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# **Southern Conference on Teacher Retirement**

## **"The World as You Know it is Ending!"**

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# Other "Expert" Opinions

**"The Sky is Falling"**

Source: Chicken Little

# Changes

- ❑ The governmental pension world is changing
  - Contributions
  - Benefits
  - System
  - Investments
  - A combination of the above

## Changes *(Cont'd)*

- NCSL Study:
  - 18 states changed their retirement plans from 2005 through 2009
  - 2010 – 21 states enacted for significant retirement legislation
  - 2011 – as many or more changes – NCSL was tracking 33 states with significant retirement legislation

## Trends in Policy in 2010

- ❑ Most changes were within traditional DB framework
- ❑ Reduced benefits for new employees with same service and compensation
- ❑ Higher employee contributions as to salary
- ❑ More restrictions on early retirement and return to work

## 2010 Trends *(Cont'd)*

- ❑ Reductions in guaranteed COLAs ( 8 states)
- ❑ Service purchase at full actuarial cost
- ❑ Employee contributions (8 states)
  - Raise health care premiums
  - Increase contributions for current or new employees
    - Requirements for substantially equivalent contributions
  - Make noncontributory plans contributory

## 2010 Trends *(Cont'd)*

- Changing Benefit Formulas & Eligibility
  - Change final average compensation (8 states)
  - Increase the age or service requirement, or both, for retirement eligibility (5 states increased vesting period, 9 states reduced early retirement benefits, 11 states increased age & service requirements for NRA)
  - Anti-spiking provisions

## 2010 "Innovations"

- ❑ New hybrid plans
- ❑ Alternative plans – DC vs. Hybrid
- ❑ Shared risk
- ❑ Choice of higher contributions for higher benefits
- ❑ Changes for current employees and retirees

# Major Legislation in 2011

- Similar themes to 2010
  - Higher employee contributions (17 states, 14 for actives)
  - Increased age and service for NRA (8 states)
  - Longer FAS (5 states)
  - Restrictions on early retirement (5 states)
  - Reduce or repeal COLAs (4 states)

## Governor Brown's 12 Reforms

- ❑ No service credit purchases
- ❑ No contribution holidays (employees or employer)
  - o No employer payment of employee contributions
- ❑ No retroactive benefit increases
- ❑ 36 month FAS
- ❑ Stricter limits on creditable compensation
- ❑ No pensions for felons (employment-related)

## Barriers to Change – State Constitution

- ❑ Is there a contract protection clause and/or a specific provision on pension benefits?
  - Contractual right
  - Accrued benefit protection
  - Vested benefit protection
- ❑ Gratuity theory

## Barriers to Change – State Courts

- ❑ Have state courts defined the contractual agreement?
  - Is the protection for what has been earned or also for future benefits?
  - What are the "contract" terms that are protected?
- ❑ Have state courts defined the accrued benefit?
  - Look to federal court cases for definition of "accrued benefit."

## Barriers to Change – State Courts *(Cont'd)*

- ❑ What groups of employees are protected?
  - Retirees
  - Those eligible for benefits
  - Those in "vested" status
  - All employees
  
- ❑ Have the courts addressed contributions as well as benefits?

## Can the Contract be Modified?

- ❑ Does State law contain a "reservation of rights?"
- ❑ Are the benefits the subject of collective bargaining?

## Can the Contract be Modified? *(Cont'd)*

- ❑ When reasonable and necessary to preserve the stability or integrity of the pension system.
  - Actuarial necessity?
  - Preservation of the "fairness" or the "purpose" of the system?

## Can the Contract be Modified? *(Cont'd)*

- ❑ When a disadvantage to employees is accompanied by comparable new advantages.
  - As individuals? Or as a whole? Through bargaining?
- ❑ When there are compelling reasons to mandate and justify a unilateral change.
  - Have any conditions been identified that would support a change in benefits under these circumstances?

## Protections are Untested

- There will be lots of litigation, state-by-state
  - Define the protection
  - Define the exceptions

## Barriers to Change – Federal Tax Law

- ❑ Anti-cutback provisions do not apply to governmental plans.
- ❑ Pre-ERISA vesting standards do apply:
  - 100% vesting of a participant's interest when the participant reaches normal retirement age
  - Normal retirement age = age at which a member can terminate and receive unreduced retirement benefit
  - This requirement has been an impediment in Cycle C filings

## Barriers to Change – Federal Tax Law *(Cont'd)*

- ❑ Plan termination also triggers vesting:
  - 100% vesting of accrued benefits on partial/complete termination of the plan, or on complete discontinuance of contributions, to extent funded
- ❑ Pre-ERISA standards will also protect vested accrued benefits as defined by the "plan."

## Barriers to Change – Federal Tax Law *(Cont'd)*

- ❑ Unsuspected hurdle to offering choice:
  - The IRS has taken the position a choice cannot be offered to existing employees in a contributory system with picked up contributions if that choice would change the contributions.
  - Guidance is expected this year.

## Barriers to Change – Social Security

- ❑ Is the plan intended to be a qualified replacement plan?
  - Does DB plan still meet safe harbors?

# Additional Change Agents

- IRS
  - Definition of Normal Retirement Age
  - Definition of Governmental Plan

## Additional Change Agents *(Cont'd)*

- SEC
  - Municipal Securities and Public Pension Unit
    - Adequate disclosure
  - Pay to Play
  - Municipal Advisors
  - Regulations of Investments, e.g., swaps

## Additional Change Agents *(Cont'd)*

- GASB – Statements 25 and 27
  - Preliminary Views



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