growing over time; both have resulted in greater fund obligations paid for largely by unsustainable increases in employer rates; and

second, the "unholy alliance" between public employees seeking greater benefits and public employers seeking lower rates. As the Commission report makes abundantly clear, the system is presently under funded because over the past three decades public employers have pushed for and received lower-than-justified contribution rates and public employees have pushed for and received higher-than-justified benefits. Public employers benefited from the change to open group aggregate accounting and higher assumed rates of return; public employees benefited from the creation of the special account and the flexibility that the definition of AFC put in their hands. In each case, the financial soundness of the pension fund was sacrificed.

Public employers and employees have been at the bar, ordered the drinks and enjoyed them. And they may continue to do so -- but only if they pay their tab. Now.

Here's how (section references are to the Summary dated 2/11/08):

1. "Earnable compensation" must be defined so it cannot be "gamed." (See sections 1 and 15)

Current law allows "gaming" of the system by employees (huge amounts of voluntary overtime in the final three years, for example) and employers (severance pay in the final year to encourage early retirement). Such "gaming" increases the obligations of the fund without providing sufficient contributions from employers and employees over the employees' careers to support the obligation.

One way to eliminate "gaming" is to define earnable compensation as base pay plus mandatory overtime in the final year. Another way is to cap earnable compensation at, say, 125% of base pay in the final year. Either will permit a more accurate actuarial calculation of public employer contributions and avoid unfunded obligations. Of course, nothing would prevent public employees from receiving voluntary overtime, vacation, holiday, severance and other forms of compensation in their final year or at any other time. It just wouldn't count toward their "earnable compensation" for pension purposes.

The change should apply to public employees hired after the effective date of the bill and, to the extent it is legal to do so, to current employees; it should not apply to retired employees.

2. Adjust the eligibility for both Group I and Group II retirement benefits by lengthening the required years of service to reflect increasing life expectancies. (See sections 31 -36).

Current law gives a pension of 50% of AFC to Group I after 30 years of service and 55 years of age and to Group II after 20 years of service and 45 years of age. With life expectancies lengthening, pension benefits are being paid for longer periods of time. If the employee's working life is not similarly lengthened, the employee's proportion of the cost of providing a longer pension is reduced and the employer's burden is increased. This burden shift must be addressed. The bill's effort to deal with this is partial, increasing the years of service for new members of Group II only. Moreover, by putting a specific number of years into statute, rather than through a formula, the proposal is a temporary fix and will have to be addressed periodically as life expectancies continue to increase.

One solution is to increase the employees' years of service by some proportion of the years that their life expectancies increase. Another is to retain the current years of service but increase the employees' contribution rate based on increasing life expectancies.

In either case, this change would apply to new employees only.

3. Limit the maximum initial retirement pension to a percentage of "earnable compensation" (as defined in 1. above) so the system is perceived as fair and reasonable by taxpayers. (See sections 16 and 37.)

Under current law, public employees' can receive pensions that exceed their final base pay. This is done by working more years than are required for a 50% pension and by increasing AFC in a variety of ways. That large a pension makes little economic sense and is costly for the system. It makes the employees look greedy and the system out of control.

The proposed limit at 75% of "earnable compensation" should be accompanied by a comparable limitation on employees' contributions. That is, once an employee has contributed for the number of years necessary to earn a 75% pension, no further payroll deductions for retirement contributions would be required.

4. Put independent trustees in charge of NHRS. (See sections 17 and 20.)

Currently, and in the bill, there are trustees who are chosen because they are members of some group that, at some time, was perceived to need a "seat at the table." The Commission report details the conflicts many of those trustees had between their fiduciary obligation to the System and their representative obligation to their constituencies. This is an untenable position for anyone. The trustees' paramount and, indeed, sole obligation is to the System and its members; there can be no other as a matter of law. Equally important, there should be no perception on the part of the public or a member of any group that a trustee "represents" anyone.

None of the trustees should be appointed based on membership in a group. All of the trustees should be experienced in business or investments and be individuals of standing and respect in the state. There should be no trustees representing members or local government, and, save perhaps for the state treasurer, there should be none who are elected officials. All trustees should be appointed by the governor.

5. Provide for COLAs along the lines recommended by the Commission but eliminate the special account. (See sections 21-24; HB 653 (2007).)

Under current law (HB 653), the flow of “gain sharing” into the special account will cease until the pension fund has a funded ratio of 85% at which time “gain sharing” resumes, albeit skimming off earnings at a higher and fixed level (earnings over 10.5%). “Gain sharing” is part of the reason the pension fund has a \$2.7 billion UAAL. It is a fatally flawed concept, part of the “free lunch” culture. The idea that we would allow it to rise from its state of suspended animation and again suck the life out of the pension fund is bizarre. Haven’t we learned our lesson?

When the funds in the special account have been exhausted by providing the Commission-recommended COLAs for retired public employees during the transition to employee-funded COLAs, public employers should pay for them from general revenues.