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An Act To Reform the Maine Public Employees Retirement System

CONCEPT DRAFT SUMMARY

This bill is a concept draft pursuant to Joint Rule 208.

This bill proposes to reform the Public Employees Retirement System plan consistent with the following principles.

First, retirement benefits that have already been accrued based on an employee's past years of service should be fully protected.

Second, plan changes should not create additional hardship for people who are already retired or who are near retirement. Instead, cost savings should be concentrated among those who are further from retirement, and who can adjust their preretirement planning and behavior to the reformed pension environment.

Third, to the extent possible, the reform should prevent dramatic discontinuities between the pensions of workers just vested and those approaching vesting or between workers just hired and future hires.

Fourth, cost-of-living adjustment should be retained as insurance for state retirees who do not generally benefit from an inflation-adjusted Social Security annuity. These cost-of-living adjustments have particular importance in insuring against the risk of a long life, when compounded inflation can erode more substantially the real value of the pension.

Fifth, the accrual of benefits going forward should be based on a benefit formula that more closely parallels the benefits most widely available in the private sector, while taking advantage of the financial gains from being a qualified Social Security opt-out plan.

Sixth, the plan should be flexible to employees with differing benefit preferences, establishing a baseline benefit that is adequate for those comfortable with later retirement or a smaller pension combined with a voluntary supplemental program for those preferring earlier retirement or a larger pension.

The reformed state pension plan consists of the following elements.

1. Defined Benefit Pension Plan

The baseline pension plan would continue to be a traditional defined benefit pension plan, similar in structure to the plan in place today.

The reformed plan draws a distinct line between past and future benefit accruals. This is done by calculating separately the Part A and Part B pension components and applying them differentially to past and future years of service, respectively. A retiring employee's total pension is the sum of Part A and Part B.

The Part A component of the pension applies to past service only and is calculated based on the benefit formula that applies to each employee who is already a participant in the current plan. For most employees, the formula provides 2% of final average salary per year of service, full benefits at 60 or 62 years of age, benefit reductions of 4 or 6% per year for earlier retirement and annual cost-of-living adjustments of up to 4% after retirement. Final average salary is based on the average of the highest 3 years.

The Part B component applies to future years of service only. The full benefit amount in Part B is 2% of final average salary, based on the average of the highest 5 years. Eligibility for the full benefit formula under Part B conforms to the normal retirement age of Social Security, including the ongoing phaseback in the normal retirement age from 65 to 67 years of age, and any future Social Security reforms. Annual cost-of-living adjustments of up to 4% after retirement are retained in the Part B formula.

The Part B benefit is decreased for retirement before the normal retirement age, or increased for retirement after the normal retirement age, using adjustment factors that conform to the adjustment factors used in the Social Security system. Social Security currently reduces benefits by 6 2/3% per year for each year before the normal retirement age and increases benefits by 8% per year for those retiring after the normal retirement age up to 70 years of age. The Maine plan would conform to these actuarial adjustment factors and to any future changes in the Social Security adjustment rates.

Current retirees would be unaffected by the reform, receiving their full pension through Part A and their full cost-of-living adjustment. Workers close to retirement, having already accrued most of their final pension benefit through Part A, would be minimally affected by the reforms. Employees who are further from retirement would have incrementally more of their pension benefit determined through Part B, preventing any sharp discontinuity between those covered fully or primarily through Part A and those covered fully or primarily through Part B.

2. Defined Contribution Pension Plan

Employees wishing to supplement their baseline defined benefit pension plan or to enable retirement at a younger age could voluntarily participate in a supplementary defined contribution savings plan. The savings plan would be an enhanced version of the plan already offered to state employees, but providing a 50% employer match, up to 8% of salary contributed by the employee, matched by up to 4% of salary contributed by the State.

New employees would be enrolled automatically in the defined benefit pension plan program with a default employee contribution rate of 4%, matched by a 2% state contribution, and allocated among investment options according to a default protocol established by the Board of Trustees of the Maine Public Employees Retirement System. Employees would have full authority to opt out of the plan, change the contribution rate or change the investment allocation.

3. Transitional Options

Each employee currently participating in the Maine Public Employees Retirement System would have several options in transitioning to the reformed system.

The first option is to retain the full Part A and Part B benefits as outlined in section 1.

The 2nd option is to cash out the Part A benefit accrual, based on the present value of accrued benefits, as calculated for each employee individually. The cash out would generally be rolled into the State's retirement savings plan established under Section 457 of the federal Internal Revenue Code or into a qualified individual retirement account. Cash outs may be advantageous to individuals planning to leave state employment before retirement and possibly to those subject to Social Security offset provisions.

The 3rd option is to convert years of service under Part A into years of service under Part B. The conversion rate would be established to equate the present discounted value of the accrued benefit and be advantageous to individuals planning to continue working in state employment after 60 or 62 years of age.