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NEBRASKA RETIREMENT SYSTEMS COMMITTEE and BUSINESS AND LABOR
COMMITTEE
September 26, 2011

[LR215 LR216]

The Committee on Nebraska Retirement Systems and the Committee on Business and Labor met at 9:00 a.m. on Monday, September 26, 2011, at Metro Community College South Campus, Omaha, Nebraska, for the purpose of conducting a joint public interim hearing on LR215 and LR216. Senators present: Jeremy Nordquist, Chairperson, Committee on Nebraska Retirement Systems; Steve Lathrop, Chairperson, Committee on Business and Labor; Heath Mello; Burke Harr; Jim Smith; and Norm Wallman. Senators absent: Tanya Cook; Brad Ashford; Tom Carlson; LeRoy Louden; Lavon Heidemann; Russ Karpisek; and Dave Pankonin. [LR215 LR216]

SENATOR NORDQUIST: (Exhibit 1) Good morning, everyone, and welcome to this interim study hearing on LR215 and LR216. The purpose of this interim study really is to collect data and kind of do a fact-finding mission on political subdivisions' pension plans in our state--specifically, defined benefits plans. Prior to being elected to the Legislature, I served as the research analyst for the Retirement Systems Committee, and it was pretty evident during that time, and through up till now, we haven't had an opportunity to do this and get a real comprehensive look at what's out there in our political subdivisions related to this topic. So I'm thankful we've had this opportunity and thankful for the Business and Labor Committee and Senator Lathrop for joining us. I'd like to, before we begin, thank the staffs of both committees and the staff of Senator Smith's office for helping to pull together all the information and line up testifiers for us today. Just a couple notes: We have a hearing agenda which is in the back of the room. There's six presenters and then we'll take public testimony, and that will just kind of be in a first come, first serve order. Please, if you are going to testify, there are blues sheets to sign in, in the back, and I ask everyone also to silence your cell phones. With that, I'll introduce the staff. Here first to my far right is Laurie Vollertsen, the committee clerk for the Retirement Systems Committee. Next to Senator Lathrop is Molly Burton, the legal counsel for the Business and Labor Committee, and then to my left is Kate Allen, the legal counsel for the Retirement Systems Committee. And then we'll start

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down on the right and each senator can introduce themselves. To my right would be you, buddy. [LR215 LR216]

SENATOR HARR: I'll introduce myself. Senator Burke Harr, Legislative District 8 here in Omaha. [LR215 LR216]

SENATOR MELLO: Heath Mello, State Senator District 5, which we're currently in right now, so welcome to south Omaha. [LR215 LR216]

SENATOR LATHROP: Steve Lathrop, District 12, Omaha, Millard, and Ralston. [LR215 LR216]

SENATOR NORDQUIST: And Jeremy Nordquist, District 7, downtown and south Omaha. [LR215 LR216]

SENATOR WALLMAN: Senator Wallman, District 30, which is Beatrice and south Lincoln. [LR215 LR216]

SENATOR NORDQUIST: All right. With that...oh, and Senator Smith. With that, we'll turn it over to him to open on this interim study and provide some comments. [LR215 LR216]

SENATOR SMITH: Good morning, members of the Business and Labor Committee and the Nebraska Retirement Systems Committee. It's good to see you all again, and I hope you all had a good summer. For the record, my name is Jim Smith, J-i-m S-m-i-t-h. I represent the 14th Legislative District in Sarpy County, and I am here today to introduce LR216. I want to thank the Chairpersons of the two committees, Senators Lathrop and Nordquist, for cosponsoring this interim study and agreeing to hold a joint hearing. I also want to thank Senator Ashford, who unfortunately is not able to be here today, for being a cosponsor of LR216. During the 2011 legislative session I introduced LB688, which

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was heard and subsequently held at my request by the Retirement Committee. The bill was broadly drafted and included language that would increase the age of certain public employees and also prohibit elected officials from participating in public retirement plans. LR216, I believe, is a better approach to this issue. Rather than assume certain solutions, as in LB688, LR216 seeks to understand the level of risk to our state of underfunded benefit plans, particularly pension plans, and then to determine what solutions are best for Nebraska. Recent budget problems experienced by local governments, and last session's CIR debate alone, make it clear that now is the time to take a serious look at the cost and sustainability of our public pension plans. I feel it is our responsibility as legislators to work to protect the retirement funds of our public workers. But it is also our responsibility to ensure that the funding obligations of such plans do not break the backs nor the banks of future generations. Our state's population is aging and a growing portion of that population is now employed by a governmental entity. Therefore, maintaining a sound public retirement system is only going to continue to become more and more challenging. Nebraska is not alone in facing an uncertain retirement system. According to a report by the Center for Retirement Research at Boston College, our nation's public pension plans are underfunded by \$700 billion, and these estimates increase significantly if more reasonable earning rates are used in the calculations. It is therefore no surprise that at least 26 states have made changes to their retirement systems in the past year, and a total of 39 states have made significant changes over the past two years according to the National Conference of State Legislators. As I mentioned during the hearing on LB688, I am not advocating for the Legislature to micromanage local governments, but I do believe with this study we can lead the way in exploring best practices to ensure sustainable and affordable retirement systems. It is my understanding that the legal counsels of the committees, along with my staff, have attempted to identify those government entities that offer defined benefit plans and to survey those groups. In addition, since LB688 proposed to eliminate retirement benefits for elected officials, we also charted which elected officials did in fact receive such benefits. The charts and summaries of the staffs' and the counsels' research are provided in your notebooks. With that, again I appreciate everybody taking

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the time to have a public hearing on this and I'll look forward to the discussion. Thank you very much. [LR215 LR216]

SENATOR NORDQUIST: Thank you, Senator Smith. Any questions from the committee? None at this time. Thank you. Our next testifier will be Kate Allen, legal counsel from the Retirement Committee, to give a kind of a brief overview of the legal framework of public pensions as contractual rights and court precedent. I also neglected to introduce Kate Wolfe, the committee clerk for the Business and Labor Committee. [LR215 LR216]

KATE ALLEN: Good morning. My name is Kate Allen and I'm legal counsel for the Retirement Committee. Until the 1970s, courts generally viewed public pensions as mere gratuities that do not vest and could be withdrawn or amended at any time. Today most states, including Nebraska, have abandoned the gratuity theory and embraced public pensions as contractual in nature, which provides significantly more protection to public pension plan participants. There are a few exceptions to the contract theory that are being used among the states. Minnesota extends protection under principle of promissory estoppel, and they look at whether there was a clear and definite promise, whether the promisor intended to induce reliance and such reliance occurred, and the promise must be enforced to prevent injustice. In Minnesota, if the conditions of promissory estoppel are satisfied, then the terms of the promise are enforceable as a contract. So it's kind of a two-step process in Minnesota. A few other states, including Connecticut, Wisconsin, Wyoming, Maine, New Mexico, and Ohio, courts have all ruled that the public pension plans create protectable property interests. In the states where pension benefits are determined to be contractual in nature, like in Nebraska, even the forms and the range of protections differ. Some states have a constitutional provision that specifically provides public pension plans create a contract between the state and participant. These states include New York, Illinois, Alaska, Arizona, Hawaii, and Michigan. However, the language in these constitutional provisions and the protections they provide also vary. New York and Illinois specifically protect both past and future

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accrued benefits, while other states' constitutional language only protect past benefits that have already been earned. In most states, including Nebraska, courts have inferred legislative intent to create a contract through an examination of the relevant facts and circumstances. Even among states where contracts have been inferred legislative intent to create a contract, the courts again have differed on whether those protections extend to just past accrued benefits, or include future accrued benefits as well. In states where a contract for pension benefits is created by statute or implied by facts and circumstances, courts must analyze any proposed changes to public pension plans under the federal constitutional contracts clause or the relevant state constitution's contract clause. The Nebraska Supreme Court has recognized that state retirement systems create contracts between the state and its employees who are members of the system. In 1982, in Halpin v. Nebraska State Patrolmen's Retirement System, the court determined that employees' reasonable expectations of pension benefits are contractual rights protected under the federal and state constitutions, which vest when the employee remains working or becomes employed under such benefits provisions. In Halpin, the court held that public employees' rights in their pension plans vested prior to them becoming eligible to receive the pension payments based on the fact that other terms and conditions of employment, like salary, were directly affected by the pension plans in effect when the employee took the job. In 1995, in Calabro v. City of Omaha, the court adopted what's known as the California rule as the rule in Nebraska, and held that a public employee's constitutionally protected right in his or her pension vests upon the acceptance and commencement of employment, subject to reasonable and equitable unilateral changes by the Legislature. In determining whether a legislative act or an administrative action unconstitutionally impairs employees' contractual rights under the United States and Nebraska Constitutions, the court undertakes a three-part analysis as described in Calabro . The court determines "(1) whether there has been impairment of a contract; (2) whether the provisions of the act or the administrative action, in fact, operated as a substantial impairment of the contractual relations; and, if so, (3) whether that impairment is nonetheless a permissible, legitimate exercise of the state's sovereign powers." Even if an act or action is deemed a substantial impairment

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of contract, such impairment may not be necessarily unconstitutional. The act may be constitutional if it is both reasonable and necessary to serve an important public purpose. The court, in Calabro, citing Halpin, stated that "The application of the tests of necessity and reasonableness requires a much greater degree of judicial scrutiny in cases involving state action which purports to abrogate the state's own financial obligation than in cases involving an impairment by the state of purely private contracts." "That the maintenance of a retirement plan is heavily burdening a governmental unit has not itself been permitted to serve as justification for a scaling down of benefits figuring in the contract." The state may make reasonable changes or modifications to public retirement systems in which the employees hold vested contract rights, but changes that result in disadvantages to employees must be accomplished by offsetting or counterbalancing advantages. In other words, to be reasonable, modifications of the retirement system that results in disadvantages must also confer comparable new advantages. I'd be glad to respond to any questions. [LR215 LR216]

SENATOR NORDQUIST: Great, thank you, Kate. Any questions from the committee? Seeing none, thank you. Next will be Carol Ebdon from the UNO Public Pension Fund Initiative to present some data from a political subdivision survey that they've conducted, and to give us a comparison of defined benefit and defined contribution plans. [LR215 LR216]

CAROL EBDON: (Exhibit 2) Good morning. Carol Ebdon, E-b-d-o-n, University of Nebraska at Omaha, School of Public Administration. A couple of my colleagues and I, last year, began this initiative looking at public pension funds, recognizing that this is an important issue in public administration. We received some funding from the University of Nebraska Foundation to do some research and training. We are in the middle of several research projects now, one of which I'm going to tell you a little bit about, and we are also anticipating doing some training for local governments, beginning in 2012. And I was asked specifically today to talk about differences between defined benefit and defined contribution plans, as well as a little bit about this project that we're doing.

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Defined benefit plans: There are about 2,500 public plans in the U.S. currently. Defined benefit plans are those plans in which retirees receive a guaranteed benefit based on retirement age, average salary, and years of service. So it's a formula that's guaranteed. The risk is borne entirely by the pension system, by the sponsoring government in the case of a defined benefit plan. There are, as you heard earlier, there is approximately a \$700 billion to a trillion-dollar gap, currently, in funding between the assets and the liabilities on the public plans depending on the source that you look at. No one really knows for sure. Assets as estimated at about \$3.2 trillion in total for these plans. About 27 percent of state and local employees are not covered by Social Security, so defined benefit plans are about the only guarantee that many employees have in the state and local governments. The plans are not portable as some other plans are. And the big scrutiny, as you know, has come in the last few years for defined benefit plans as a result of the financial meltdown that occurred in 2008. The average loss in investments in that year alone was 25 percent for public plans. And since revenues are primarily...in pension plans, are primarily from investments, a 25 percent loss was a huge issue in that year. Fifty-eight percent of all revenues for defined benefits plans come from the investment earnings. So after a catastrophic loss such as occurred in 2008, the only...you're not going to grow your way out of that, so the only way really to get those plans back up to full funded status is by either cutting benefits or by increasing contributions, or some combination of the two. The average funded level for plans was down to 84 percent in fiscal year 2008, and down to about 78 percent in the following year 2009. A little bit of what we know about defined benefits plans from research that's been conducted recently--a couple of things. I'm particularly interested in administration, so management such as board, composition, and size are things that interest us in some of the work that we're doing right now. So those are things that can affect the rate of return. There are some studies that show that larger boards may make a difference. The percentage of board members that are plan participants may make a difference, although there are mixed findings in some of those studies. The difference in the rate of return across plans, almost 90 percent of that is based on the asset allocation--so how much of the investments are for equities versus fixed income,

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international alternatives, things like that. So again, the type of investments are extremely important. Other findings are that politics can make a difference. Governments that have fiscal constraints have been found to be more likely to underfund their plans, and there are a number of cases. New Jersey, for instance, is notorious for not funding their plans during bad years when they need money in their general fund, so they will not contribute to their pension plans in those years. Also during times of fiscal constraints, a number of governments change the actuarial assumptions that are used to make their funded levels look higher. And then, finally, larger plans typically have higher returns than smaller plans. As you heard earlier, most states have made some changes in their pension plans in the last few years. A lot of these have been cuts or increased contributions. There are a number of debates that are going on in terms of defined benefit plans, and I've kind of listed what are the five major kinds of debates that are taking place among experts. The first is: What is a reasonable rate of return? There are some who believe that using a fixed 30-year Treasury bond rate is more realistic than assuming that we're going to have 8 percent returns, which is kind of the common assumption across defined benefit plans. So that's a big issue. What is the optimal asset allocation? How much risk should public pension plans be taking? The more risk you take, there is the potential for greater returns but also the potential for greater losses. What is an acceptable funded ratio? Historically, 80 percent has been considered kind of the norm for what's acceptable. There's some debate about what that should be going forward. What is the appropriate benefit level? This, of course, is a major public policy issue for elected officials in governments: How much should employees or retirees have to live on after they retire? And then, finally, are defined benefit plans sustainable? This is particularly an issue when many private employees no longer have defined benefits plans, and taxpayers are not happy about paying for defined benefit plans for public employees. Defined contribution plans are the opposite end of the spectrum from defined benefit plans. In a defined contribution plan, the benefits are not guaranteed as they are in a defined benefit plan. The amount that a person ends up retiring on is based on how they choose to invest the funds based on the options that are presented by their plan sponsor, how much they contribute, and

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what options they choose to contribute in. And so the risk in a defined contribution plan is borne by the employee, rather than the employer in a defined benefit plan. The employer usually hires one or more service providers, and they usually have a variety of investment options. This is better for government in the sense of less risk and also lower administrative costs. On the up side for defined contribution plans also from the employees' standpoint, they have more portability. And there's research that shows that younger employees are more interested in moving between employers over the course of their lifetime as opposed to the older generations who were more interested in staying for 30 years with one employer. So the portability of a DC plan might be beneficial. There are two states that have DC plans: Michigan and Alaska. Alaska started theirs in, I think, around 2005. Indiana recently began a new DC plan for new employees but it's optional. I think that started this year. The little bit of what we know about the research related to defined contribution plans, there's actually not a lot in the public sector because most public sector employees have historically been covered by defined benefit plans. So a lot of the research is on the private sector side for defined contributions where defined contribution plans are much more common. We do know a little bit though. What we know is that participants don't change their asset allocations once they make their initial allocation. They tend to stay with what they have, which is bad over time, because the experts recommend that you should limit your risk as you get older, so your asset allocations should actually change as you go through your career. That doesn't typically happen. Also, on the public plan side, seven to nine investment options is considered best practice. Public plans tend to offer more--many more options than that. The participation rate, again this is often optional for participation. The participation rate is only 22 percent, which is extremely low. And also we found that participants and, oftentimes, the government sponsors know very, very little about the costs and the investments involved in the defined contribution plans. So there's very little expertise involved in making the decisions. One study found that 33 percent of plan participants in defined contribution plans, or in government plans at all, did not know whether they had a defined contribution or a defined benefit plan, and had no information about what their benefit levels were, so they really knew nothing about

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what they would get when they retired. And one piece from the private sector, we know that things that have made a difference are automatic enrollment. If someone has no choice and is automatically enrolled in a plan, that improves their participation; and if the employer matches, that improves the participation as well. We don't know much about the public sector yet, about that. And then our public pension fund initiative. One of the studies we're doing is looking at cities and counties in Nebraska to find out what is out there now, how many cities and counties actually have plans, what type of plans they have, what types of decisions they make. We're very interested again in the administrative side and how the decisions are made. So we asked questions about plan types, benefits and contributions, investments, and management. The Nebraska Association of Counties and the League of Municipalities cosigned the cover letters for us, which we appreciated. Unfortunately, we've had a fairly low response rate and I have very little to tell you at this point. I do have one chart in here just to show you what we've learned so far, which is that we've got a response from 220 cities, 41 percent; and 26 counties, which is only 28 percent of the counties that have responded. On the defined benefit plan side, if our respondents are representative, there are very few defined benefit plans in cities and counties. We found only six of the cities noted that they have DB plans; only four of the counties. There's a bit of confusion on the county side because some of the counties are in the state system, and some of them we think said they have plans of their own when we think they might be in the state system. So we're still working through some of that which is part of why I don't have more detailed data to give you. On the defined contribution side, 77 cities reported that they have DC plans, which is 35 percent, which is a fairly significant size. Eight of the counties, which is 31 percent, reported having DC plans. We're still sorting through the data, and again, we have some issues with the data that we have, so we're going to have to go back and ask some additional questions. And we are also hoping that we'll get responses from more counties. Certainly, as we get more information on the survey, we will provide you with more details later. What we can say, preliminarily, is that there does appear to be some confusion among the governments about exactly what they have and some basic data about their plans that they have not been able to give us. And we also had some

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anecdotal evidence that there are issues with some of the DC plans that are offered in the state of Nebraska. For example, we're aware of one jurisdiction that had to pay penalties to the IRS because they weren't following the proper law about contribution rates. We are aware of another community that has been, for several years, paying extremely high administrative costs without realizing that their costs were way higher than the average. And then we've also heard from respondents that in some cases they hire an outside vendor, and they basically just turn it over and do very little oversight and monitoring once that happens. So we think there are some issues there. So overall, I guess three main points that I would make based on the research that's been done. There are some significant differences in funding levels in DB plans across states and cities; some of them, nationally. Some of them are well funded; others are in very, very bad shape. The state of Illinois, the last number I saw, I think the state of Illinois is only 51 percent funded. So there are some significant issues, but it depends on how they've been managed and what changes have been made after the '08 crash. Secondly, there is a lot of interest in shifting from DB to DC plans. A number of states have been looking at this but it has not happened in the last few years. There are issues in terms of costs. It can be very costly, particularly when your unfunded liabilities and your DB plan are high, and there may be some labor union issues as well, that contribute to that. And then finally, just in looking at DC plans, there are a lot of questions in DC plans related to the amount of education, the amount of government oversight of those plans, and the participation rates that do lead to some important public policy questions and issues. And then the last three slides, there's simply a list of some sources if you're interested in further research. And I'd be happy to answer any questions. [LR215 LR216]

SENATOR NORDQUIST: Thank you, Carol, for that testimony. I guess the one question I have, you mentioned the, obviously, in the DC plan, the employee is the one that makes the investment choices out of an array usually, or (inaudible), yeah, so makes a selection out of a number of options. Have you seen any research...and to kind of get back to why we made the change from a DC plan to a hybrid plan in Nebraska was that employees...we saw the rates of return on their plans weren't up to par, partly; and

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partly, it was because they took the default option, which was either a conservative or conservatively moderate investment choice, and didn't see the rates of return that someone with investment experience could have gotten them. Have you seen research, nationally, related to that as well? [LR215 LR216]

CAROL EBDON: There is definitely research nationally that speaks to that and that does make that point clearly. [LR215 LR216]

SENATOR NORDQUIST: I mean I'd be very concerned that if 33 percent of plan participants don't even know what type of plan they're in, I wonder what kind of investment choices they're making then as well, so. Any other questions from the committee? [LR215 LR216]

SENATOR SMITH: Yes. Regarding the 220 cities and the 26 counties that responded to your survey, any particular observations you can make about the fiscal conditions of those that have defined contribution plans as opposed to defined benefit plans? And then also as a follow-up to that, any particular changes you're seeing taking place, movements to improve the defined benefits plans? [LR215 LR216]

CAROL EBDON: As far as the first question, again we're still looking at the data, Senator. And it's some of the information we got, again from counties, I think they were reporting information that's really part of the NPERS plan, and so we need to go back and sort that out. And we think that some that said they had DB might not really have DB, based on what they told us, and some of the asset and liability information isn't complete. So I really can't give you any details to answer that question. I hope that we'll be able to in the near future but I can't today speak to that. And in terms of the second question which was changes from DB to DC, I believe? Do you mean nationally? [LR215 LR216]

SENATOR SMITH: Or just among those that responded to the survey, were there any

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changes recently in any of their plans? [LR215 LR216]

CAROL EBDON: In what we have seen so far, we have not seen changes from the respondents in their plans. But we did not specifically ask questions related to changes. We asked more about how decisions are made, what type of investments do you use, how do you make the...do you use outside consultants, do you do things internally, do you have a board? So we were asking questions of that nature. I don't believe we specifically asked, have you made any significant changes? [LR215 LR216]

SENATOR SMITH: Okay. Thank you. [LR215 LR216]

SENATOR NORDQUIST: Thank you. Any other questions? Seeing none, thank you. [LR215 LR216]

CAROL EBDON: Thank you. [LR215 LR216]

SENATOR NORDQUIST: Our next testifier will be Donn Jones, who is an actuary from SilverStone, to talk about the potential costs associated with doing conversions just in general. Before Donn starts, I will say we have a number of handouts up here, and in an effort to save trees and government resources, if you are interested in receiving the handouts, if you sign in on the back and give us your e-mail address we will get those out either later this afternoon or tomorrow, so. Donn, please go ahead. [LR215 LR216]

DONN JONES: Good morning. My name is Donn Jones. I misspell my first name; it's D-o-n-n, last name J-o-n-e-s. I'm a principal with the SilverStone Group, and I work there as a consulting actuary and work with both corporate and governmental or public retirement systems. For two periods of time I was the actuarial consultant to the Nebraska Retirement Systems Committee, during the '80s and then for a short stint earlier in this decade. I was asked today to offer some informal remarks about the implications of a retirement plan or retirement system restructuring that would bring new

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employees into a defined contribution system, or alternatively, into a hybrid defined benefit system, and in that context, we'll assume that existing employees would remain in place with no change. The only effect would be on those hired after an effective date. Carol made reference to the types of plans and I hope I will not try your patience to go back and repeat some of the fundamental features of three types of plans: traditional defined benefit plans, the defined contribution, and the hybrid. So I'm going to start there. You can waive me off if I'm going back and becoming too basic. But, first of all, traditional defined benefit plans are those like the school, the judges, and the State Patrol in the state of Nebraska. The benefit is a monthly retirement income paid for life. The amount of that income is a function of the benefit formula, final average pay, and the years of service, in addition to the age at which the participant retires. Member contributions are defined as a percentage of pay, 5 percent of pay. Employer contributions are based on an annual actuarial valuation that takes into account all of the features that affect the plan. Both member and employer--employer in this context being the political subdivision that sponsors the plan--go into a pooled investment fund managed by professional managers. The employer contribution, as you well know, can change from year to year, reflecting a lot of different conditions, but principally, plan experience. So if there are investment losses, traditionally the contribution recommendation goes up; vice versa with investment gains. If pay goes up at rates exceeding expectations, that drives contributions up; and retirements earlier and at a higher rate tend to increase the requirements. Shift gears to defined contribution plan. Member contributions are defined as a percentage of pay. Employer contributions are also defined as a percentage of pay. Typically, the contribution rates are uniform; that is, they are the same from age to age, although they could be structured so they would be different by age or would be different by the lengths of the service of the employee. Plan experience doesn't affect the employer contribution. Of course, that's the plus that most people see. The member and the employer contribution are placed in individual retirement accounts that may be self-directed, meaning the individuals manage those funds. The benefit amount is very simply the accumulated value of that, that is vested at the point in time of termination or at ultimate retirement. Typically, the benefit is taken in

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a lump sum. Even though an annuity option may be made available, the fact that the information is presented consistently in terms of a single sum tends to lead the person to thinking, I'll take it out. Yes, they can roll it over, but there's no assurance of a life income. It will be spent at the rate at which the participant so chooses. Talk about hybrid defined benefit plans for a minute. These are defined benefit plans that look or have some feature that resemble a defined contribution plan. I think by far the most popular of the hybrids is a cash balance plan, and anything I say from this point will be in that context. Again, the state employees, and the county employees since 2003, new people have come into cash balance, those people in 2003, and then at, I think 2000 and later, had an option to choose between the two. The underlying building block is what some people call a hypothetical or notional account. It's identified for each participant. Into that notional or hypothetical account, is an employee contribution credit, let's say 5 percent of pay; as well, an employer contribution credit, let's say 10 percent of pay. And at this point it looks and smells a lot like a defined contribution plan. The change is in the third step or at interest crediting rate that has some element of guarantee associated with it is pledged to provide an assurance that the accounts will grow at, at least, some minimal level. And for that reason, it finds itself in the happy family of being a defined benefit plan. Again, the benefit amount is really related to the value of that hypothetical account. Member contributions are defined as a percentage of pay. Employer contributions, like other defined benefit plans, are based on annual actuarial valuations. They either reflect the contribution structure plan experience and the funded status of the plan. The contributions that will be recommended by the actuary maybe exceed, may be higher or lower, than the employer contribution credit. It's not like a defined contribution plan in that respect. Again, both member and employer contributions are added to a pooled investment fund, very likely the same pooled investment fund; probably one plan with two benefit structures: one that applies to existing employees, one that applies to new. While the employer contribution can change from year to year based on the actuarial valuation, typically there's moderation. Because the investment strategy policy is set in relation to the guarantee provided on the accounts, generally investment losses are smaller. Investment gains are also smaller. Pay increases don't

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have the leverage that they do under a final average pay plan because the credits are based on each year's pay during the career, and retirement patterns simply have no bearing on the employer contributions. Again, the tendency is for the participants in these plans to take a lump sum even though a monthly income option is available. All right, well, let's...with those definitions, let's talk about the implications of shifting new employees into a defined contribution plan. Some of these are overlooked, and the first one is often overlooked is that the benefit delivered is simply different. Unless you credit the contribution based on age or length of service, it's simply going to be true that members that leave earlier in their career will take more and people that work till retirement will take less, if overall, the cost of both systems are equivalent. This is simply a different distribution of benefit value. Again, we've already mentioned the fact that the form of payment tends to be lump sum, not an annuity. Early retirement features where there's unreduced benefits based on meeting a roll or meeting an age are simply not a factor because the benefit is simply limited to what's in the account. Larger employee and member contributions are expected to produce the same benefit if you buy the notion that investment managers, who are professionals, will produce over a long period of time a better rate of return than employees who are managing their own accounts. I think the heart of this discussion is really, what's the impact on what we've called employer contributions going forward? If you maintain the existing plan for existing employees and introduce a defined contribution plan for the new employees, what we have found and what most people have also found is that for a relatively long period of time the total contributions DB and DC are going to equal or exceed what you were contributing before. The actual pattern is going to depend upon the employee turnover, how rapidly you shift from one system to another, the funding status of the plan, the DB funding policy, just how responsible the political subdivision is in meeting the obligation that the actuary presents, and then, of course, the scheduled defined contribution rate. So all of those factors blend in to and affect this, but I think the thing that we want to be cautious about is, simply, don't expect a sharp decline in contribution requirements. All you're achieving over time is probably stability, not necessarily reduction in contributions. Do expect those larger contributions to exist for maybe a 15-

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20-year period, perhaps almost a generation before they're going to decline. Shift gears one more time and talk about the implications if we shift from a traditional defined benefit plan to a cash balance plan. Again, benefit delivery is like a defined contribution plan. Again, unless you grade the credits by age or service, you're going to find a greater delivery earlier and less delivery late. Form of payment tends to be lump sum. Early retirement features again are swept aside because, again, we're focusing attention on the account that's hypothetical, that's maintained. What it will purchase or what it provides is what you get. As already mentioned, we really are talking generally about two benefit structures within one plan, so we don't observe the loss of new member and employer contributions for new employees with this strategy. Those contributions will continue to flow into the same investment fund. There could be a separation; there does not necessarily have to be a separation. So at least the overall funding status of the defined benefit plan is going to continue to benefit from contributions made for new employees. Before we step away from a traditional defined benefit plan, let me talk a little bit about why those plans have been so popular. Really, if you're going to step back and design a plan that's secure for the members, provides adequate retirement income designed to attract and retain employees, the defined benefit plans have very attractive features and offer considerable flexibility. Benefit delivery tends to focus on providing retirement income for people that complete long periods of service and retire. Early retirement features can be included for a population where that seems to be justified. Cost of living factors apply very directly if your income is based on monthly income for life. Pooled assets are managed by professional investment managers and generally expected to provide a greater rate of return. And when we start to look at the unfunded liabilities, which are the crux of the matter, you manage this by plan design, funding practice, and effective investment management. Look back at plan design. Plan design is the introduction of a hybrid cash balance plan for new employees as an example of a plan design. We're not changing the contract as it relates to existing employees but you certainly can change the rate at which the new members would accrue benefits into the future. That could be done with cash balance. It could also be done with traditional defined benefit by changing the retirement age or

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changing the benefit factors that apply for new employees. Let me close with just five or six observations that are based on, I guess, my experience as a long-term observer and advisor. On the surface, these concepts seem to be pretty straightforward, but as you start to examine them, I think you're going to find that there are subtle distinctions. I have to encourage you to be patient and address those distinctions with the help of experienced advisors. Be guided by objectives. Figure out what you want to accomplish. And very likely, what you're going to want to accomplish for one set of employees will differ to some extent to the next. Finally, patience and perspective. Patience--these systems are long-term structures. Problems that exist are not going to go away in one or two or five years. Sometimes you're again talking about a generation. You have to be on the right path but expect that path to be longer than you would prefer. And last of all, perspective. I think don't be blown away by current environment. Look back for 15, 20 years at the experience of the existing plans, and make some judgment and assessment based on that longer period of time. Yes, this is the current environment, but if you focus too much attention on it, there is some chance that the decisions made will not be the best for the interest of all of the political subdivisions and the employees in those systems. Any questions? [LR215 LR216]

SENATOR NORDQUIST: Senator Lathrop. [LR215 LR216]

SENATOR LATHROP: I do. First, I want to thank you for coming here today. I always learn something when I sit down with you, and... [LR215 LR216]

DONN JONES: Well, that's the mission right there. [LR215 LR216]

SENATOR LATHROP: Yeah. And for those people who were not aware of it, you were involved in our working group on the CIR issues, and that was very valuable for me, and I think for the group to understand some of these issues. And I want to ask some questions maybe to clarify. Some of your topic, which is the cost of making a conversion, and I don't want to talk about a particular city, the city of Omaha, but I do

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want to talk about a hypothetical city if I can. And the interest in this subject matter, which is making the conversion from defined benefit to defined contribution, seems in part to be a function of the fact that we have underfunded pension, defined benefit pensions. Would you agree with that? [LR215 LR216]

DONN JONES: Yes. I think the principal concern is the variation in contribution requirements that's disconcerting. You think you know where you're at in terms of obligations on the part of the political subdivisions, and you find out you didn't, and you're affected by circumstances that are beyond your control. Investment losses, principally, is the usual culprit. And, of course, the stress is greater of when you're working with a retirement system that is underfunded because you not only have to address what's happening as you go forward but you're in a hole. [LR215 LR216]

SENATOR LATHROP: Right. And that, it strikes me, and we listened to Kate, our first testifier, talk about the legal implications of making that conversion, which is to say you can't tell somebody who has a contract right to a defined benefit contribution or a pension, that we're going to change your pension. Right? If we do something, it is going forward with the new employees. [LR215 LR216]

DONN JONES: That I think has been the accepted strategy, and I think Kate did a nice job of developing that. It's not really an actuarial topic; it's more legal. But I can say that most states struggle with that question. Interestingly, in the last two or three years, more people are asking, you know, why, and exploring it. But I think, generally speaking, the desire or the intent is to effect the plan for the new employee. [LR215 LR216]

SENATOR LATHROP: Okay. And that really is where we run into the rub in making the conversion, which is, if you are underfunded, a defined benefit plan currently is using contributions from current employees to help pay for the retirement benefits of somebody who retired five years ago. [LR215 LR216]

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DONN JONES: Right. Well, and you're also, with the shift that you've described the defined contribution, you're taking out...there's no new new flow from the new members that come on board. So those contributions and the corresponding employer contribution is going to their individual account. And those monies are very valuable, and that's why you have an underfunded plan, and the loss of some very valuable contributions makes the situation more challenging. [LR215 LR216]

SENATOR LATHROP: And if we analyze the process of making the conversion, we would start with, where do the dollars come from that pay the current retirees? And one source says: the existing members. Another source says: contributions made by the members when they were working. The other is investment income, and then contributions by the political subdivision. [LR215 LR216]

DONN JONES: That's right. [LR215 LR216]

SENATOR LATHROP: That's the pool that pays the dollar to the guy who retired five years ago. [LR215 LR216]

DONN JONES: That's correct. [LR215 LR216]

SENATOR LATHROP: And when you say to the new employees, "You're not going to participate in the defined benefit plan; going forward, you new guys are going to participate in a defined contribution plan," we essentially say to them, "The political subdivision and you will contribute to an individual account, and that account, as it grows with your years of service, when you retire that's the money you'll have available to retire." [LR215 LR216]

DONN JONES: That's correct. [LR215 LR216]

SENATOR LATHROP: When you make the conversion to a defined contribution plan for

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new employees, those new employees are no longer helping to pay the cost or the benefit to the guy who retired five years ago. [LR215 LR216]

DONN JONES: Exactly. [LR215 LR216]

SENATOR LATHROP: And as a consequence, Donn, do the political subdivisions that wish to make that conversion to defined contributions need to make up the deficiency in the pension in order to meet the obligations to those who have a contractual right, a legal right, to the defined benefit? [LR215 LR216]

DONN JONES: Absolutely. [LR215 LR216]

SENATOR LATHROP: And so if a municipality finds itself underfunded and they wish to make that conversion, they either need a long-term strategy or they need to come up with the cash to make that whole. [LR215 LR216]

DONN JONES: Yeah. Typically, the long-term strategy where again there are no, in quote, requirements--you might say there's some moral obligations, there's some legal obligations that Kate has pointed out--but, typically, you've got considerable flexibility in whether you cover that loss in 10, 20, 30, or ad infinitum. You always want to have at least a sufficient amount to cover the benefits paid to the retirees, and being able to shorten that period of time when that unfunded obligation goes away is certainly ideal. But if your average employee is 35 or 40, that plan is going to be around for 20 or 30 years, and only then will all of those obligations be established. And the requirement of a fund...you always want to have money in the plan that would cover the obligation for those that retire, and you want to have everything else you can in order to anticipate those who will retire very shortly. [LR215 LR216]

SENATOR LATHROP: So the cost to our hypothetical political subdivision, which is making up the deficiency in their plan, and the deficiency would be defined essentially

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by how much money do we need today to take care of the retirement obligation we have to all the people who have a contractual right to that DB benefit going forward. [LR215 LR216]

DONN JONES: That's correct. [LR215 LR216]

SENATOR LATHROP: And we can hope that the market will go up, which would help; but otherwise, it is the...the only two places we can get the resources to make that plan whole are the membership or the political subdivision. [LR215 LR216]

DONN JONES: And investment return. [LR215 LR216]

SENATOR LATHROP: And investment return. So we have three resources. So going forward, unless our hypothetical political subdivision issues bonds to make up the deficiency or comes to some agreement with the collective bargaining units, this needs to be a long-term approach. [LR215 LR216]

DONN JONES: Generally, it would be a long-term approach. [LR215 LR216]

SENATOR LATHROP: Okay. Thank you. And again I appreciate your being here today and your education of this committee. [LR215 LR216]

DONN JONES: All right. Thank you. [LR215 LR216]

SENATOR NORDQUIST: Thanks. Do you have a question? Okay. Someone from Omaha is going to come and present on their plan. But just so...just looking at their numbers and with your expertise here, I just want to make sure I get my hands around it. Total contribution rate on the police and fire in 2011 was 45 percent, and the normal costs is about 25.8 percent. So is that telling us that out of that 45 percent, 25.8 is going and paying the costs associated with the benefits earned in this fiscal year, and then the

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remainder is going towards the unfunded liability? [LR215 LR216]

DONN JONES: I think that's a fair way to separate it. You could be more precise about...but that's a good start. [LR215 LR216]

SENATOR NORDQUIST: Okay. Okay, I just wanted to make sure that I understood normal costs being essentially what's earned this year. [LR215 LR216]

DONN JONES: Kind of the cost assigned to the current year by the actuary. There are somewhat different methods but.. [LR215 LR216]

SENATOR NORDQUIST: And then roughly the 20 percent is, would you call it legacy costs? Or yeah... [LR215 LR216]

DONN JONES: Um-hum. I agree with that. [LR215 LR216]

SENATOR NORDQUIST: ...earned previously? Okay. Any other questions? Senator Smith. [LR215 LR216]

SENATOR SMITH: Thank you. Mr. Jones, thanks for the information. Just for clarification, on a traditional defined benefit as it moves to a defined benefit cash payout... [LR215 LR216]

DONN JONES: Cash balance. [LR215 LR216]

SENATOR SMITH: Cash balance...in those particular cases, they still look like they're the same in terms of a defined benefit because there's mandatory and directed participation in the plan. The difference is, at the end of it, on the cash option, they just receive what the value of the plan is at the end, at retirement. [LR215 LR216]

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DONN JONES: Well, both the defined contribution and the cash balance will produce that same result. I think the cash balance finds itself under the umbrella of defined benefit because the interest crediting rate, that is, in effect, the investment return, has some element of guarantee associated with it. I believe in the state of Nebraska that's not less than 5 percent. There's a formula. I would say not less 5. In a defined contribution plan, it would be however that individual had invested the account and there would be no guarantee. So the cash balance kind of comes under the umbrella of defined benefit because of the nature of the guarantee. [LR215 LR216]

SENATOR SMITH: Okay. [LR215 LR216]

SENATOR NORDQUIST: Any other questions? Seeing none, thank you so much for being here, Mr. Jones. [LR215 LR216]

DONN JONES: Thank you very much. [LR215 LR216]

SENATOR NORDQUIST: Next, we have Mark Koller and Paul Lutomski from the city of Lincoln to review their plans, and also they've done some extensive work on examining conversions, as well, for their city and will discuss that with us. [LR215 LR216]

MARK KOLLER: Good morning, Senators, committee members, and those in attendance today. My name is Mark Koller. I'm the personnel director for the city of Lincoln and Lancaster County. I'm also the administrator for the police and fire pension fund. With me today is Paul Lutomski. Paul is the pension fund officer, and we have prepared some comments relative to our plan that would address your topic today, and that would be a conversion from a DB to a DC. We're going to speak from a PowerPoint, and Paul is going to take over from this point on. Thank you. [LR215 LR216]

PAUL LUTOMSKI: Thank you. As Mark said, my name is Paul Lutomski. I want to

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clarify one thing before I get started here. The agenda says we're going to present the results of an actuarial study examining DB to DC plan. [LR215 LR216]

SENATOR HARR: May I interrupt for a second? Can you talk into the mike? [LR215 LR216]

PAUL LUTOMSKI: Sure. [LR215 LR216]

SENATOR HARR: I'm half deaf, so thank you. [LR215 LR216]

PAUL LUTOMSKI: The comments we are making here are not from an actuarial study. We do perform an actuarial study every year on our pension plan, and from that study the actuary provides and we do five-year budget forecasting. But these are just internal comments on the idea of a DB to DC conversion. As you know, the previous speakers have already covered the differences between defined contributions and defined benefit plans. The city of Lincoln has a defined contribution and the police and fire pension is a defined benefit. Civilians are in the defined contribution and I'm calling it "old" here. Normally, it has a 12 percent employer contribution and a 6 percent employee contribution. We have a new defined benefit plan implemented in the last year. So for civilians, this entails a 9 percent employer contribution and a 7 percent employee contribution. A note here is that all civilian new hires, except for one labor union, are under this plan. And as you know, there are differences between DB and DC, but I want to point out some things that are important that haven't been discussed yet is that, in the city of Lincoln defined contribution plans, those participants also contribute to Social Security, the annuity portion of that. So they're putting in, in addition to their 7 percent DC contribution, 6.2 percent for Social Security. And, of course, the city is matching that 6.2 percent. So their pension is 13.2 percent on the city's part if you want to compare DC to DB normal cost. With the defined contribution plan--our old one, our new one--DCs don't normally have any sort of coverage for death or disability benefits. And I think this is a very important distinction when you're looking at most of the types of

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people that are covered by a DB plan, because those are police officers and firefighters, and they're out there risking their lives because of their job, and civilian positions normally do not have any sort of requirement like that. So that's important to me to keep that in mind all the time when comparing DC to DB coverages. And now this is a slide, it's kind of busy, but it's a breakdown of our normal costs. And as Senator Nordquist said, this is the cost to provide benefits for services currently being rendered. The numbers here are from the last time we did an actuarial report. We do this every year. We're in the process of updating it right now. But normal costs for service pensions, which means someone that's vested, we have cliff vesting. The vesting occurs at ten years of service. So after ten years, the average--I mean this is kicks in right away when people start working--but the average percent of salary on normal costs is about 16 percent. I've highlighted the next two, which are the pre-retirement death benefits that I stressed before, and then disability benefits. So if someone dies in the course of performing their duties, which thankfully does not happen very frequently given the modern safety methods--but it does happen--we plan .4 percent of salary for that eventuality. Disabilities occur more frequently, of course, and those are basically .6 percent as a percent of salary on normal costs. So if you add those two things together, they come to about 1 percent of the total. Termination benefits basically means that we're giving people back the money that they have contributed to the pension plan, plus the interest that money has earned if they leave before becoming vested at ten years of service. When you add all that together, the total normal cost in any given year for services rendered during that year for each employee is about 18.83 percent of what we're calling their base salary, which is really their hourly rate of pay, shift differential, and longevity pay. It doesn't include any other forms of pay or benefits. The employees, on average, contribute a portion of that. In our situation, we have three different pension plans. They have--well, I should say different benefit structures. The average employee contribution is 6.69 percent. We have some people that contribute 8, some that contribute 7.6, some that contribute 7. After a certain number of years, 21 years for two of the plans, they stop contributing. So the average is 6.69. That average is going to trend upwards for the city of Lincoln because the people that contribute 8 percent, those

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are the newer employees, they're going to contribute that 8 for their entire career. So we're going to see that trend upward. We think we'll get to 8 percent in about 12 or 14 years. So the employer, the net employer normal cost that the city needs to put in is 12.14 percent. And we're not...Lincoln isn't contributing to Social Security, so it's just the 12.14 percent is the cost of this pension plan. And I want to stress this is for public safety employees. There's other people in police and fire departments that are not in this plan. These are public safety. But again, the normal cost is 12.14. They don't contribute to Social Security. And I want to touch on this a little bit in the new aspect because there's two things that affect people that do not...that receive a pension during the job when they don't contribute to Social Security. One is called the windfall elimination provision, and I think that's important to consider. The other is the government pension offset. And what the windfall elimination provision...oh, it's if a person receives a pension such as this, and they have a part-time job and they're contributing to Social Security from their part-time job, or, say, they have a job before they become a police or a firefighter or after they became a police or firefighter, if they have 30 or less years of substantial Social Security earnings, they're going to have a reduction of whatever Social Security money they get because of their receiving this pension. And the reduction can be substantial sometimes. I don't want to sit up here and proclaim to be an expert on Social Security or any sort of legal examinations, but the reduction can be up to half of what they would normally have otherwise received. If they didn't get this pension, basically that means they would get twice the amount of Social Security money that they would get if they hadn't been here. So that's an important thing to consider, that these pensions for government employees often take the place of Social Security benefits for these members. And the other consideration is called the government pension offset, and it basically applies to widows and widowers of people in these types of pensions. And this one is a little bit easier for me to explain, but let's say we have a firefighter who is receiving a pension and he picks a survivorship benefit on his pension, he also had a part-time job where he's getting a Social Security benefit. The example in the IRS is, say, a \$500 Social Security benefit. If his widow gets \$600 from the city of Lincoln police and fire pension, that means she is entitled to nothing

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from Social Security regarding his benefit. There is a dollar-for-dollar government pension offset on that. If she was getting \$500 from the city of Lincoln and the offset...let's say, if his pension...or if his police and fire pension is only \$100 and she's getting \$500, then there would be a \$100 offset, so she'd get \$400. But it's a dollar-for-dollar decrease to a widower because of this. Now she can still get her own Social Security, or he, if they had their own job. But the entitlement for their spouses is basically dollar-for-dollar reduced. So those are some things that I like to keep in mind. Now regarding any sort of conversion from DB to DC, you know, we're talking about new employees, there's a question regarding whether those new employees need to contribute to Social Security. And I don't feel comfortable giving an answer one way or another on that, but I think that's important. [LR215 LR216]

SENATOR LATHROP: Paul, can I ask you a question before you go on? [LR215 LR216]

PAUL LUTOMSKI: Sure. [LR215 LR216]

SENATOR LATHROP: Can you tell us, because I have to tell you before I got into this whole CIR and the work that we did with Donn in the working group, I was not aware of the fact that some people aren't on Social Security. And you've talked about it today and I think it might benefit us to know, is there a rule of Social Security or a requirement, or do the cities exempt their firefighters or their first responders? How's that...how do they not have to contribute to Social Security, I guess is the question, and what are the rules if you can share those with us? [LR215 LR216]

PAUL LUTOMSKI: All right, I will be glad to share those. I will tell you what I know and encourage you to seek legal counsel on the... [LR215 LR216]

SENATOR LATHROP: I'm not going to hold you to a lawyer's definition. But give me a working understanding, because I don't know. And the next thing you were going to talk

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about is, well, we may have to enroll these guys in Social Security, which tells me it might be an election. [LR215 LR216]

PAUL LUTOMSKI: Sure. [LR215 LR216]

SENATOR LATHROP: So can you divert from your planned remarks and share that with us? [LR215 LR216]

PAUL LUTOMSKI: My understanding is the Social Security Act was implemented in about 1935, and at that time it exempted all government employees. Then something, Section 218 came around. I don't know if it was exactly then or following then, but from like '35 until maybe 1956, Section 218 was an option for governments to, group by group, work with their state Social Security administrator to sign up groups of employees that were municipal workers into the Social Security system. So if, I mean, initially they were not covered, they could be signed into the system via Section 218. So civilian employees, in the case of Lincoln, were signed up for Social Security. Police and fire were not signed up. I suspect...I have some very old notes saying that they were consulted and they declined the coverage, but it isn't a fact...it isn't that they were exempted out of it; it's that they were never in it. [LR215 LR216]

SENATOR LATHROP: So it's not a situation where all firefighters and police are exempt from Social Security and the city needs to make up or compensate for that. [LR215 LR216]

PAUL LUTOMSKI: Not that I know of. But that would be a good question for the state of Nebraska to research, is which groups are or are not contributing to Social Security. I get the understanding from working here that most police and fire do not contribute to Social Security. [LR215 LR216]

SENATOR LATHROP: Okay. That's helps. [LR215 LR216]

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PAUL LUTOMSKI: All right. So if a DC plan is going to be implemented for new hires, they may need to contribute to Social Security. And I understand there was...it's called the Omnibus Reconciliation Act of 1990 that added a Section 31.3121(b)(7)(F) that said that employees of municipalities were to be considered employees in terms of pension coverage. So what that basically meant, that was in 1990, if you were a municipal government employee, you weren't in Social Security and you didn't have any sort of retirement plan, you needed to be put into a retirement plan or the employer needed to pay for Social Security on your part. There are regulations as to what is an acceptable retirement plan. Once they've been considered an employee, my understanding is if they had, in our case, a defined benefit plan, and that defined benefit plan provided you the same as or better benefits than you would have gotten had you been in Social Security for the same time period, then that would be an acceptable retirement system. I can't say with any equal certainty what would be an acceptable defined contribution system, but that's something that definitely needs to be investigated. And then, of course, a switch from DB to DC, for even new hires, may be subject to legal challenges without union agreement. Because as I said, early on, the city changed their defined contribution plan. One of the things that is going on, that is not a legal challenge at this point but it's just a discussion right now, is the fact that even though new hires aren't working yet, they will be part of the union, and the union should be able to represent those people in terms of their benefits. So there's some complication issues regarding going forward for this. And now on the financial side, this is a real rough cursory cost comparison: hypothetical defined contribution versus existing defined benefit. For the employer, as I said, the city of Lincoln is putting in 9 percent on the DC. If Social Security needs to be included in that, there's another 6.2 percent. And then for a defined contribution plan, in order to provide those death and disability benefits that are necessary for these types of workers, that would be another plan. Another 1 percent probably needs to be set aside for those kind of benefits. So the total cost of a defined contribution, if Social Security needs to be included, is 16.2 percent. If it doesn't, it's 10 percent. Now you compare that to the normal cost of our DB plan, and that's 12.14

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percent, so it actually could be more expensive to have a DC under this scenario with Social Security. Yes, sir. [LR215 LR216]

SENATOR HARR: If I can interrupt for a second. This 12.14 percent for the existing defined benefit, is that number stable, raising, lowering, where is...? [LR215 LR216]

PAUL LUTOMSKI: That is the normal cost and that's stable. What's unstable, as Mr. Jones said, is the extra cost that comes from unforeseen events, such as the stock market decline, and that's the unfunded accrued liability costs that can vary from year to year, and can be smoothed and amortized over longer periods of time also. But to back up on the 12.14--this is the normal cost slide--and unless the benefit levels change or the experience changes significantly, that should be fairly level. [LR215 LR216]

SENATOR HARR: Thank you. [LR215 LR216]

PAUL LUTOMSKI: So DB to DC, we think it would require approval from existing employees. It would...oh, okay, this actually is something that the committee may not be exploring. But if you include the existing employees in the switch, that can only happen if the existing employees approve of this. And then, as you understand, it would involve a transfer of all or part of the existing DB members' actuarial pension benefits. So like if someone who worked here 15 years, they're vested in the DB plan, they should be able to get a DC account with the same amount of money that has the present value of those DB benefits--and here's an example of that. Let's say the employees agree to take 40 percent of their existing account value, so whatever they have actually earned on the DB side, they're saying, we'll accept only 40 percent of that and you can put that in a DC account to us. We've got, the example, \$135 million market value. We need to set \$95 million aside for payments, future payments to retirees. Need to set another \$1.7 million for vested members who worked here for ten years and now are gone, and we're going to start paying them when they're 50. So we have \$39 million remaining, and that's where the 40 percent comes in. That's basically 40 percent of the services, the

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value of services rendered. So if they will take 40 percent, we could switch them over to a defined contribution plan and go forward from there. Otherwise, reasonably, you would think that they should expect to get 100 percent of the value of their defined benefit plan placed into their DC plan--and that's where the bond issuance that you spoke about. In this case, the employer would need an immediate addition because you can't owe people money in a DC plan. They would have to come up with \$59.3 million immediately to transfer existing employees into the DC plan and give them full credit for their prior DB service. In closing, I just want to point out some advantages and disadvantages of defined benefit plans: (1) provide guaranteed income to retirees. And as Donn Jones touched on, or alluded to perhaps, per dollar of benefit pay, it's actually less expensive to provide benefits through a defined benefit plan than through a defined contribution plan, because of the professional management of the assets. I mean most of the money from these plans, 60 percent, comes from interest on the assets. These monies can be invested with help from professionals. The DB plans don't have a, I guess, life cycle like a human would where when a person gets older they want to take less risk. They're putting their money in safer investments that, just by the nature, are more inclined to earn less on a risk return basis. So these plans can weather the storm better than an individual. Some employees aren't covered by Social Security. DB offers irreplaceable financial security in those cases. Provides more income for career employees and motivates the employees to continue in service. In fact, our plan has a kind of a tiered system where, you know, ten years is vesting, 25 years is retirement, after that we have a DROP plan. It kind of encourages people to stay until age 50 at least. And then while employed, it provides an automatic inflation protection. In other words, when a person earns more money, their pension goes up because, as a defined benefit, it's based on years of service and your final average salary. Lincoln doesn't have this but a lot of plans do. Cost of living protection after retirement can be provided in a DB plan. Disadvantages--I think that's why we're here. One is it provides less income for noncareer employees and wasn't designed with portability in mind, and more people are moving around now. Third is the major disadvantage I think we're talking about, is that the cost of the plan will fluctuate from year to year as a result of

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experiences being different from the actuarial projections. Four, it's difficult for employees to understand how much the employer is contributing on their behalf. And, five, a little more complicated to administer. Okay. Questions? [LR215 LR216]

SENATOR NORDQUIST: Thank you. I don't think we included it in the survey. But the amortization of your unfunded liability, is that over 25 or 30 years? [LR215 LR216]

PAUL LUTOMSKI: Ours was over 30 years, and... [LR215 LR216]

SENATOR NORDQUIST: And then do you smooth returns? [LR215 LR216]

PAUL LUTOMSKI: We smooth over a five-year period. [LR215 LR216]

SENATOR NORDQUIST: Okay. Any other committee questions? No? Seeing none, thank you, gentlemen. [LR215 LR216]

MARK KOLLER: Thank you. [LR215 LR216]

PAUL LUTOMSKI: Thank you. [LR215 LR216]

SENATOR NORDQUIST: Our next presenter will be Pam Spaccarotella, the finance director for the city of Omaha. [LR215 LR216]

PAM SPACCAROTELLA: (Exhibit 3) Thank you. Good morning. I'm Pam Spaccarotella, finance director for the city of Omaha, and I have with me today Pat Beckham from Cavanaugh Macdonald who are our actuaries for both of our funds that we administer. I prepared some remarks that have been handed out to you and I thought, based upon what everybody has heard today, that I would just go ahead and start with basically where the city of Omaha's funded ratio is. And so, what in the presentation that I have there, I have the plan provisions, the plan assumptions, board membership. But if you

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go to the third page in, it starts with the plan funding status. And so just as a reminder, the city of Omaha has two defined benefit plans. One plan is considered the civilian plan which is for our civilian employees and then the second is called the police and fire plan, which is again for our police and fire members. Both the civilian plan and the police and fire plan are severely underfunded. Both systems use an asset smoothing method in the valuation process. As a result, the plan's funded status and the actuarial contribution rate are based on the actuarial smooth value of assets, not the pure market value. As of January 1, 2011, the civilian plan had total assets of \$240.3 million and an actuarial liability of \$409.4 million. So our unfunded actuarial liability for our civilian plan was \$169.1 million and its funded ratio was 59 percent. The actuarial recommended contribution rate is 33.91 percent. We have a member contribution rate of 9.325 and matching city contributions of 11.025. So the current contribution shortfall is 13.563 percent. It's important to note that the recommended contribution rate includes both the normal cost and an unfunded liability cost. The normal cost, which represents the liability for the current year service, is 13.8 percent, which is substantially less than the actual contribution rates. So but for the unfunded liability, the current contribution rates would be sufficient. As of January 1, 2011, the police and fire plan had total net assets of \$456.2 million and an actuarial liability of \$1,028,900,000. The unfunded actuarial liability is, therefore, \$572.7 million and its funded ratio is 44 percent. For the police and fire, the actuarial recommended contribution rate is 63.47 percent. We have combined contributions for members in the city at 44.759 percent, so our current contribution shortfall is 18.71 percent. And again, it's important to note that the recommended contribution rate includes those two components, the normal cost and the unfunded liability cost. The current normal cost is 25.836 percent, which is substantially less than the actual contribution rates. Historically, I thought I'd talk a little bit about the funded ratio, historically, for the city of Omaha funds. On January 1, 2001, the funded ratio for the police and fire plan was 85 percent and the civilian plan was 96.1 percent. Since that time, the funded ratio has declined, and in 2009, the funded ratio dropped significantly primarily as a result of the investment losses sustained in the fourth quarter of 2008. By January 1, 2009, the funded ratio for the police and fire plan was 45.8

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percent and the civilian plan was 62.9 percent. Preliminary calculations projected the plan would run out of money in the year 2030, and the city would then be forced to pay retirement checks approximating \$173 million out of the general fund each year thereafter. Due to the sharp decline in funded ratios and the projected fund balance, then-Mayor Mike Fahey commissioned a task force to review the police and fire pension system. Specifically, their objective was to provide recommendations that will lead to the equitable restoration of the police and fire pension system integrity and achieve actuarial balance for all stakeholders in a reasonable amount of time. In May 2009, the task force issued a draft report, and I believe that was provided to the committee, in which those recommendations were made. Specifically they stated any solution with respect to the police--and the task force was just with respect to the police and fire plan--so any solution must be a 50/50 solution. In other words, 50 percent of the necessary funding would come from increased contributions by the city and approximately 50 percent of the necessary funding would come from decreasing the value of police and fire employee benefit accruals. Second, spiking must be eliminated. Third, they proposed three possible solutions for decreasing the value of police and fire benefits, which included a final average pay plan, a career average plan, and a fixed dollar plan. And then, finally, the task force recommended funding alternatives for the city of Omaha, which included a property tax increase, a 5-cent sales tax increase, and a garbage fee. In May 2009, Mayor Jim Suttle was elected to replace Mayor Fahey. He was tasked with the implementation of the task force recommendations. In late 2010, the city was successful at negotiating a police contract with the police union that increased the city's contributions 13.5 percent and decreased the union's benefits 13.5 percent, recognizing the task force recommendation that any solution must be 50/50. Spiking for police officers was eliminated. The police union opted for a career average plan, and the restaurant tax of 2.5 percent was enacted in order to fund the city's obligation. Immediately following the police contract, the city began negotiating with the fire union. A tentative agreement was reached with the union in July of this year that would provide for a 13.5 percent reduction in benefits and would eliminate spiking and would also be funded by the restaurant tax. The agreement was voted on and agreed to

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by the union on August 1 and 2, and was rejected by the city council on August 9 following the introduction of various amendments. Mayor Suttle reintroduced the contract, following communications from the union that it would not entertain any amendments, and the introduction was placed on file. A resolution was subsequently adopted revoking previously granted authority to the administration to negotiate union agreements. Currently, the city council has requested city legal to recommend several law firms to engage their services to act as a negotiator on their behalf. As of today, no negotiations have yet been conducted pending the engagement of outside counsel. The city finance department has encumbered funds for both 2010 and 2011 for the anticipated pension contribution for the fire union. And finally, it's important to note that the changes in the police contract, as enacted on September 18, 2010, did have the positive effect on the unfunded pension liability that we were expecting. And I believe that valuation report was provided to you, but if you go to page 5 of that report, you'll see that the changes in the plan provisions decreased the unfunded actuarial liability by \$52 million, from January 1, 2010, to January 1, 2011. We are encouraged by those results and we look forward to a successful resolution with respect to the fire contract. And we'd be happy to answer any questions that you have. [LR215 LR216]

SENATOR NORDQUIST: Thank you for your testimony. Questions from the committee? Seeing none, thank you. [LR215 LR216]

PAM SPACCAROTELLA: You're off the hook. [LR215 LR216]

SENATOR NORDQUIST: Let's see, we have an estimated hour and a half here. We scheduled this till noon. How many public testifiers do we have? A couple? Three? Okay, great. In whatever order you would like to step up, the mike is open. Please state and spell your name. [LR215 LR216]

JIM KRIEGER: I'm Jim Krieger, K-r-i-e-g-e-r. Chairman Nordquist and Chairman Lathrop, members of the committee, I'm Jim Krieger, vice chair and CFO of Gallup, and

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I serve as the chairman of the Greater Omaha Chamber of Commerce. I'm here today on behalf of the Omaha Chamber and the Lincoln and Nebraska Chambers of Commerce. We thank you for your continuing discussion on this very important matter. As you are well aware, the insolvency of defined benefits plans offered by governments in general, has been a recurring theme for many years around the country. Too often, discussion of these systems centers on great difficulties of sustaining benefits well into the future. Recent efforts have often focused on how to patch up existing models of defined benefit plans. We believe it imperative that the discussion also include possible alternatives: a straight 401(k) plan; a cash balance plan; something of a hybrid--this is used for most Nebraska state and county employees; police and firefighter participation in Social Security in conjunction with a 401(k) or a cash balance plan. This discussion begins with the basic premise: What constitutes a fair retirement plan for public employees? What is fair to the employee and fair to the taxpayer? Also inherent in this discussion is the question of liability and who should carry the liability. With a defined benefit plan, employees contribute but the obligation to provide promised benefits falls completely upon the taxpayers. Conversely, under a 401(k) plan, it is the employee who assumes the risk of market investments and is liable to ensure they have what they will need when they retire. The employee is also given greater flexibility in investment use of funds and balances upon any time of leave and portability. We are confident that once these questions are answered, a way can be found to provide such a plan on sound financial footing. It won't be easy by any means. Converting from a defined benefit plan leaves an obligation that must be covered, but if properly designed, could get us out of the annual grappling with long-term sustainability problems. A change from defined benefit plans is not without precedent. Michigan made the change to a defined contribution plan for state employees in 1997. A study released in July by the Mackinac Center for Public Policy shows that the state saved \$167 million through 2010 and, more importantly, that the defined benefit plan's unfunded liability would be \$2.3 billion to \$4 billion higher today had the change not been made. In addition to sustainability, a crucial factor is predictability. In a recent "Stateline" article on Nebraska's state employee cash balance system, it was observed that there are no surprises in a cash

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balance system. Taxpayers know exactly what the state is contributing each year to the workers' retirement accounts--wide transparency. In any solution we find this, the "no surprise" factor, would be a welcome element. This is a nationwide problem, and cities and states are seeking solutions. Nebraska has been a leader in this before, and I am confident we can be a leader of this again. As was often stated during the Legislature's 2011 session, this is a time for meaningful, significant, and comprehensive reform. We are fully committed to working with you in the committees to find answers to this pressing issue. Thank you for allowing us to be part of the process, and thanks for the opportunity to participate this morning. [LR215 LR216]

SENATOR NORDQUIST: Thank you for being here, Mr. Krieger. Any questions from the committee? Seeing none, thanks for your testimony. [LR215 LR216]

JIM KRIEGER: Thank you. [LR215 LR216]

SENATOR NORDQUIST: Additional testifiers? [LR215 LR216]

ROGER REA: Good morning. [LR215 LR216]

SENATOR NORDQUIST: Morning. [LR215 LR216]

ROGER REA: Senator Nordquist, Senator Lathrop, and Senator Smith, for the record, I am Roger Rea, R-o-g-e-r R-e-a; I live in Omaha; and I currently am the president of the Nebraska State Education Association-Retired. As additional background, I served for five years as one of the public members of the Public Employees Retirement Board, or PERB; I currently serve as a trustee for the Omaha School Employees' Retirement System; and I'm on the Executive Committee for the National Council on Teacher Retirement. I've participated in retirement training issues through several national organizations which specialize in public employee retirement issues. I have made retirement issues a passion for about the past 30-plus years. I would like to concentrate

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my testimony on just three issues today. First, there is a clear distinction and a definite distinction between retirement systems that are controlled by state law as compared with those which are controlled exclusively by a collective bargaining agreement. As you are aware, state law controls the retirement benefits for school employees, both those of Omaha as well as the rest of the state, for State Patrol, for the state judges, and for the state and county workers. The benefits of these retirement systems are a matter of state law. Each and every time a benefit change is proposed, the actuarial costs associated with that benefit change are presented along with a method of paying for that increased cost through increased contributions from the members of those systems or their respective employers. There have never been any benefit changes in any one of the six retirement systems controlled by state law that have not been accompanied by an actuarial analysis of the costs as well as public hearings on the proposed changes. The retirement systems governed by state law are funded at a level that the Pew Center on the States describes as one of the 16 best-funded retirement systems in the nation. The Nebraska retirement systems that are governed by state law are among the best in the country. The second issue is that defined benefit retirement systems provide a predictable benefit that keeps retirees out of poverty and reduces, if not eliminates, the probability that retirees from those systems will require public assistance during their retired lifetimes. A recent report by the National Institute on Retirement Security, or NIRS, showed that the prevalence of poverty among the elderly is much higher for individuals who do not have a pension than it is for those who do have a traditional pension. The percentage of poor households, which is defined as a household with an annual income of less than twice the federal poverty level, is roughly twice as high for households with no pension than it is for households that do have a pension. The third point that I would make is that a defined benefit plan provides replacement incomes at a very affordable contribution rate. Research by the National Institute on Retirement Security a few years ago concluded that a defined benefit retirement plan provides economic security for retirees at a total cost about 46 percent lower than for an equivalent retirement income provided by a defined contribution plan. That reduced cost comes from three components that are present in the defined benefit plan but absent in

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the defined contribution plan. Those three components are a pooling of longevity risk, which is the risk that a retiree will outlive his or her retirement savings; a more balanced portfolio for participants based on long-term investment goals rather than short-term investment goals of retirees who are nearing retirement age; and higher returns and lower fees that are associated with a defined benefit retirement plan, where large sums of money are managed on a global basis by institutional investment firms. Individual investment accounts that might make up that larger pool of investments would have significantly smaller balances to invest and may not be able to take advantage of the lower fees associated with institutional accounts. LR216 is intended to study the public employee retirement systems which are controlled by collective bargaining agreements. I would again point out that there is a--six retirement plans that are currently controlled by state law, and each and every one of them involves a public hearing as well as an actuarial cost analysis. Research has clearly shown that defined benefit retirement plans are a very efficient and cost-effective way to provide an adequate retirement benefit for public employees. Plan members as well as taxpayers have lower contribution rates for a defined benefit plan than would be required to provide the same retirement income through other methods. I suggest that you consult the research as you consider any changes in the state law for retirement plans that are not currently controlled by state law. I'd be happy to respond to any questions. [LR215 LR216]

SENATOR NORDQUIST: Thank you, Mr. Rea. Questions from the committee? Seeing none, thank you for your testimony. Any additional testifiers? [LR215 LR216]

JERRY HOFFMAN: Good morning, Chairmen Nordquist and Lathrop and Senators. My name is Jerry Hoffman, J-e-r-r-y H-o-f-f-m-a-n. I'm here representing the 28,000 members of the Nebraska State Education Association. The materials that I'm handing out to you will be--my remarks will be confined to those materials, although I'll be happy to answer any questions that you may have. Mr. Rea just presented some information relative to the Pew Charitable Trusts. This is from their 2011 report, which shows that Nebraska is, in fact, in the top ten of the best-funded plans in the country, as of fiscal

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year 2009. And again, this is based on actuarial evaluations of the plan. What you will see--and I will just sort of walk you through all of the data that's in here--Nebraska's fund, as of that year, was 88 percent funded. There was a last required contribution made, 100 percent of it, in the amount of \$180,411,000. And that is a liability that is shared between the employer and the employee. So the idea that only taxpayers foot the bill on these liabilities is not true. And, in fact, what we see here is that the employer and employee contribution rates increase in order to pay for the unfunded liability. And then the balance of that comes from any yields that come from the market increase. And, in fact, that has been the case in terms of the Nebraska Public Employees Retirement System in that since 1992 the yields on the investments in the defined benefit plan have exceeded 9 percent. That number is from the Nebraska Investment Council, which manages the investment of the plan monies. The third piece that I want to identify...the contribution rate increases by employees and employers, the second being greater than 9 percent rate of return, and the third piece is one around portability and longevity. And that is, this is a plan that was put in place in 1945, thereabouts, and the purpose of it, really, was to allow for adequate and sufficient income for school employees after they have worked their careers in the schools for 30-plus years. And in Nebraska this has been a tremendous benefit in several ways. First of all, it is an incentive for teachers, bus drivers, other school employees to really become part of the community of that school. And furthermore, as the career experience increases for teachers, that also translates into better learning for students. So that when you are encouraging teachers to be a teacher for a long period of time, that experience, which is one of the most helpful things a teacher can--brings to a classroom for improving student achievement, that, in fact, we see a retirement system that is on par with improvements in public schools. So career for a teacher and for school employees is a central feature of this plan. In terms of portability, for Nebraska, a teacher can move from any school district--as long as it's not the Omaha school district, because it has its own plan--so that there is, in fact, some portability. Teachers who are in Nebraska and who wish to move from one school to another are still part of this defined benefit plan. So it encourages both portability and it encourages or provides an incentive for careers.

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The other piece that I want to provide some information to you about is to kind of get us a little bit out of the weeds on defined benefit plans and into our communities and look at what retirement benefits hold in terms of community and economic development. And that is the second sheet that you have before you, which comes from the National Institute on Retirement Security. And I'm not going to read through this whole thing, but there are some elements here that I think is really important for us to consider when it comes to retirement benefits, that this is the income that people have which is spent in the community, income that is spent in small businesses, on Main Street businesses. And, in fact, it helps to both encourage and create jobs and job growth in our towns. The impact on jobs and incomes, for example...now, this is 2006 data, but I think that we can say from--for six years, six-year-old data, that the message is the same here. Retiree expenditures stemming from state and local pension plan benefits supported 3,937 jobs in the state of Nebraska. The total income to state residents supported by pension expenditures was \$191 million. Of this, the greatest share, \$107.3 million, was comprised of employee compensation, that is, wages and salaries. So retiree benefits, income, that is both spent in the community means that there is contribution to the sales tax revenue by retirees. It means that retiree income is supporting small businesses in our towns. And, finally, it means that retiree income is supporting wages and salaries of people who are employed by businesses in our communities. So with that, I would leave it open to any questions that you may have of me at this moment. [LR215 LR216]

SENATOR NORDQUIST: Thank you, Mr. Hoffman. Any questions from the committee? Seeing none, thank you. [LR215 LR216]

JERRY HOFFMAN: Thank you. [LR215 LR216]

SENATOR NORDQUIST: Any additional testifiers this morning? [LR215 LR216]

JOHN CORRIGAN: Good morning... [LR215 LR216]

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SENATOR NORDQUIST: Morning. [LR215 LR216]

JOHN CORRIGAN: ...members of the committee. My name is John Corrigan. I'm an attorney with the law firm Dowd Howard and Corrigan, C-o-r-r-i-g-a-n. And I've been asked just to say a few words today on behalf of the Nebraska AFL-CIO. We appreciate the fact that you're looking at these issues, both the issues of funding and the issues of collective bargaining, as we've been through some tumultuous change in the landscape of collective bargaining in the last year, and we're just starting this next week to find out how that's going to work under new rules. But in looking at switching--or the concept that we have to move from defined benefit plans to defined contribution plans, I think it's important to realize, where did this defined contribution plan concept come from? The 401(k) section of the Internal Revenue Code was enacted in 1979 in order to provide a tax shelter for some executives at the Kodak corporation who had received a bonus and they wanted to not have to pay taxes on that bonus. In 1979 about 90 percent--85 percent to 90 percent of the cost of retirement benefits was borne by employers in this country; the rest was borne by employees. By the year 2000, 50 percent of the cost was borne by employers and 50 percent by employees; they went to the 401(k) plan primarily, throughout the country, in the private sector. Not only did the employees have to pick up another 40 percent of the cost of their retirement, they had to pick up 100 percent of the responsibility to manage those funds at the same time that they had to manage their families, their personal lives, and their day jobs. And the beauty of the economies of scale created by the defined benefit plans is that working people have the advantage of contributing to a fund which can afford to pay professional managers to secure their financial futures. When you shift that burden to working people, no matter what profession they're in...in my own profession, I see it all the time: experienced, sophisticated people don't spend time investing and watching these numbers. There may be some geniuses out there, and good for them. But the fact of the matter is, this is a huge transformation of wealth from working people into the pockets of financial managers. And they're paying fees on that--I think Mr. Lutomski put it beautifully in the sense that the reason these returns aren't as good in the defined contribution plan is

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those guys are paying percentages of their individual accounts in investment fees. We believe in the process of collective bargaining, and I think the testimony of Ms. Spaccarotella demonstrated perfectly that collective bargaining can resolve these problems. And the collective bargaining which takes place in the city of Lincoln--you saw their pension system, it's not under water. But if you don't let collective bargaining solve the problems, of course, you'd have to rely on the courts. And the courts have been fairly protective of these plans in the benefits they create, because there is the concept of financial security. Promises are made; we expect them to be kept in our society and especially in Nebraska, where we pride ourselves on being true to our word. So from the perspective of labor, we ask that you not lose sight of the long picture that can be protected through collective bargaining and also the fact that the employees themselves enjoy a great benefit of having to pool these monies in order to buy professional services to handle these investments. Because the alternative is you're going to pay some guy or some firm in New York City percentages on top of the administrative fees that you're paying already to invest money that people aren't paying attention to in Nebraska. So with that, I'd entertain any questions you may have, and I thank you for your time. [LR215 LR216]

SENATOR NORDQUIST: Thank you, Mr. Corrigan. Any questions from the committee? Seeing none, thank you. Any additional testifiers? Seeing none, thank you all for being here this morning. Again...oh, what did we do? I gave up on the (inaudible). Sorry. [LR215 LR216]

DAVID NABITY: Good morning, Chairmen Nordquist and Lathrop. Thank you for putting this panel together. I...my name is David Nabity, and I represent the Omaha Alliance for the Private Sector. And one of the reasons that our organization got started back in 2009 is because we began to look into the labor contracts and the pension packages that were made available to the police and fire departments in the city of Omaha. And, you know, when I look at the proposal that Lincoln put together, you know, to me, it looks like they've done a pretty good job. For whatever reason, they've managed to

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make sure that the benefit formulas didn't get out of whack. They made sure that the funding amounts were where they needed to be. And the research that our organization did would say that what you see out of the Lincoln package is pretty close to what you'd see across most of the Midwestern cities. In Omaha, for some reason, we got way out of balance. Things got way off course. And Mrs. Spaccarotella mentioned that in 2001 the funding ratio of the pension in Omaha was 85 percent. And now it's 45 percent. And her comment was that it was because of market losses that that occurred. What actually happened is in 2003 the existing mayor wanted to freeze wages for police and fire. In exchange for that, the union officers came to the mayor with the suggestion that they drop the retirement age from 50 to 45, and they increased the top payout at that time from 55 percent to 75 percent. That change somehow or other made it past the personnel board, the city council; the actuaries did not do a good enough job estimating how many people would actually retire under this new benefit formula early. And the end result of that was some 300-plus police and firefighters retired. And that makes up, I am told, about half of the drop from 85 percent to 45 percent. I know I'm close. I might not be exactly accurate, but I think I am pretty close. When we were looking at retirement plans as we were beginning to study this, we asked the question: What's a reasonable contribution? What's fair? What is the right amount of money to ask a taxpayer to pay to provide for police and fire or any government entity that has a pension plan? And what we found is, out of the array originally that we looked at that the CIR used, the average contribution was 13 percent. If we looked at a number of the cities across the Midwest that weren't in the array, the average contribution was 17 percent. We saw that some cities were actually covered by a statewide plan, like Mr. Rea had talked about. I believe Iowa, Minnesota, and Wisconsin have statewide plans. But those statewide plans have a much lower contribution amount, and the benefit formulas are much more reasonable than what we have under the existing labor contract. And I guess the one thing that I want to leave you with is, we're told that the amount of money, based on what we just heard from Mrs. Spaccarotella--was that 63.47 percent of salary is what has to flow into this plan in order to just keep up with the liability. Well, how much is too much? You know, if Lincoln's contribution is--I come back

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to this--18.83 percent and we're at 63, when does it get ridiculous? When does it get out of control? And when do the citizens of Omaha need the state to step in and say: Wait a minute; this has just gone--this has gone off the rails. You know, the lug nuts have popped off the car and the wheels are rolling down the highway. We have a problem. And I would tell you that in Omaha we don't have a little problem, it is a huge problem. And I'm not sure what your committee can do. I'm not sure what the state can do. But I would encourage you to exhaust all opportunities, exhaust all possibilities, study Iowa, study Minnesota, study Wisconsin, look at how they've put together state plans. Is there any reason why a police officer or a firefighter in Omaha should get a better pension than the police and firefighter in Lincoln? Should the person in Lincoln get a better one than Grand Island? You know, obviously, you know, larger metropolitan areas and taller buildings and those things require a level of skill that you wouldn't have in Scottsbluff. But the point is, Iowa's protection industries are all covered under the same pension, and they, frankly, have the same health insurance package as well. If what you're seeing here isn't evidence that something is broken and needs to be fixed, I don't know what it could be. What if we see more investment losses over the next three or four years and that 63 percent becomes 100 percent of salary? At what point in time do you say: The benefit formula and the package that exists in the labor contract in Omaha is so far out of bounds that we have to make adjustments and changes. So to whatever extent you can do that, I think the citizens of Omaha would be thrilled. And I'll answer any questions that you might have. [LR215 LR216]

SENATOR NORDQUIST: All right. [LR215 LR216]

SENATOR LATHROP: Dave, I may make an observation, and that is, today, so far, I appreciate your summary of how we got to--"we" being the city of Omaha, and I should say, "how the city of Omaha," because I'm not on the city council--how the city got to where they're at. And I don't think there's a person in the room that doesn't think that the shortfall in the funding of the pensions that we've talked about today isn't a problem. I think everybody recognizes it's a problem. And we may accept your version of history, I

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don't know enough to even weigh in on that. The question then for us as state senators, as legislators, is, what can the state do about it? And what I heard today in the summary of what the law is, is that we can't legislate and simply say, everybody is going to convert to and cover their employees under a defined contribution plan. The implications are problematic from the point of view of we can't interfere with a contract, right? Right? These people have a right to these defined benefit plans. So there is a deficiency. The question is, how do we work out of that? And if we legislated that the--every municipality and every political subdivision shall convert to a defined contribution plan, which may be what you're advocating, the difficulty with that is, is that what's the city of Omaha to do the day after we pass that bill? Because they'd literally have to have \$500 million in bonds that they couldn't do. And so it is a problem. I appreciate one thing, and this topic came up when we were talking about the CIR, and that may be that if a municipality is going to make a change to the pension plan, that it be actuarially approved and that they identify a source to pay for it, because that's really the problem. And I'm not trying to blame any particular mayor or any particular city council, but that's the issue--and the market dropping significantly. I don't know about you, and I'm not going to relate my experience here, but I think everybody in the room had a bad experience when the market went down in 2008, and that's contributing to the issue. So our...I want to be clear. It is good to have the discussion; it is good to have this study; and we are open to ideas. But we have to work within what we can do lawfully. And we're also--we also, in some respects, have to--if we're going to make those kind of changes, we need to have the political subdivisions on board and have them say: You're not going to make a mess out of my city finances if you, the Legislature, act. And that's the part I'm struggling with. And that's the part, frankly, that I haven't heard, other than it needs to be--and I think Donn Jones talked about this--the solution has to come over a generation. If we're going to make the conversion, the solution has to come over a generation. And it has to be in partnership with the employees and the employers. And then we need the market to go up. [LR215 LR216]

DAVID NABITY: Well, if I may respond, one thing we know for sure is the benefit

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formula--the actual payout promises of the labor contract in Omaha are far more generous than what you'll see with the other cities across Nebraska, let alone across the Midwest. An easy fix to the cost would be for, through collective bargaining, for the union to be willing to see that they should move their formula back to 2003. But say, for example, they don't, though. Where your committee comes in is in CIR reform and making sure that if there's any changes or amendments that need to be made in the legislation that you just recently passed, that the city of Omaha gets credit for the huge annual cost of funding the pension. [LR215 LR216]

SENATOR LATHROP: And... [LR215 LR216]

DAVID NABITY: That has to be something that... [LR215 LR216]

SENATOR LATHROP: And let me suggest, for people who are not students of the LB397, that that bill, in the end, did bring us to evaluate employee compensation on an hourly-rate value, to include the value of the pension, health insurance, and their wages, so that if we are, as you've suggested, out of whack by comparison to the contemporaries in the array, that that should adjust itself. And I appreciate the concern that you've brought here today, that everybody has here today, but understand, we just passed that last year. And so I think affording the bill an opportunity to level out where we're at...because, you know, one of the things that we recognized when we worked on LB397 last year is that, in some respects, cities borrowed money, effectively, from their pensions. And they did it by having an obligation to fund and not fully funding their pensions from year to year because they were in a tight spot, and they weren't, so far, under water, or upside down, as they find themselves today. So, effectively, they borrowed, and they never really paid the money back by getting the pension back to where it needed to be. So the years where the employees had better than their contemporary, or better than the array, improvements in their pensions--that should level itself out, and we should find, after the reforms, our public employees at or on par with their contemporaries doing like work. And I'm hopeful that that's the--that that takes

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place. That's certainly a significant concession made by the collective bargaining units who participated in that process. And the expectation that we had in the Legislature is that, to some extent, we'll find our--for example, the Omaha firefighters getting on par with their contemporaries in similar cities doing like work. Legislating our way out or simply saying, we're going to wave the wand over the political subdivisions and alter contractual rights, we (inaudible) do it. I'm convinced, after listening to Kate today and my own understanding of the law, that we can't just legislate our way out of it and... [LR215 LR216]

DAVID NABITY: But somehow Iowa did it. And somehow Minnesota did it. [LR215 LR216]

SENATOR LATHROP: Well, I'm not sure how they treat it, but I know how Nebraska treats the obligation to people who are in those plans, and it is a contractual right. And here's the problem, and we talked about it some in the CIR hearings. And that is, we can pass these laws, and these people that have a contractual right--it's no different than the contracts that you enter into in your business--they'll be in the courthouse and enforcing them. And ultimately, my own judgment is it comes back to collective bargaining, bringing them to the table and getting the concessions through the collective bargaining process. But again, we always appreciate your insight and your history lesson. [LR215 LR216]

SENATOR NORDQUIST: Yeah. Thank you. Any other questions? Senator Smith. [LR215 LR216]

SENATOR SMITH: Yes, I just wanted to say thank you to all the folks who have taken time to be here today and to give their comments and to bring expert testimony on this issue. And, you know, I just want to make it really clear, at least from my perspective, that the intent here is not to target any work group or the public sector. You know, I don't think anyone here would dismiss the relevance, the importance, of the employees in

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our--in the public sector, vital to the course of doing business, to our economy. So please don't take any comments that--or my interest in having this hearing wrong. We have--I have the utmost respect for our public employees. However, from my testimony and from the first couple folks that spoke as well, it was clearly laid out that there's a risk across our country, and there is a risk in the collective in Nebraska in public pensions. Some are doing better than others. We heard from Mr. Nabity; obviously, Omaha is not doing well at all. But in the collective, there is a risk, and it may not be a risk to the immediate, but it's a risk to our future generations. And, once again, Nebraskans are, you know, pride themselves--they find great solutions to these problems. And just because we're not as bad off as maybe some other states are, that's not to say that this is not the right time for us to get ahead of this problem and to make it work. And so, again, I would say that maybe we cannot wave the wand and have legislation that fixes everything, but we as leaders--me and my colleagues here--we as leaders can certainly create discussion around this issue and help to drive towards a solution. And, you know, great solutions are not easy to come by. And despite what some things were said here today, there are no guarantees in life. We have to protect our future generations, and we have to do something now. And I think taking leadership and having this discussion today is part of that. And I appreciate everyone for being here and speaking. [LR215 LR216]

SENATOR NORDQUIST: Thank you, Senator Smith. Any other comments from the committee? Senator Mello. [LR215 LR216]

SENATOR MELLO: Thank you, Senator Nordquist. And the previous testifier has already left. And it was more just a point, I think, of clarification in the sense of...I know some of the documents will be available for the public on-line afterwards, but historically that information provided by the city of Omaha showed that the largest increase in unfunded liability happened from January 1, 2001, to December 31, 2002. So just in reference to your time frame in regard to what contract that the fire and police maybe were operating under, that's something that, I think, for historical purposes I think you

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should know. Also, the largest single increase happened in 2008. And I think that was mentioned by multiple testifiers today, that the market, obviously, has a significant impact over defined benefit plans. But seeing a \$165 million swing in one year, compared to the previous four years of \$147 million, that obviously, I think, shines a significant light in regard to the ups and downs of the market in regard to all investment and retirement plans. So it's just more for a point of clarification for the record. Thank you, Senator Nordquist. [LR215 LR216]

SENATOR NORDQUIST: Anyone else? Seeing none, just one more...if you haven't signed in and are interested in getting the handouts, please do so. And if you don't, for some reason...these are a lot of big files; hopefully, they all go through; it may take a couple e-mails, but if you don't get them by the end of the day tomorrow and would really like them, please call our office, and we'll make sure they get to you. So thank you, all. [LR215 LR216]