Employee Benefits – Progress and Challenges

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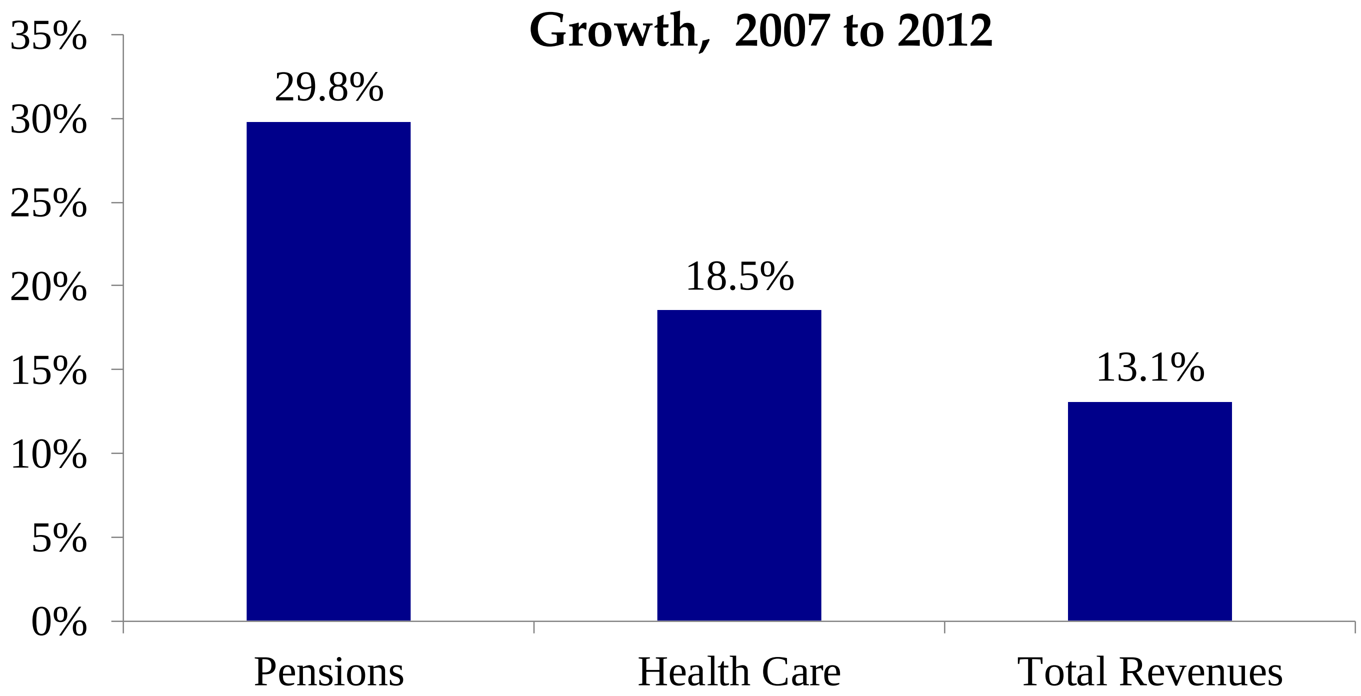
Massachusetts Taxpayers Foundation

Municipalities Face Enormous Unfunded Retiree Liabilities

	2012 Unfunded Liability ($ billions)	2012 Total Liability ($ billions)	Funded Ratio
Municipal Pensions	$13.2	$32.0	58.5%
Municipal Retiree Health Care	$30.0	$30.0	<1.0%
Total, Retiree Benefits	**$43.2**	**$62.0**	30.2%

Benefits Costs Are Crowding Out Basic Services

- Municipal spending on pensions and health care is rising much faster than revenues, cutting into funding for other local services



Municipal Health Reform (2011)

Municipal Health Reform Law Provides Flexibility While Preserving Benefits

- The municipal health reform law allows municipalities to achieve significant immediate savings and control health care costs over the long term by making modest adjustments in plan design
- At the same time, it ensures that municipal employees will still receive generous health care benefits by tying the minimum benefit levels to those available in the highest-enrolled GIC plan
- The law also required all eligible retirees to enroll in Medicare, reducing retiree health care obligations for those communities which did not already require enrollment

Municipal Health Reform a Huge Success

- More than 260 municipalities and regional school districts have adopted modest changes in health plans to achieve $237 million in savings
- Employees have benefitted as well:
  - In communities using the reform law process, employees receive up to 25 percent of the first year savings
  - Employees share in reduced premiums; for most employees the reduction in premiums more than offsets increases in co-pays or deductibles

Long-Term Savings Will Benefit Municipalities and Employees

- The reform will slash the double-digit annual growth in health care premiums for cities and towns, saving municipalities and employees a total of more than $2 billion over the next 10 years
- These savings will allow municipalities to preserve hundreds of jobs

Pension Reforms (2009, 2010, 2011)

2009 – Eliminating The Most Egregious Benefits

- Redefined compensation for pension calculations
- Prohibited creditable service for officials earning less than $5,000
- Eliminated termination retirement allowances for elected officials
- Eliminated one day for one year of service for elected officials
- Required elected officials to serve at least 10 years to vest in the pension system

2010 – Enhanced Benefits; Limitations for New Employees

- Increased minimum allowance paid to surviving spouses of disability retirees from $6,000 to $9,000
- Local municipal option to increase $12,000 COLA base in increments of $1,000 (with no maximum)
- COLA base increased from $12,000 to $13,000 for all retired state employees and teachers
- For new state and municipal employees, capped pensionable earnings at roughly $130,000

2011- Major Reforms

- Raised the minimum retirement age from 55 to 60 and the full retirement age from 65 to 67 for most employees
- Lengthened the period for calculating the pension benefit from three years to five years
- Reduced the incentive to retire early by adjusting the benefit scale so that it mirrors Social Security's benefit neutrality
- Other small changes, such as anti-spiking measures, elimination of section 10 benefits, and training requirements for pension board members

However, Savings Are Small in Short Term

- Because the pension reforms apply only to new hires (beginning April 2012), savings are limited in the early years

- Pension reforms (in present value terms) will save municipalities only $500 million out of a total liability of $32 billion

Investment Losses from the Stock Market Crash Negate Progress in Pension Funding

- Stock market crash caused investment losses and forced extension of funding schedules
- In 2012, the state's 99 local pension systems had approximately $13.2 billion in unfunded liabilities, compared to $13.5 billion in 2000
- Municipal pensions were just 58.5 percent funded in 2012, compared to 59 percent in 2000. Of the 99 systems, 97 are below 80 percent funded and 26 are less than 50 percent funded

State Makes Two Positive Changes

- The Treasurer proposed reducing the assumed rate of return to 8 percent from 8.25 percent
  - More realistic rate of return
  - Requires larger annual contributions which will strengthen fund
- Governor and Legislature shortened payment schedule to 2036 from 2040 (2015 state budget)
  - Reduces long-term costs by billions of dollars
  - Commits the state to increased annual contributions of 10 percent for the next three years, 7 percent thereafter
  - Change viewed favorably by rating agencies

Retiree Health Care (OPEB)

The Retiree Health Care Challenge

- Municipalities face a total of approximately $30 billion in unfunded liabilities for retiree health care, more than twice the $13.1 billion in unfunded pension liabilities
  - This is what these governments <u>owe now</u>, in today's dollars, for lifetime retiree health care for current retirees and employees already eligible for future benefits
- In addition, the state has an unfunded liability of approximately $16 billion for retiree health care

The Retiree Health Care Challenge

- Rather than paying down liabilities as they are doing with pensions, municipalities have opted to pay-as-you-go
- Cities and towns spent an estimated $800 million on retiree health care benefits in fiscal 2012, almost equal to unrestricted (general government) aid
- Without change, spending is expected to grow to $1.5 billion in 10 years

The Need for Urgent Action

- Controlling these costs is critical in preserving local services
- The longer that retiree health care obligations go unaddressed, the more severe the consequences for retirees
- As with municipal health reform, even with changes in eligibility and benefits, retirees would still receive a very generous benefit

Liabilities Create Tough Choices

Municipalities have three options to deal with these enormous liabilities:

1. Continue with the status quo, allowing the costs of retiree health care and pensions to crowd out funding for more and more services
2. Meet current obligations and place the full burden on taxpayers
3. Reduce retiree health care obligations through reform while still preserving a generous benefit

MTF Proposal - Reduce Retiree Health Care Obligations Through Reforms While Still Preserving a Generous Benefit

- Increase minimum eligibility to age 65 for all pension group classifications from the current age 50 or age 55, depending on pension group
- Increase minimum years of service from 10 years to 20 years
- Change the current system in which all employees received full benefits and 10 years of service by pro-rating benefits to years of service
  - Minimum benefit at 20 years increasing to maximum at 30 years

MTF Proposal - Reduce Retiree Health Care Obligations Through Reforms While Still Preserving a Generous Benefit

- Pro-rate benefits for part time employees, rather than providing full benefits after just 10 years of part-time service
- Changes would not affect:
  - Current retirees, current employees within 5 years of Medicare-eligibility age and at least 9 years of service, and current employees within 5 years of maximum pension benefit and at least 20 years of service