The Issue: Why ERS Retirees Should Be Given Consideration for a Cost of Living Adjustment and Why Equity across Retirement Systems Should Be Achieved

GSRA believes that all employees/educators should be treated equitably while working for the State or school system and after retirement from the Employees Retirement System or Teachers Retirement System. Our intent in these pages is to provide clarifying facts to explain how the differences in retirees' treatment has evolved and why ERS retirees should be awarded a one-time benefit adjustment in FY 2017 and annual Cost-of-Living Adjustments thereafter. Nothing in this Issue Paper should be interpreted to imply that GSRA wishes to have TRS benefits or COLAs reduced! On the contrary, it is GSRA's position that all state retirement funds be more in line with TRS to insure future benefits are maintained and all retirees receive adjustments for lost purchasing power due to inflation.

<u>The Issue of Prefunding of COLAs</u>

- The **TRS** Board adopted its COLA policy in December 1969**.** The TRS Board instructed the system's actuary to include in the 1968 actuarial valuation the COLA policy as one of the actuarial assumptions. The assumption of granting a COLA is one factor in determining both the employee and employer contribution rates, which when applied to the relevant payrolls yields the amount of funds to be budgeted. Prefunding the COLA allows TRS to collect and invest these funds throughout a member's working career so that the system has adequate funds to grant the COLAs once a member retires and becomes eligible to receive COLAs.[1]
- In 1968, the **ERS** Board adopted a policy for discretionary COLAs to be applied on an annual basis but did not include future COLAs for ERS members in the actuarial projections. Despite this, the board's COLA recommendations, the Governors' budget recommendations, and the General Assembly's appropriations for the next 33+ years were not only sufficient to provide COLAs, they were sufficient to increase the percentage of the pension fund that covered liabilities. The State's method of funding was to appropriate the required funds as a percentage of salary in the personal services line item for all agencies with ERS members. Throughout the period from 1980 to 2007, COLAs were awarded to ERS retirees when the funded ratio for the ERS trust fund ranged from 47% in 1983 to 104% in 2000. Although the actuarially determined state contribution rate for ERS did not include prefunding for future COLAs, the actuarial assumptions with resulting employer contributions, employee contributions, and return on investments were sufficient for the ERS Board to approve COLAs for ERS retirees through January 1, 2009 (although reduced in FY 2008 and FY 2009) and with a subsequent one-time adjustment payment made on October 1, 2009.

<u>Why does TRS include a 3% COLA in their actuarial computations and ERS does not?</u>

- The law is almost the same for both TRS & ERS. The policy/regulation adopted by each of the boards and subsequent instructions to the actuaries to include a COLA in the actuarial assumption is the difference. By including the cost of a COLA in the actuarial assumptions, the TRS established an employer contribution rate that includes prefunding of COLAs and is partially the reason that TRS can give COLAs annually. Since the ERS Board did not adopt policy and instructions to include COLAs in the actuarial assumptions, the ERS COLAs were not prefunded and were paid on an ad hoc basis. **This issue needs to be addressed in ERS policy/regulation so as to include a 3% COLA in the actuarial projections for ERS,**

[1] Comments by Mr. Jeff Ezell, Executive Director of TRS.

as the TRS retirement fund currently does. This would allow both boards resources to make their COLA decisions, and should the ERS Board elect not to grant a COLA in a given year, the increased contribution could improve the funded ratio of the retirement fund. **GSRA believes that such a change deserves further consideration.** A change in this area should move TRS and ERS retirement systems toward a position of equity in granting COLAs. This will probably not be an easy issue to solve, especially considering the cost involved, but the effort should be made!

ERS and TRS Employee Contribution Rates Presented Chronologically

- **TRS** employee contribution rates were 6.00% from FY 1962 – 1995, 5.00% from FY 1996 – 2009, 5.25% for FY 2010, 5.53% from FY 2011 – 2012, and 6.00% from FY 2013 – present.
- **ERS** employee contribution rates were 5.25% prior to FY 1981. From FY 1981 to FY 1983 the rates remained at 5.25% (with the state paying 4.75% of the 5.25% in lieu a significant salary increase) for Old Plan members. In FY 1983 the employee contribution rate for Old Plan members deducted from their paychecks was raised from 0.25% to 1.25% bringing the total employee contribution rate to 6.00% (1.25% plus 4.75% of employee rate paid by the state), which continues to the present. Along with the increased employee rate in FY 1983, the New Plan was created and new employees on and after FY 1983 were hired on the lower and same pay scale as Old Plan members. The post FY 1983 employees received the benefit of the reduced employee contribution rate at 1.25%, but with reduced benefits. The State continued to contribute the additional 4.75% of salary to the ERS fund, but ERS does not consider this 4.75% as part of the New Plan's employee contribution. GSEPS members hired after January 1, 2009 have an employee contribution rate set at 1.25% with reduced benefits and a prohibition against ever receiving a COLA.

Facts behind the Differences in Contribution Rates

The two retirement funds' employee contribution rates were within a percentage point of being the same prior to 1980 with each fund's employees contributing either 5.25% (ERS) or 6.00% (TRS). Only when the State tried to limit increased salary and personnel costs in the Annual State Budget did the employee contribution rate for the two plans diverge dramatically. Employees covered under the two plans did not request this change in policy toward raises or retirement plan changes nor did they have any say in these decisions.

- In 1980, the governor recommended in his FY 1981 budget and the General Assembly approved a 2% salary raise for ERS employees in addition to funding for the State to "pick-up" 4.75% of the 5.25% employee contribution rate. Thus, the employee's "take-home pay" was increased and the state decreased funds for awarding salary increases. The post 1980 retirement deduction of 0.5% from salary was split—with 0.25% for retirement and 0.25% for life insurance[2]. The cost of the state employer pick-up of 4.75% of salary was added to the employer (state) contribution and paid into the fund to provide the retirement benefits. The effective employee contribution rate for ERS members remained at **5.25%** (with the State picking up 4.75% and deductions from the employees' salaries of 0.5%) until 1982 (FY 1983).

[2] In 1980, the state also contributed 0.25% of salary for life insurance – currently, the state contributes "0" for the life insurance plan for "old" and "new" plan members; GSEPS members do not have a state-supported life insurance plan.

- The 4.75% contribution was considered a "pick-up" in lieu of a salary increase for two reasons: (1) If an Old Plan member terminated employment prior to vesting, the member would receive payment for the accumulated 4.75% contributions in the same manner as if the member had had the contributions deducted from the member's paycheck, and (2) when an old plan member retired, the 4.75% was added to the member's formula salary for calculating retirement benefits.
- The Governor in 1980 was amenable to treating TRS members in a similar manner—offering smaller salary increases and reducing the employee contribution rate for TRS active employees[3]. However, educational professional organizations lobbied against participation in the "increased take home pay" concept for TRS covered employees, and asked for and were granted a 9.00% salary increase through the budget process[4].
- In 1982, the State raised the ERS members' retirement contribution rate by 1.00% to 1.25% for retirement and 0.25% for life insurance beginning in FY 1983, and created the "New" retirement plan for new employees hired between July 1, 1982 and December 2008.
- While the state continued to pay the 4.75% "pick-up" for Old Plan members, the state's employer contribution rate was not changed to delete the 4.75% for New Plan members effective July 1, 1982. The state, however, changed the character of the 4.75% "pick-up" for new plan members in two ways: (1) the 4.75% contribution would not be paid to "New Plan" members who terminated their employment prior to their vesting, and (2) the 4.75% would not be added to retirement salary for the computation of retirement benefits.
- The employees have continued to pay 1.25% of salary into the ERS fund each year. When considering the Legislative approval of the 4.75% retirement "pick-up" in lieu of a salary increase, the rate **effectively** contributed by ERS Old Plan and New Plan members is **6.0% since 1982—the same or higher rate than TRS members[5]. TRS members' retirement contribution rate was reduced from 6.00% to 5.00% in 1996 through 2009. It is widely assumed incorrectly that ERS members contribute only 1.25% toward their retirement, and that the State for some unknown reason actually contributes at a higher rate than**

[3] Bill Tomlinson, who worked for OPB at the time and now a current GSRA member remembers vividly that this was offered because he was the OPB manager that suggested the idea and assisted in making the offer to ERS and TRS.
[4] TRS has no knowledge of this statement and cannot verify the statement's accuracy.
[5] As noted in P.2, ERS and GSRA have different opinions as to the effect of the 4.75% on New Plan members. The following is the opinion of the ERS Executive Director: "The total dollars (employee and employer—on a percentage basis) that are being put into the plan are the same for the Old Plan and the New Plan. But the characterization of those dollars is different. No longer is that 4.75% considered an employee contribution in any way, shape, or form. In the New Plan, the employees contribute their 1.25%. In the Old Plan, it's the 1.25% plus the 4.75% pickup – which is also put into the Employee Contributions bucket and would be refundable if any Old Plan member requested a refund. The old GSRA argument is that the 4.75% is really an employee contribution – made by the employee in the form of foregone salary. I've said that for the Old Plan, I "might" be able to see an argument (though it strikes me as implausible given the amount of time that has passed). But in the New Plan, it's not. The dollars still need to get into the system to keep it actuarially funded, so since the New Plan employee was not required to make the contribution, the state had to assume responsibility as an employer contribution. That is not the same as the state making an employee contribution on behalf of the member."

that for TRS members thus showing favoritism to the ERS retirement fund. In reality this is not the case, but the myth has been reinforced even though inaccurate[6].

- **TRS' employee contribution rates were raised between 2010 and 2013 until they once again reached 6.00% --the same as ERS Old Plan members.**

Based on the above information, GSRA believes the answer to the question: "Do ERS members pay much less than TRS members?" The answer is: Not because of anything ERS' retirees or active members did, but rather because of actions taken by the State to decrease state costs. ERS retirees and their benefits have suffered because of these decisions. ERS Old Plan members continue to pay and New Plan members continue to pay through reduced salary the same employee contribution rate as TRS members do for retirement. Most retirees are members of the Old Plan; New Plan members did not begin to retire in significant numbers until 2012 when 30 years passed after the New Plan was implemented. No GSEPS Plan members are currently eligible for retirement benefits. So the answer is that the two retirement systems' employees effectively paid the same amount in employee contributions until the State implemented GSEPS.

Other Factual Information that Have Impacted the ERS Fund and Retiree Benefits:

- Annual Step increases for ERS employees were withheld by Governor Zell Miller in 1991 and abolished in 1992. ERS employees were eligible for merit increases from 0%-5.00%, but were not guaranteed increases each year due to availability of funds. The state salary scale for teachers has annual step increases for the first 9 years of employment, then a step increase every 2 years thereafter until year 21 of service when the step increases cease.
- ERS retirees received a reduced COLA of 2% in FY 2008 and FY 2009 and have not received a COLA since January 2009. A one-time adjustment was made to ERS retirees in October 2009. TRS retirees continue to get a 3% COLA each year.
- The ERS actuarial report did not include anticipated funds for a COLA in FY 2017 and the ERS Board has not yet approved a COLA for ERS retirees. However, **there is no legal prohibition of adding funds to the agencies' budgets for FY 2017 for the ERS to adjust the benefit payment for the loss of retirees' purchasing power, as well as language that expresses legislative intent for the use of these additional funds. The General Assembly chose to include funds and associated language for a one-time benefit adjustment of 3% for members capped at $30,000 for members with benefits above $30,000.**
- In an effort to reduce retirement plan costs and to align benefits, the ERS retirement plan has—since 1980—devolved from the Old Plan to the New Old Plan to the GSEPS Plan with each successive plan offering less retirement benefits to the ERS retiree. The GSEPS Plan affords less benefits than any other retirement plan offered to state employees by ERS or TRS. The TRS plan has been maintained essentially unchanged. Efforts to implement a GSEPS-like Plan for new teachers entering employment have met with stiff resistance on the part of educational professional organizations who have lobbied against the establishment of such a plan.

[6] Lost in the discussion as to whether the pick-up applies to New Plan members or not is the fact that besides losing the 4.7% salary increase, New Plan members are **ADDITIONALLY** penalized by not receiving the benefit of this amount if they terminate before vesting, and by having the calculations of their retirement benefits not include the 4.75%.

- In 1999, **both** ERS and TRS retirees received COLA increases based on the fiscal year in which they retired. Those retiring before July 1, 1979 received a 10% COLA; those retiring between July, 1, 1979 and June, 30, 1984 received a 7% COLA; those retiring between July 1, 1984 and June 30, 1989 received a 5% COLA; and those retiring between July 1, 1989 and June 30, 1997 received a 3% COLA. This was done to provide an offset for low wages during previous years of economic downturn.
- Between FY 1976 and FY 1983, the TRS benefit multiplier was increased from 1.75% to 2.00%. Each time the multiplier was increased, the employer contribution rate was also increased to pay for the increased benefit. In 1999, efforts were made to more closely align the multiplier for calculating benefits for ERS's Old and New Plans and TRS Retirement Plan by increasing the benefit multiplier in the ERS New Plan to 2.00% for each year of service; however, no additional funds were appropriated to the ERS fund to cover this additional cost**. The ERS New Plan and the TRS Plan each now use the same multiplier (2.00% for each year of service) for calculating retirement benefits.**

Costs Related to Granting of COLAs:

- The ERS projects the cost of a single 3% COLA granted to all retirees of ERS managed plans to be $365 million over 25 years, of which, based on information from OPB, would be roughly $237 million in State funds.
- A one-time 3% adjustment to all ERS retirees is $39 million ($25.35 million in State funds) and would require a 0.15% increase in the employer contribution rate. Hopefully the reduced State cost resulting from matching federal funds will make budgeting the funds more palatable to legislators and the Governor. Based on ERS policy this one-time adjustment would be amortized over the next 25 years with an annual cost of $3.5 million. The FY2017 Budget currently has $3.5 million allocated for this purpose (35% of which is to come from federal funds).
- Making this 3% adjustment an annual event but not including the 13th check amount into the base benefit would cost $520 million over the next 25 years and would add 2.01% to the employer Contribution rate each year. Based on ERS policy the annual increased cost of providing this one-time non-base adjustment would be about $46.6 million per year for 25 years with 35% or $16.31 million coming from federal funds reducing the state portion each year to $30.29 million.

Recommendations for Action:

The following recommendations are updated since this issue paper was distributed last month:

- For FY 2017, GSRA requests the Board to award retirees the one-time benefit adjustment funded in the FY 2017 budget. GSRA further requests that this adjustment be awarded to retirees as stated in page 34 of the ERS Handbook-*Plan Guide*.
- For FY 2018, GSRA requests the Board to instruct the actuary to include in the assumptions costs for a full 3% COLA, and then award the 3% COLA to retirees in two 1.5% portions. As you know, this was done for over 25 years leading up to 2008, but no COLA has been awarded to ERS retirees since January 2009 (8 years as of July 2017). The customary 3% COLA was reduced to 2% in 2007 and 2008. Since January 2009, inflation in the retirees' most frequently purchased goods and the cost of medical insurance/services have severely impacted retirees. To the extent that making such award will require

modification of the *Model Framework for the Annual Consideration of COLA Adjustments*, GSRA requests that such modification be made.

- Clarify Board policy that future annual actuarial valuation reports shall include the assumption of two 1.5% cost of living adjustments when valuing liabilities and determining the annual required contribution. Beginning in FY 2019, award annual COLAs and request funding as determined by the annual valuations.
- Request legislation in the 2017 legislative session to delete O.C.G.A. code section 47-2-29(b), thereby allowing COLAs to be awarded to employees hired on or after July 1, 2009. Include the projected cost in the actuarial valuations of such COLAs for the defined benefit portion of employees hired on or after July 1, 2009.

Summary:

The only reason that the two retirement systems' employee contribution rates are not the same is a direct result of the State's action to reduce State expenses in the Annual Budget and reduce ERS fund liabilities. The State's action was not the result of any action on the part of ERS active or retired members and should not be used as a reason to penalize ERS retirees. Considering the State's pick up of 4.75% of the employee's contribution in 1980 in lieu of a substantial salary raise for active employees, the ERS Old Plan members have paid effectively the same rate as TRS retirees, and ERS New Plan members have served at a 4.75% (as compounded) reduced salary for the intervening years that counterbalances the contribution rate to 6.0%. The State implemented the ERS New Plan in 1982 to reduce retirees' liabilities and benefits and to reduce State costs. Then the State built on the objective to reduce State cost by further reducing retiree liabilities and benefits when it implemented the GSEPS Plan in 2009.

GSRA supports the TRS Board's decisions relative to COLAs and in no way advocates a change in the TRS policies or regulations. We simply point out that the ERS and TRS boards have managed the plans differently for COLAs. Therefore, the inclusion of COLAs by TRS but not ERS in the actuarial projections to determine the Annual Required Contribution (budgeted rate[7]), should not penalize ERS retirees. Keeping the ERS retiree's original retirement benefit by adjusting for inflation should be a goal in the same way as provided for the TRS retiree. GSRA hopes that Georgia will move to establish a system of parity, fairness and uniformity in which all employees regardless of where they work in state government receive similar pay increases and benefits. Recognizing the need for a one-time adjustment for ERS retirees in the FY 2017 budget is a good first step. Implementing the other actions in years to come, as outlined above, should move the State toward a position of more equitably treating its employees while they work and in retirement.

Respectfully Submitted,

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[7] Actuarially Determined Employer Contribution (ADEC) rate.