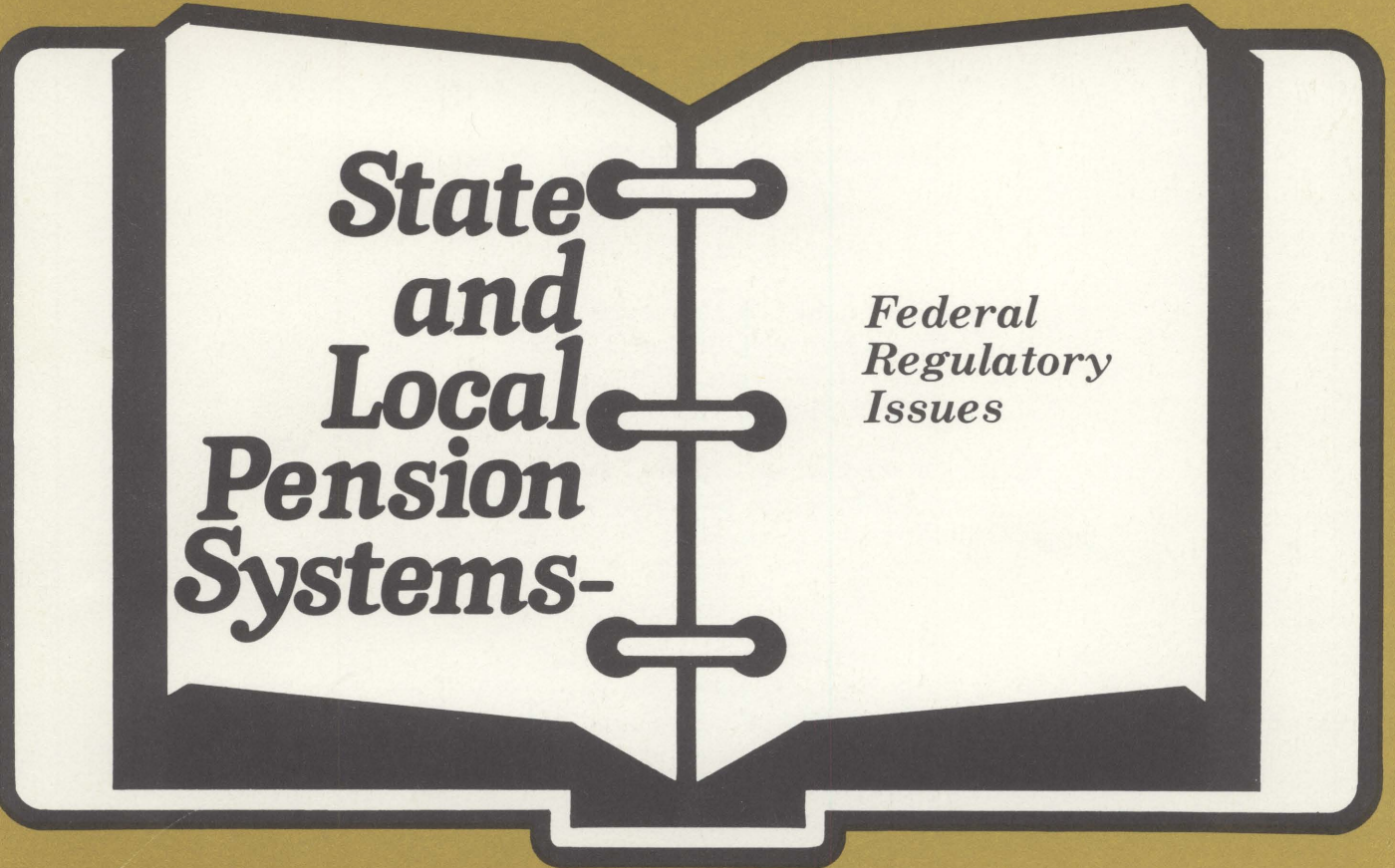


A COMMISSION REPORT



**State  
and  
Local  
Pension  
Systems-**

*Federal  
Regulatory  
Issues*

ADVISORY  
COMMISSION ON  
INTERGOVERNMENTAL  
RELATIONS



Washington, D.C. • December 1980

A-71

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# Preface

**I**n this report the Commission has undertaken to answer the question—should the federal government regulate state and local government employee pension systems and, if so, in what ways? In 1974 Congress passed the *Employee Retirement Income Security Act* (ERISA) which brought private pension plans under extensive federal regulations. More recently, bills have been introduced in Congress to extend federal regulation to cover various aspects of state and local employee pension plans. In addition, efforts to reform Social Security have resulted in proposals which would extend compulsory Social Security coverage to state and local employees.

ii

These proposals drew the attention of the Commission because they appeared to run counter to a fundamental principle of American federalism, namely, that the states ought to

be free to formulate their own employee compensation policies without being restrained by federal government regulations or mandates.

The Commission previously studied public pension problems in its *City Financial Emergency* and *State Mandate* reports, and made recommendations calling upon the states to assume fully their responsibility for ensuring the financial soundness of state and local retirement systems. At a time when rising pension costs have prompted growing public support for increased state regulation and reform, imposing federal controls on state and local policymakers would be ill-timed as well as deleterious to our federal system.

**Abraham D. Beame**  
Chairman

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Full responsibility for the content and the accuracy of the study rests, of course, with the Commission and its staff.

**Wayne F. Anderson**  
Executive Director

**John Shannon**  
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# Contents

	<i>Page</i>
<b>Chapter 1. The ACIR Recommendations on Intergovernmental Aspects of State and Local Pension Systems</b> .....	1
Summary .....	1
Background for the ACIR Study .....	3
Federal Regulation Issue .....	4
Background .....	4
Reasons for the Commission’s Recommendation Against Federal Regulation .....	4
State Sovereignty .....	5
The Diversity and Uniqueness of State and Local Systems ....	5
State and Local Progress in Regulating Their Pension Systems .....	7
The National Interest Does Not Require Federal Regulation ...	8
The Question of Limited Federal Regulation .....	9
<b>Recommendation #1. Hands-Off Strategy on Federal Regulation</b> ...	10
Exemption of Public Retirement Systems from IRS Regulations ...	10
Background .....	10
Reasons for the Commission’s Recommendation That IRS Qualification Standards Not Apply to State and Local Governments .....	11
<b>Recommendation #2. Remove IRS Regulations</b> .....	12
Social Security Coverage for State and Local Employees .....	12
Background .....	12
Proposals for Extending Social Security Coverage .....	12
<b>Recommendation #3. Hands-Off Strategy on Mandatory Social Security Coverage</b> .....	15
Keep Option to Withdraw from Social Security .....	15
Background .....	15
Reasons for the Commission’s Recommendation to Keep the Withdrawal Option .....	15

<b>Recommendation #4. Keep Withdrawal Option</b> .....	16
<b>The State-Local Role in Public Pension Systems</b> .....	16
Background .....	16
Reasons for the Commission's Recommendations for an	
Enhanced State Role .....	17
Reaffirmation of the Previous ACIR Recommendations .....	17
Permanent State Pension Commissions .....	17
A Comprehensive State Data Base on Pension Systems .....	17
<b>Recommendation #5. Permanent State Pension Review</b>	
<b>Commission</b> .....	18
<b>Chapter 2. The Diversity of State and Local Employee Pension Plans</b> ....	19
Diverse Characteristics of State and Local Plans .....	19
Regional and Administrative Patterns .....	23
Summary .....	28
<b>Chapter 3. Problems and Practices</b> .....	31
Funding .....	32
Disclosure .....	36
Benefits .....	42
Conclusion .....	43
<b>Chapter 4. State Regulation and Reform</b> .....	45
Major Survey Finding—Extensive Reporting and	
Disclosure Requirements .....	52
Major Survey Finding—Recent Upsurge in Reform Activity .....	53
Forces Behind State and Local Pension Reform .....	55
State Pension Commissions .....	58
<b>Appendix. Summary of the Major Provisions of the Public Employee</b>	
<b>Retirement Income Security Act of 1980 and the Employee</b>	
<b>Benefit Administration Act of 1980</b> .....	61
Purposes .....	61
<b>Title I. Public Employee Retirement Income Security Act</b>	
<b>of 1980</b> .....	62
Coverage .....	62
Exemption for Plans Meeting Minimum State Standards .....	62
Fiduciary Standards .....	63
Internal Revenue Code Qualifications .....	63
Enforcement .....	64
Advisory Council .....	64
Preemption .....	64
Effective Dates .....	64
<b>Title II. Employee Benefit Administration Act of 1980</b> .....	64
Employee Benefit Administration .....	64
<i>ACIR Model Legislation.</i>	
<b>4.201 Establishment of Consolidated State-Administered</b>	
<b>Pension System</b> .....	L-1
<b>4.202 State Standards, Review, and Assistance Regarding</b>	
<b>Local Retirement Systems</b> .....	N-1

## Tables and Exhibit

### Tables

1. Social Security Coverage of State and Local Employees: by Region and State, March 1977 .....	14
2. Number, Membership, Benefits, and Assets of Employee-Retirement Systems, by System Characteristics, 1976-77 .....	20
3. Number, Membership, and Benefit Operations of Employee-Retirement Systems, Last Month of Fiscal Year, 1976-77 and 1966-67 .....	22
4. Finances of Employee-Retirement Systems, 1976-77 and Prior Fiscal Years .....	24
5. Number and Membership of Employee-Retirement Systems of State and Local Governments, by Membership Size of System, by Type of Administering Government, by State, 1976-77 .....	26
6. Methods of Funding State and Local Government Defined Benefit Retirement Systems .....	34
7. Frequency of Defined State and Local Government Benefit Retirement System Actuarial Valuations .....	38
8. Auditing Practices for State and Local Government Retirement Systems .....	39
9. State and Local Retirement System Disclosure to Members, by Size of System .....	40
10. State Reporting and Disclosure Requirements for Major State-Administered Systems .....	46
11. State Reporting and Disclosure Requirements for Local-Administered Systems .....	50

### Exhibit

1. NCSL Checklist .....	57
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# The ACIR Recommendations on Intergovernmental Aspects of State and Local Pension Systems

## SUMMARY

**P**rompted by growing public concern about the impact of the costs and future liabilities of state and local government employee retirement systems upon the financial health of state and local government, and by the growing importance of state-local pension issues in intergovernmental relations, the Advisory Commission on Intergovernmental Relations (ACIR) undertook a study of the intergovernmental aspects of current proposals relating to state and local pensions. This report examines proposals for federal regulation of state and local retirement systems, and for mandatory Social Security coverage of state and local employees. Various aspects of state and local pension policy are analyzed, including current pension problems, practices, state regulations and reforms; and the state-local pension commission is described as the institution best suited for achieving meaningful state regulation and reform of state and local retirement system.

At its meeting on December 7, 1979, the Commission considered the staff study and made several recommendations (full texts of the recommendations appear at the pages cited):

## THE ACIR RECOMMENDATIONS

**No federal regulation.**

The Commission opposes all forms of federal regulation of state and local retirement systems because such regulation represents an unjustifiable and undesirable intrusion into the sovereignty of state and local governments in the fundamental area of personnel and their compensation. Even mild forms of federal regulation are rejected because they can be expected to lead to more extensive and undesirable intrusion in the future (pages 4-10).

**Exempt state and local pensions from ERISA requirements.**

The Commission recommends that all ERISA provisions, such as the IRS reporting requirement and the contribution and benefit limitations, be amended by Congress to specifically exempt state and local government retirement systems (pages 10-12).

**Exempt state and local pensions from IRS nondiscrimination qualifications.**

The Commission recommends that Congress amend the Internal Revenue Code so that state and local retirement systems are not required to conform to the nondiscrimination qualification in order to receive "qualified" tax treatment in the future, because such provisions are not relevant to state and local pensions and their imposition will harm state and local employees (pages 10-12).

**No mandatory Social Security for state and local employees.**

The Commission recommends Congress resist pressures to mandate compulsory Social Security coverage for state and local employees because mandatory coverage, even in its mildest form, would impose excessive costs on state and local governments and undermine fundamental state control of government employee compensation (pages 12-15).

**Keep Social Security withdrawal option.**

The Commission recommends that the option to withdraw from Social Security, currently available to state and local governments and their employees, should be continued (pages 15-16).

**State regulation and/or consolidation.**

The Commission reaffirms its support of state regulation and/or state consolidation of state and local retirement systems (pages 16-17).

**State compensation for mandated costs.**

The Commission reaffirms its support of state compensation to local governments for mandated retirement costs which go beyond widely accepted tests of reasonableness (pages 16-17).

**State-local pension commissions.**

In addition, the Commission recommends that each state establish a permanent state-local pension commission to analyze problems of state and local retirement systems on an ongoing basis and to make recommendations for state and local action resolving these problems (pages 17-18).

**State information on all state and local systems.**

To assure adequate reporting and disclosure of retirement system information to state-local pension commissions and to the public in general, the Commission recommends that any state which does not already have such information should undertake to obtain a comprehensive initial accounting and evaluation of the funding and benefit characteristics of all state and local retirement systems within the state (pages 17-18).



## BACKGROUND FOR THE ACIR STUDY

For many years the subject of public employee pensions lay dormant in the field of public finance; state and local government retirement systems were relatively obscure and noncontroversial public institutions. Pensions were viewed as fringe benefits; unfunded pension liabilities were not figured into debt limits of local governments. Pension benefits to public employees were considered mere gratuities provided to needy public servants and were not included in collective bargaining arrangements.

State and local pensions emerged from obscurity in the decade of the seventies as budgetary difficulties in many of the nation's cities led to a re-examination of the rapidly growing costs of government. The uncontrollable nature of pension costs, combined with the fact that many state and local governments had accumulated sizable pension debt in the form of unfunded liabilities of retirement systems, caused some observers to identify state and local retirement systems as potential fiscal time bombs. Public interest in pensions therefore initially was focused on the funding issue as public employees, taxpayers and public officials sought to place pension funding on a more sound actuarial basis than previously. More recently, questions relating to benefits, investments, and disclosure have become the subject of public concern and discussion. What kind of pension benefits should be provided in the public sector? How should pension funds be invested? What kinds of information should be disclosed to the public?

Underlying all funding, benefit, investment, and disclosure questions is the fundamental issue of government accountability: What level of government should control state and local retirement policy? Should the federal government or state governments regulate state and local pension systems?

Since 1973, public awareness of the intergovernmental aspects of state and local government pension problems has increased considerably, with some critics questioning the willingness and ability of the states to regulate

their own systems and those of their local jurisdictions. Congress, which took on the responsibility for regulating private pension plans with the passage of the *Employee Retirement Income Security Act of 1974* (ERISA) has begun to turn its attention to public pensions. A recent report by the House Pension Task Force has supported federal regulation of state and local plans in areas of reporting, disclosure and investments. In 1980, the "Public Employee Retirement Income Security Act" (PERISA) was introduced to implement this recommendation. (A summary of PERISA—HR 6525—appears in the Appendix to this report.) In addition, the Treasury Department is devoting some attention to state and local retirement systems; there are indications that the IRS may enforce provisions of the *Internal Revenue Code* which could in effect regulate state and local plans.

Another current question is that of mandatory coverage under Social Security for state and local employees. Present law allows uncovered public employee groups to remain outside of the Social Security system, and provides those within Social Security with an option to withdraw. This preferential treatment is not accorded to the private sector. About 30% of state and local employees are not presently covered by Social Security. The preferential treatment given to public employees has been criticized on grounds of excessive cost to the federal government, and compulsory Social Security coverage of state and local employees has been proposed as a solution to the substantial financial difficulties which have plagued the Social Security system during the last decade. Such compulsory coverage, even if it is only applied to new state and local employees could be quite costly to state and local governments, and would take away from state government a good deal of control over retirement policy for public employees.

The importance for intergovernmental relations of these two issues (the level of government which should control public pension systems, and the nature of state-local employee coverage under the federal Social Security system) prompted the Advisory Commission on Intergovernmental Relations to initiate this study of state and local retirement systems, focusing mainly on the question of state vs.

federal control over state and local retirement policy.

In addition to this ACIR study, there are several other large-scale studies under way in the pension field which may ultimately shed additional light on the issues and recommendations considered in this report. The President's Commission on Pension Policy has been established. Several studies relating to specific aspects of pension policy are in progress, including several relating to intergovernmental issues. For example, HEW's Universal Social Security Coverage Study Group is completing a comprehensive study dealing with the issue of mandatory Social Security coverage. Another significant study, currently in progress, is the HUD-Urban Institute project on state and local retirement systems, their current funding status, benefit levels, projections of costs and other aspects of state-local retirement policy. This study is important, not only because it should be of great value as a complement to the findings and focus of the Congressional Pension Task Force Report, but also for its unique data gathering effort upon which several federal agencies are relying for their own research efforts in this area.

Although the ACIR could wait for the findings of others before making its recommendations in the field, the speed with which Congress is proceeding to consider proposed legislation to regulate state and local retirement systems requires that ACIR's views be made known at this time if they are to have any impact upon future legislation. Moreover, the ACIR's interest and special competence in the field of intergovernmental relations means that its report will address prime intergovernmental questions that are not apt to figure prominently in other studies. Thus Commission action on these questions at this time can be particularly constructive in contributing to the President's pension policy study, other ongoing studies, and Congressional and state-local action on pension matters.

## FEDERAL REGULATION ISSUE

### Background

Proposals that the federal government regulate state and local employee retirement sys-

tems are of relatively recent origin. Following the passage of the *Employee Retirement Income Security Act of 1974* (ERISA), an act designed to regulate private sector pension plans, members of Congress have submitted bills in a parallel development to regulate state and local retirement systems. Just as ERISA was passed as a means of reassuring private sector plans, proposals for the "Public Employee Retirement Income Security Act" (PERISA) were advanced as a means of providing public employees the same kind of protection ERISA ensures for private sector employees. Both PERISA and federal administrative decisions to enforce the *Internal Revenue Code* tax qualification sections upon public sector pension plans are aimed at establishing vesting, fiduciary, funding, benefit, and disclosure requirements for public pension plans similar to those applied in private pension plans.

Although the original proposals for federal regulation of public employee pension plans included funding, vesting, and certain other requirements, the Congressional Pension Task Force has now scaled down its regulatory proposals for state and local retirement plans so as to include only minimum reporting, disclosure, and fiduciary standards.<sup>1</sup> The narrowed-down form of federal regulation of state and local retirement systems is intended to protect plan participants as well as taxpayers by putting a spotlight on pension funds and by penalizing fraud and improper pension investments.

### Reasons for the Commission's Recommendation Against Federal Regulation

In recommending against federal regulation of state and local pension systems, the Commission rested its case upon five major arguments.

- Our federal system with its emphasis on state sovereignty requires that states have full responsibility for determining all basic components of their public employees' compensation, and that of the local employees within the states.
- The unique and diverse nature of state and local retirement systems requires the

kind of adaptation and fine tuning that only state and local government control and regulation can provide.

- State and local governments have made significant progress during the past few years in putting their own retirement systems in order.
- There is no convincing evidence that the federal government has any compelling “national interest” in regulating state and local public pension systems.
- Even mild or limited forms of federal regulations are undesirable given the tendency for federal regulatory agencies and the courts to take a friendly piece of legislation and turn it into an unfriendly set of regulations.

Each of these arguments is examined in more detail in the following section.

## State Sovereignty

**If states are to have any claim to independence within our federal system, they must be free to control all of the basic components of their employees’ compensation.**

Proposals for federal regulation of state and local pension systems have a common strain: they would conflict with the ability of states and their local governments to structure their own employee-employer relationships. According to the doctrine of state sovereignty, how a state designs its compensation policy—including the various benefit, funding, vesting, investment, and disclosure characteristics of its retirement systems—should be left for the states to decide. PERISA would clearly violate state authority over these fundamental employment decisions and state freedom to structure integral operations in an area which has been a traditional function of state and local government.

Defenders of the federal system argue that the state’s ability to control its personnel system is one of the most essential requirements to the maintenance of state sovereignty. Underpinning this contention is the belief that the level of government which controls employees’ compensation will affect the services performed as well as the loyalty of the employees. If pension decisions for state and local employees are to be made by

Congress, their orientation and political activity shifts to Washington, and the states are weakened in the process. Predictably, the states’ sense of responsibility slumps.

The possibility exists that federal regulation of state and local systems, in addition to being unwise intervention into state and local affairs, may also be unconstitutional. The Supreme Court decision in *National League of Cities vs. Usery* established that one element of state and local compensation policy, wage determination, could not be limited by federal minimum wage standards because such limitation violated state sovereignty. Some legal experts believe that the principle extends to other components of state and local wage and benefit practices.

The impact of federal intervention in state and local affairs which would result from federal pension regulation should not be underestimated. Pensions constitute a significant element of employee compensation for state and local government. State and local employer and employee contributions average about 17% of total payroll. By virtue of their deferred nature pension benefits play an important part in employee retention, productivity, and loyalty. State and local retirement systems also provide early retirement, disability, and death benefits which play a particularly important role in such essential functions as police and fire services.

Finally, the funding and investment policies of state and local retirement systems can have a significant effect on tax and expenditure trends and on the economic stability of state and local jurisdictions. Thus, the choice of funding policies for retirement systems affects more than just compensation policy. It also affects the general fiscal condition of state and local governments, and the degree of fiscal and political stress they confront.

## The Diversity and Uniqueness of State and Local Systems

**The unique and diverse nature of state and local retirement systems makes them poorly adapted to federal regulation. Only state and local government regulations and standards can provide the adaptation and fine tuning required to accommodate the diversity of state-local pension systems.**



There are essential differences in concept underlying public employee retirement systems and private sector plans. State and local funding methods reflect the permanence of governmental units while private sector enterprises may be comparatively short-lived. Hence the primary concern of public retirement systems' funding policy is protection against relatively brief financial emergencies. Private sector plans, in contrast, face the problem of solvency of the fund in the event that the business ceases, one of the problems which prompted ERISA.

In addition, many public plans, especially the numerous small local police and fire pension plans, are designed with a view to their usefulness in attracting and retaining police and fire department employees. This unique characteristic makes it difficult for them to conform to ERISA-type federal benefit and vesting provisions. Even federal disclosure and reporting standards could impose excessive costs on such small local plans (as has happened with plans of many small private firms following enactment of ERISA).

There is wide diversity in the characteristics of the various state and local pension plans. The variation in the way different states handle their unique pension problems is proof that state and local governments require full powers to custom build their systems to meet their diverse needs. For example, states in the Northeast and Midwest tend to have old (or mature) retirement systems which often have already accumulated substantial unfunded liabilities and very generous benefits. Reform in these states therefore tends to take the form of upgrading the funding levels and lowering benefit costs. Sunbelt states with rapidly growing employment, however, tend to emphasize the prevention of the development of funding and benefit problems via the passage of process legislation (such as reporting and disclosure regulation) and advance funding requirements. Some states have consolidated statewide retirement systems, whereas others do not. Experiments (such as the New England Retirement Law Commission project) are being made with consolidation of information and disclosure for areas greater than a single state.

There are also substantial variations in state regulation of locally administered systems. For

example, some states completely regulate almost all of their locally administered systems in the disclosure areas; others show mixed degrees of statutory regulation of disclosure; and an occasional state has no disclosure regulation whatsoever.

It is the ACIR's position that diversity within the federal system is desirable. Federal regulation of the various systems cannot be as responsive to the diverse problems facing state and local systems with respect to personnel and their compensation as state regulation. Imposition of uniform federal standards would be destructive to diversity, which is one of the basic tenets of our federal system.

Because states bear ultimate responsibility for the fiscal health of their local governments, states ought to have the responsibility for regulating local retirement systems. States have mandated retirement benefits in the past—a situation which led ACIR to recommend that the state assist in the funding of such benefits whenever they exceed standards of reasonableness. Federal intervention would risk weakening or cutting off this line of intergovernmental accountability. In addition, the undercutting of state control over local pensions would weaken the hand of the states in preventing and dealing with any future local government financial emergencies. This would be particularly dangerous since some financial emergencies experienced by localities in the recent past have been directly related to their obligations for funding pensions and retirement benefits.

States and local governments have had a long and largely successful history in the operation of their public employee retirement systems. In many ways, these diverse systems have pioneered developments in the pension field. Many state and local pensions were established long before private plans, or before the federal Civil Service Retirement system, and federal Social Security came into existence. States and local governments have also pioneered in the study of pension problems and in the regulation and consolidation of retirement systems. The formation of state and local pension commissions, designed to study pension problems, dates back to the 1920s and before in several states. Federal regulation could inhibit such desirable innovations and experimentation.

## **State and Local Progress in Regulating Their Pension Systems**

**Federal regulation of state and local pension systems is not appropriate at this time because states and local governments are demonstrating a willingness to put their own retirement systems in order, and they have made significant progress toward that end in the past few years.**

State and local governments have been leaders in adopting improvements and reforms in their pension plans, and should be allowed to continue this progress without federal interference. For example, state and local plans have pioneered in adopting inflation indexing and early retirement provisions as well as disability and death benefits. More recently, states have studied and implemented many new and innovative reforms in the area of state oversight and financial assistance.

As referred to earlier, each state responds to its own unique problems. Sunbelt states where new plans or existing plans are expanding have recently shown a willingness to adopt promptly "process" measures including strict state disclosure and reporting regulation of all local systems to prevent the types of abuses that may crop up in the public pension field. Tennessee and Florida have also enacted a full-funding regulation which is as stringent as ERISA requires of private sector plans.

New York, Massachusetts, California, and Maryland (all possessing "mature" plans) have recently adopted measures to reduce their pension costs such as (a) limiting the cost of living increases, (b) integrating state and local systems with Social Security, and (c) reducing benefits for new employees.

Other states have sought pension plan reform which brings local retirement systems under the umbrella of a consolidated state system. South Dakota's recent state-local retirement system consolidation is a striking example. The New England Retirement Law Commission's project (cited earlier), which seeks to computerize public employee retirement information and disclosure for the entire New England area, is an example of progress toward consolidation.

Perhaps one of the best examples of an innovative state approach is in Kansas.

**Kansas**—The State of Kansas has established a comprehensive set of funding policies to govern its state and local pension plans. Most public employees are members of two statewide plans—the Kansas Public Employees' Retirement System and the Kansas Police and Fire System. The policies governing these systems require that an annual actuarial valuation be conducted to determine the contribution rates necessary to pay full normal costs and amortize any unfunded liability over a period of years, and that the cost of all changes must be actuarially estimated and funded. Furthermore, although state mandating of local benefits was not a major problem, the 1978 legislature adopted, in law, a policy of paying all costs, including the local share, of any post-retirement benefit improvements and appropriated \$16.8 million to cover such costs for the next four fiscal years.

The 1976 Kansas legislature, following an interim study, also enacted a set of supervisory practices and standards for the 20 remaining local retirement systems. Under the act, all city-administered systems must have an annual actuarial valuation, and by 1981 must be funded sufficiently to pay normal costs and amortize any unfunded liability over a period of years. The valuation must be conducted by the state actuary or an actuary certified by the trustees of the Kansas Public Employees Retirement System, and the Trustees must certify that the city has levied a sufficient tax to meet the funding requirements. The act also requires any changes in local benefits to be actuarially evaluated and funded.<sup>2</sup>

The ACIR in conjunction with the National Conference of State Legislatures (NCSL) undertook a 1979 survey of state and local retirement systems which showed the extent to which state and local governments have improved their pension systems. This survey showed that state reporting and disclosure requirements are extensive for the large state-administered systems which contain about 90% of all state and local pension participants. The large majority of states require regular ac-

tuarial valuations, audits, fiscal notes, and reporting to states and to employees. For those states which did not require these disclosure practices by statutes, they were often required by established board policy. These findings raise questions about the relevance of the House Pension Task Force claim that there is a "lack of public pension policy" for regulating state and local pension plans.

The ACIR-NCSL survey findings were less clear on state regulation of locally administered systems. Five of the 14 states responding have completely regulated almost all of their local-administered systems in the five above mentioned disclosure fields; only one indicated no regulation relating to any of the disclosures; and the remaining 13 states showed mixed degrees of statutory regulation.

8 The survey provided evidence indicating that pension reform of one kind or another had recently been enacted or is being considered for the near future in at least 23 states. Many of these reforms correspond to pension reform guidelines and suggested reforms made by state pension commissions and special study commissions. The NCSL Task Force on Public Pensions has encouraged the establishment of these pension commissions as a primary step designed to bring about state and local retirement reform.

More empirical evidence of state and local pension reform progress comes from a 1979 study of disclosure for the municipal bond market by Bruce V. DePalma and Carol M. Palczynski. Their findings indicated that, in general, bond market disclosure practices have improved considerably. In particular,

... there was a strong response on the part of issuers to reveal pension fund information. Specifically, pension fund detail disclosure increased from 11% to 74% over the three-year period of the study. Also reflecting this increase was the improvements in the reporting of those items regarding the method of pension funding and the extent of unfunded past service. The former showed a moderate increase from 11% to 47% in 1978 while the latter improved significantly from a

poor disclosure level of 11% in 1978 to 74% in 1978.<sup>3</sup>

In this case the reform was highly correlated with guidelines designed for the municipal bond market by the Municipal Finance Officers Association, hence both the state-local sector and the private sector appear to be working in tandem toward pension reform.

Thus, state and local governments have demonstrated considerable interest in improving the operation of their retirement systems even in the absence of federal regulation.

### **The National Interest Does Not Require Federal Regulation**

**There is no convincing evidence that the federal government has any clearly defined, compelling "national interests" which are being badly undercut by state and local public pension policies and practices.**

The "national interests" compelling federal regulation of state and local pension systems have not been the subject of any study nor have they been weighed against potential harm to state and local systems. In fact, there has seldom been any recognition that potential ill effects for the entire federal system may result. Nor has any convincing evidence been provided showing state and local governments to be incapable of solving their own problems or that national interests are not being served by current state-local reform efforts.

As its past track record concerning retirement systems shows, the federal government has not exhibited the necessary political courage and competence to face up to its own Social Security, military, and Civil Service pension problems. State and local governments therefore have strong reasons to fear federal regulation.

In addition, studies of the federal management of private pension funds have indicated that federal management in the past left a good deal to be desired because of the various national interests involved. For example, the Department of the Treasury manages the assets of several federal trust funds, including the railroad retirement system. Responsibility to these funds dictates that assets should be invested to secure high interest returns for the pension

trust. But the Department of the Treasury has another and conflicting responsibility, namely the financing of public debt in a manner that will secure for the federal government the lowest interest costs for federal borrowing. In the past this conflict of interest at times has been decided to the detriment of the pension trusts.<sup>4</sup>

States and local governments have equally strong reasons to be apprehensive about the fact that with federal regulation, decisions on the major characteristics of their pension plans would be made in the area of Congressional politics and national interest groups.

The one case in which the federal government intervened in state-local pension investments is an interesting and perhaps revealing experience—the case of the New York City financial loan legislation. In this case, the federal government chose to come to the aid of the city only on the condition that the city's pension funds invest heavily in city bonds. The contradiction between this federal action and the principle of requiring pension systems to diversify investments became apparent when the directors of the federal loan plan found it necessary to propose legislation to exempt the New York City pension funds from potential violations of IRS qualification standards on fiduciary requirements.

The political and economic interests of the Congress are revealed in several recent proposals to amend ERISA to require that specific types of pension investments be made. For example, the 1976 "Dole Amendment" would require 20% of all pension assets to be directed to residential mortgages. The Weicker bill would require 2% of all pension assets to be set aside for venture capital. These may be useful objectives, but they demonstrate how readily, and perhaps arbitrarily, the stated federal purpose could be changed from its original formulation, once federal regulation was accepted in principle.

### **The Question of Limited Federal Regulation**

**Limited federal regulation may have unanticipated, counterproductive side effects and can be expected to lead to more extensive and undesirable regulation.**

The first four findings presented in this section

are general arguments against all forms of federal regulation of state and local retirement systems. While most public pension experts would agree with these arguments with respect to the regulation of major aspects of state and local plans—such as vesting, funding, investments, benefits, and coverage—some might make an exception for the case of a strictly limited federal role in the area of reporting and disclosure. According to this point of view, federal regulation could be effectively limited not only in the scope of regulation, but also in the form of regulation. The latter would be achieved, theoretically, via the creation of an intergovernmental (federal-state-local) agency to regulate public plans deemed to be insufficiently regulated under existing state systems.

Several factors argue against a limited federal regulatory role. Experience in the past has indicated that there is a tendency for federal agencies and the courts to take a friendly piece of legislation and convert it into an unfriendly set of regulations. Each opening wedge of federal control inevitably seems to lead to stronger and stronger controls and regulations, as administrative regulations are tightened and made more stringent, and as federal officials apply for additional legislative authority to extend the effectiveness and scope of the formerly limited regulation.

Commenting on HR 6525 (the 1980 version of PERISA) before a group of state legislators and state and local pension experts, Donald Seifman spelled out some of the ways in which the limited regulation contemplated in the bill could eventually weaken state and local control of their pension systems:

You will find that after PERISA, as there was in ERISA, that the Congress will seek alternatives to your plans as they have to the private retirement mechanisms which have existed prior to ERISA. They will seek the utilization of IRAs to supplement retirement systems and other simplified pension plan mechanisms. These mechanisms will take you out of the picture. These mechanisms will develop as a result of the complications contained in this bill and they will provide alternate methods of having retirement systems which will not involve you and will be developed to ameliorate the effect of Congress' own

baby. They will take away the incentive for hard work and loyalty to employers which is the foundation of retirement systems.<sup>5</sup>

10 Even if federal officials are successful in maintaining a strictly limited federal role, however, it is likely that various unanticipated and undesirable side effects will outweigh the anticipated beneficial impacts. Limited federal regulation could stifle innovative state-local initiatives which might otherwise have taken place. Instead of concentrating on important problems relating to major aspects of pension policy, much state and local effort would be required to guarantee conformance to certain (or more likely uncertain) legal requirements relating to federal reporting and disclosure standards. Federal requirements would lead to duplication in the case of states which maintain different approaches toward disclosure and reporting; they would be expected to raise costs of retirement systems. Delays in the issuing and implementation of federal regulations would result in inadequate reporting and disclosure for states which would have otherwise developed their own standards in the interim. Thus, while the concept of a strictly limited federal role may appeal to some well intentioned individuals, real world practicalities argue against it.

It should be noted that federal proposals to regulate state and local pensions, though they have become over time more limited in nature, cannot be considered "strictly limited" as defined above. The most recent 1980 PERISA proposal, HR 6525, includes a federal regulatory agency with no specifically designated state and local representation on the board (not an inter-governmental agency). The bill covers not only reporting and disclosure standards, but also federal regulation of fiduciary aspects of state and local retirement systems. Since fiduciaries are responsible for funding and investments as well as other crucial aspects of pension policy, some pension experts argue that this bill would result in extensive federal regulation of almost all aspects of state and local retirement policy. While the bill does contain an exemption provision which would allow states with sufficient reporting and disclosure regulation to be certified as exempt from federal regulation, this exemption would not cover fiduciary regulation.

For the foregoing reasons, the Commission did not adopt a recommendation calling for limited federal regulation of state and local retirement systems, adopting instead the following:

*Recommendation #1*  
**Hands-Off Strategy on  
Federal Regulation**

**The Commission recognizes the problems facing state and local retirement systems, commends the many state and local governments which have taken corrective action, and urges all state and local governments to give high priority to the study of their public retirement systems and take any corrective action indicated by such studies. The Commission opposes federal regulation of state and local retirement systems because such a policy represents unjustified and undesirable intrusion into the sovereignty of state and local governments in the fundamental area of personnel and their compensation.**

**Consistent with this philosophy, the Commission also recommends that all ERISA requirements, such as the IRS reporting requirement, as well as the contribution and benefit limitations in Section 415A of the Internal Revenue Code, be amended by Congress to specifically exempt state and local government retirement systems.\***

**EXEMPTION OF PUBLIC RETIREMENT  
SYSTEMS FROM IRS REGULATIONS**

**Background**

The controversy involving Internal Revenue Service regulation of public retirement systems has its roots in the early history of tax treatment of retirement funds, as well as in the more recent enactment of ERISA. Congress originally established an income tax preference for retirement benefits in 1926 to avoid potential disincentive effects of the income tax upon savings within private sector pension plans. This tax preference consists primarily of tax deferral for employer contributions and for

\* Further background materials on ERISA requirements appear in the discussion of Recommendation 2.

earnings from pension funds until such funds are distributed as pensions to retirees. In order to obtain this tax treatment for private plan participants, the federal law provided that the pension fund had to be created for the exclusive benefit of employees.

The specific IRS qualifications for the tax preference have evolved over time. In 1972, Internal Revenue Service Ruling (72-14) held that state and local retirement systems must meet the Section 401(a) qualification requirements to obtain favorable federal tax treatment. Basically, today's qualification standards applicable to public employee retirement systems consist of two nondiscrimination standards:

1. The system's benefits, contributions, and coverage must not discriminate in favor of highly paid officials and employees.
2. Trust investments and income must be for the exclusive benefit of employees and beneficiaries.

With the passage of ERISA, Congress specifically exempted public plans from most of the ERISA regulations, such as funding, vesting, and participation standards. However, public plans were not exempted from certain requirements related to the issuing of reports to the IRS and the benefit and contribution limitation related to Section 415 of the *Internal Revenue Code*.

Prior to the enactment of ERISA, federal tax authorities seldom if ever enforced the qualification standards upon state and local plans, and the majority of public plans did not apply for such qualification. Recently, the IRS has taken steps to implement both the new ERISA reporting requirement which applies to state and local plans, as well as the pre-ERISA income tax qualification standards which technically apply to state and local plans. Recognizing the far reaching implication of their current authority, IRS officials have on several occasions requested a legislative determination of how to apply and enforce current qualification standards.

Because many state and local plans cover a wide range of public employees with different benefits (ranging from judges and legislators to general labor), there is ground for concern that entire statewide systems could be disqualified under the nondiscrimination standards. This

could result in a loss of the tax-exemption preference for the employee participants of the qualified plans; employees would be taxed on current compensation plus the employer's contribution. (Under a qualified plan, the employee is not taxed on the employer contribution and pension fund earnings until this income is received as a retirement benefit.)

### **Reasons for the Commission's Recommendation That IRS Qualification Standards Not Apply to State and Local Governments**

The Commission reached the decision that *Internal Revenue Code* qualification standards should not be employed to regulate state and local retirement systems for several reasons. In the Commission's judgment, Congress did not intend to make the provisions of the *Internal Revenue Service Code* applicable to state and local pension systems. Prompt Congressional action should be taken to remove any question concerning Congressional intent by specific legislative provisions so that state and local retirement systems will not be required to conform to the nondiscrimination qualification in order to receive "qualified" tax treatment.

Application of the nondiscrimination qualification to public pension systems could be highly detrimental to state and local plans, particularly those statewide plans which cover a wide range of employees. State and local employees can only be harmed by IRS enforcement of nondiscrimination provisions and potential exposure of their pension funds to taxation. In addition, the IRS has no expertise in administering regulations in the area of public pensions, and should not be expected to apply its experience gained in the regulation of private pension plans to public plans because it is not relevant.

While the potential damage of IRS regulation could be alleviated by clarification by Congress of the way in which the *Internal Revenue Code* should be applied, the Commission prefers a more definitive solution. It recommends that Congress amend the *Internal Revenue Code* so that state and local retirement systems specifically are not required to conform to the nondiscrimination qualification in order to receive "qualified" tax treatment in the future. This

will eliminate the danger that tax regulations could be employed in the future to regulate state and local retirement systems—a back door approach to the federal regulation of public pension systems which the Commission specifically opposed in *Recommendation 1*.

#### *Recommendation #2*

### **Remove IRS Regulations**

**The Commission concludes that Internal Revenue Code qualification standards—a back door regulation approach—ought not be employed in order to regulate state and local retirement systems. In the Commission’s judgment Congress never intended to empower the Internal Revenue Service to regulate state and local pension plans and the Commission strongly opposes any IRS effort to exercise such power. To remove any doubt, the Commission recommends that Congress amend the Internal Revenue Code so that state and local retirement systems are not required to conform to the nondiscrimination qualification in order to receive “qualified” tax treatment in the future.**

12

## **SOCIAL SECURITY COVERAGE FOR STATE AND LOCAL EMPLOYEES**

### **Background**

At the present time, there is no mandatory coverage by the federal Social Security system for public employees. Federal, state, and local employees are the largest category of workers in the nation exempted from compulsory coverage. However, state and local employee groups may opt to be covered by Social Security with the approval of the state and federal governments, and many of them have elected to be so covered. At present, it is estimated that only about 30% of state and local employees remain outside social security coverage. Those who are not covered are concentrated in certain areas: for example, only 36% of police and firemen have Social Security coverage (the rest are usually covered by generous pension systems set up to attract persons to these potentially hazardous jobs). Over half of the state and local retirement systems are presently not covered.

Because some public employees are outside the Social Security system, and because of the Social Security benefit formula, there are gaps and excesses in Social Security coverage of state and local employees. Two percent of full-time state-local employees receive neither a state or local pension nor Social Security. Others who have retired from both public and private jobs are able to “double-dip” from the public treasury, frequently enjoying excessive Social Security benefits on the basis of a bare minimum of covered quarters of employment.

While these gaps and overlaps in Social Security coverage have existed for some time now, only recently has there been much concern over them. Since the Social Security system has come under financial pressures during the 1970s, proposals have been made to promote the system’s financial stability, provide additional revenues, stop abuses, and move toward universal coverage by extending mandatory coverage to all public employees. Proposals for such compulsory Social Security coverage, however, have generally been postponed until several major studies are completed detailing the options available, and discussing the constitutional questions involved. Nonetheless, the Advisory Council on Social Security has advocated compulsory coverage for new state and local employees as a reasonable step in the direction of achieving universal coverage.

### **Proposals for Extending Social Security Coverage**

Proposals for extending Social Security coverage to state and local employees are of two varieties: one would provide for mandatory coverage of all state and local employees, while the other would provide for mandatory coverage of all new state and local employees as a method of gradually phasing in the system without undue disruption of existing plans.

The Commission’s consideration extended to both methods of extending Social Security coverage to state and local employees, and the Commission concluded that there were such serious objections to both of them that continuation of the present situation of exemption from mandatory Social Security coverage of state and local employees should be continued.

Arguments against the mandatory coverage of all state and local employees can be categorized under two major objections: the potential constitutional problems involved, and the costs and uneven impact of the change from voluntary to mandatory coverage.

Just as there are serious doubts as to the constitutionality of federal regulation of state and local public pension systems based on the recent Supreme Court ruling in the *National League vs. Usery* decision, which held that the imposition of federal minimum wage standards to local government wages was a violation of state and local sovereignty, so are there similar doubts concerning the constitutionality of requiring Social Security coverage of state and local employees. Both requirements interfere with the fundamental rights of sovereign governments to determine conditions of employment for their employees. Such questions of constitutionality are relevant whether the mandatory coverage applies to all employees or just new employees.

While mandatory coverage for public employees could be expected to improve the integrity of the Social Security system by eliminating the gaps in coverage for those employees who have neither public pensions nor Social Security, thereby increasing the equity of the system, it poses serious problems for the integrity of the public pension plans which would be brought under the system. Mandatory coverage could raise overall public employee labor costs, because state and local governments could not legally reduce previously promised benefits to employees, and would also have to bear the increased costs resulting from the necessity to pay the employer portion of the Social Security tax. As a result, overall state-local pension costs would rise, and the burden of these costs would fall on state and local governments—some of which could be hard pressed to meet higher costs. These most affected would be local governments responsible for police and fire plans presently outside of the Social Security system. It has previously been pointed out that only 36% of police and firemen are covered by Social Security.

In addition, the impact of additional costs would fall unequally throughout the country: for example, none of the state-local employees of Massachusetts are presently covered by So-

cial Security. Other states with a major portion of their employees without Social Security coverage include Ohio (99%), Nevada (96%), Colorado (80%), Louisiana (69%), Maine (65%), Illinois (63%), Texas (63%), California (58%), and Connecticut (43%). All together, two-thirds of all state and local employees currently outside of Social Security are found in these ten states, and the magnitude of costs for the extension of Social Security coverage to them is estimated to be quite large. Annual costs to states are estimated to be about \$1 billion for California, \$360 million for Ohio, and \$175 million for Louisiana. Eleven states (and their local governments) are fully covered by Social Security: Maryland, New Jersey, Pennsylvania, Alabama, Mississippi, North Carolina, South Carolina, Virginia, Idaho, Wyoming, and Washington. Table 1.

The regions which would be most affected are New England (67% not covered), the Great Lakes (47%), and the Far West (46%). The Mideast Region, as a whole, is 98% covered. Hence there will be a great deal of variation between regions in the cost effects of mandatory coverage.

The differential effects of mandatory coverage would be equally striking on the benefit side. Some public employees would receive more in terms of combined pensions and Social Security than they would have received before via double-dipping (though admittedly, they will pay more to the federal government for the benefits). Because most local police and fire systems are not covered by Social Security, they generally provide relatively generous and comprehensive benefits. Mandatory coverage, therefore, would add Social Security benefits on top of already generous benefits—a supplementation of benefits hard to justify.

Important, but often overlooked, is the distinction between mandatory and the existing voluntary methods of arriving at universal Social Security coverage. The mandatory approach would force state and local governments currently outside the Social Security system to pay into the system, forcing their overall retirement costs to rise—in many cases above reasonable levels. Through the voluntary approach, public employees negotiate with states and local governments to be allowed to join Social Security. Through this bargaining



*Table 1*  
**SOCIAL SECURITY COVERAGE OF STATE AND LOCAL EMPLOYEES,  
 BY REGION AND STATE, MARCH 1977**

Region and State	Number of Jobs	Number Covered	Percent Covered	Region and State	Number of Jobs	Number Covered	Percent Covered
<b>United States</b>	<b>12,252</b>	<b>8,796</b>	<b>72</b>				
<b>New England</b>	<b>667</b>	<b>219</b>	<b>33</b>	<b>Southeast</b>	<b>2,684</b>	<b>2,323</b>	<b>87</b>
Connecticut	155	89	57	Alabama	195	195	100
Maine	61	21	35	Arkansas	110	104	94
Massachusetts	318	—	0	Florida	469	393	84
New Hampshire	50	45	90	Georgia	303	258	85
Rhode Island	51	38	75	Kentucky	169	120	71
Vermont	32	26	82	Louisiana	229	70	31
				Mississippi	133	133	100
<b>Mideast</b>	<b>2,269</b>	<b>2,222</b>	<b>98</b>	North Carolina	293	293	100
Delaware	34	21	61	South Carolina	163	163	100
Maryland	230	230	100	Tennessee	231	206	89
New Jersey	400	400	100	Virginia	289	289	100
New York	1,050	1,016	97	West Virginia	100	99	99
Pennsylvania	555	555	100				
				<b>Southwest</b>	<b>1,085</b>	<b>745</b>	<b>67</b>
<b>Great Lakes</b>	<b>2,277</b>	<b>1,212</b>	<b>53</b>	Arizona	145	131	90
Illinois	609	222	37	New Mexico	77	65	84
Indiana	289	255	88	Oklahoma	160	146	91
Michigan	536	475	89	Texas	703	403	37
Ohio	555	4	1				
Wisconsin	288	256	89	<b>Rocky Mountain</b>	<b>388</b>	<b>237</b>	<b>61</b>
				Colorado	174	35	20
<b>Plains</b>	<b>1,039</b>	<b>834</b>	<b>80</b>	Idaho	55	55	100
Iowa	180	170	95	Montana	52	47	90
Kansas	156	138	89	Utah	77	70	91
Minnesota	240	172	72	Wyoming	30	30	100
Missouri	256	177	69				
Nebraska	107	100	94	<b>Far West</b>	<b>1,844</b>	<b>1,001</b>	<b>54</b>
North Dakota	51	34	67	California	1,338	563	42
South Dakota	49	43	87	Nevada	39	2	4
				Oregon	157	146	93
				Washington	225	225	100
				Alaska	29	25	86
				Hawaii	56	40	71

14

process (not necessarily collective bargaining), an equitable solution may be reached with public employees agreeing to reduce their state-local pension or wage demands in return for Social Security coverage and benefits. This can result in lower total retirement costs, while overall benefits remain reasonable.

An additional objection to mandatory Social Security coverage is particularly related to proposals that the coverage be gradually phased in by having it apply only to new employees. Mandating Social Security for new employees would force state and local governments presently outside the system to create entirely new pension plans for new employees, adding to administrative costs. It could also cause potential morale problems between new and current employees, who would have different compensation arrangements. Morale problems could be intensified if Social Security taxes rise faster than benefits.

Although some Commission members felt that phasing in mandatory coverage of state and local employees should be supported if it becomes necessary to insure the financial soundness of the Social Security system, the majority felt that the resolution of the wide range of current Social Security problems should not come at the expense of state and local governments and their employees. Most of the problems presently facing the Social Security system have no relationship to the question of coverage of public employees and those that do can be solved without resorting to mandatory coverage.

### *Recommendation #3*

## **Hands-Off Strategy on Mandatory Social Security Coverage**

**The Commission finds that Social Security options currently available to state and local governments and their employees should be continued both to prevent the imposition of excessive costs on state and local retirement systems and to insure the states the freedom they need to determine the compensation policies of their employees. The Commission, therefore, recommends that the Congress resist pressures to mandate compulsory Social Security coverage of state and local employees.**

## **KEEP OPTION TO WITHDRAW FROM SOCIAL SECURITY**

### **Background**

Current federal law allows state and local government employee groups to withdraw from Social Security coverage provided two conditions are met:

1. The employee group must have at least five years of coverage in Social Security.
2. The state must give the federal government notice of intent to withdraw two years in advance, after which the withdrawal takes effect and is irrevocable. The state may, however, rescind this notice of intent any time within the two year period.

Recent newspaper accounts indicate that about 100,000 workers, representing 243 government bodies, have said that they intend to withdraw in 1980 and 1981; this number may be considerably diminished if, as frequently happens, some of the governments rescind their withdrawal notices during the two-year notification period. Alaska state employees, who withdrew on January 1, 1980, became the first major state-employee withdrawal.<sup>6</sup>

15

### **Reasons for the Commission's Recommendation to Keep the Withdrawal Option**

The Commission considered several alternatives relating to the present state and local option to withdraw from the Social Security system: eliminating the option altogether, tightening up the conditions for withdrawal, and maintaining the present option. The Commission's decision to recommend keeping the present withdrawal option was based on two important factors: (1) state and local governments have entered the Social Security system only under the condition that they could withdraw in the future if the system's benefits and costs no longer suited their interests, and (2) removal of the withdrawal option would be an unwarranted interference with the sovereign right of state governments to determine the conditions of compensation for their employees (discussed in more detail under *Recommendation*

tion 1). In addition, the very minor percent of previously covered employees (0.8%) who have been withdrawn from the system by June 1977, indicates that the maintenance of the withdrawal option would not seem to pose a threat to the integrity of the Social Security system.

While there has been a relatively minor number of withdrawals, to remove this option from states and local governments would build an additional "uncontrollable" cost item into state and local budgets. In view of recent and projected payroll tax increases, rising Social Security costs can impose a considerable burden which some state and local governments may not be able to carry.

#### *Recommendation #4*

### **Keep Withdrawal Option**

16     **In order to assure that state and local governments continue to have sufficient latitude in controlling their employees' compensation, the Commission recommends that Congress neither eliminate nor place additional limitations on the existing provision for state-local withdrawal from Social Security.**

## **THE STATE-LOCAL ROLE IN PUBLIC PENSION SYSTEMS**

In contrast to the first four recommendations which oppose federal control of state and local retirement policy, this—the fifth recommendation—advocates a larger state role in the improvement of state-local pension policy. This recommendation for the establishment of permanent state pension commissions, and for comprehensive accounting and evaluation of all state and local retirement systems, when added to the Commission's previous state-local pension recommendations, prescribes a comprehensive program which will help the states begin to put their own pension houses in order.

### **Background**

#### **PREVIOUS COMMISSION POSITIONS**

The Commission has examined specific aspects of state and local retirement policy in two

reports in recent years. Recommendations in both reports lay a strong foundation for state policy in dealing with local retirement systems.

In 1973, the Advisory Commission on Intergovernmental Relations issued a report and recommendations on *City Financial Emergencies*. This report pointed out that cities were under increasing financial stress, and identified some of the key factors causing such stress. The Commission concluded that underfunded, locally administered retirement systems posed an emerging threat to the financial health of local governments and recommended that:

Locally administered retirement systems be strictly regulated by the states, or alternatively, be consolidated into a single state-administered system. At a minimum, states should require substantial funding for all systems based on a reliable computation of full funding requirements.<sup>7</sup>

The Commission's report further noted that due to a "lack of knowledge" about the present and future costs of local retirement systems, and due to "inherent local political problems in providing adequate funding," there are two essential responsibilities the state should assume in the area of retirement policy:

First, the state should require an accurate and current valuation of all local systems. Second, the state should require realistic funding based on such valuation.<sup>8</sup>

In its July 1978, report, *State Mandating of Local Expenditures*, the Commission examined the impact of state mandates upon the activities of local governments, and identified state mandates affecting local retirement systems as a particularly important problem area. In this study, the Commission reiterated:

... its previous policy conclusion and recommendation: that underfunded, locally administered, retirement systems pose an emerging threat to the financial health of local governments and that such systems should be strictly regulated by the states, or alternatively, be consolidated into a

single state-administered system. The Commission further recommends that states fully finance their mandates that increase retirement benefit levels and costs beyond widely accepted tests of reasonableness.<sup>9</sup>

The study also noted that many states “heavily mandated” minimum retirement benefits upon local governments, and that these benefits are extremely costly in too many cases. Nevertheless, such mandates have had “widespread acceptance . . . particularly if fully or partially funded by the state.”

### **Reasons for the Commission’s Recommendations for an Enhanced State Role**

While there are indications that states are moving in a positive direction toward state-local pension regulation and reform, there remains a persistent need to maintain a firm and aggressive position in support of this movement. The Commission’s recommendation relating to the state-local role in public pensions consists of three specific measures to strengthen the state role in public pension regulation:

1. a reaffirmation of the Commission’s previous, broad-ranging recommendations relating to state regulation, consolidation, and financing of state and local retirement systems;
2. a recommendation that each state create a permanent state-local pension commission; and
3. a recommendation that each state provide the state-local pension commission with a comprehensive data base with which it may analyze all retirement systems within the state.

### **Reaffirmation of the Previous ACIR Recommendations**

Since the 1973 publication of *City Financial Emergencies*, state and local governments have experienced the effects of a major recession, as

well as persistent inflation. Many state and local governments have been hard-pressed to raise sufficient revenue to improve the funding status of pension plans. State and local balanced budget requirements, and the movement to impose more stringent limits on taxes and spending, have probably hampered intentions in some states and localities to improve retirement system funding. Thus, the “pension time bomb” has not been defused; and the Commission felt it highly appropriate to reaffirm its previous recommendations relating to the state-local role in public pension systems. This reaffirmation of the Commission’s position has been sought by many pension experts as a means of reinforcing the current state-local pension reform movement.

### **Permanent State Pension Commissions**

Permanent state-local pension commissions have already proved to be useful in states which have established them. As “the most common mechanism used to bring a sense of order to the pension world,” the state-local pension commission is invaluable as a central institution through which states and local governments can properly address their public employee pension problems.<sup>10</sup>

The most common function of a pension commission (sometimes called a pension review committee) is reporting to the legislature on the costs and funding of proposed benefits changes. More generally, the state-local pension commission is desirable because it can provide the kind of ongoing, independent, and undivided attention to retirement costs and related matters which is absolutely necessary for such a complex and costly budget item. It can also serve a variety of purposes—i.e., study problems and recommend reforms; serve as an information clearinghouse; propose changes in benefit structures and financing; review actuarial and financing reports; and perform other state regulatory functions related to retirement systems.

### **A Comprehensive State Data Base on Pension Systems**

Basic to the work of state-local pension commissions, and to every serious effort to un-

derstand the fiscal costs and benefit consequences of public employees' compensation arrangements is a comprehensive initial accounting and evaluation of the retirement system. While a number of states already have state-local pension commissions and comprehensive data on their state and local retirement systems, others still do not. It is for these states that the Commission recommends that each state provide the pension commission with a comprehensive data base; with such a data base, the pension commission can review the entire array of state and local retirement systems and formulate overall public pension policy goals on a statewide basis.

Topics for review by pension commissions, once the data base has been established, include: evaluation of disability provisions, early retirement, cost-of-living provisions, double dipping, integration with Social Security, vesting and portability arrangements, funding methods and recent changes in the level of funds, investment policy, and potential improvements in disclosure, and reporting to all interested parties. In addition, study could also be directed to major reform measures, including the possibility of modifying existing pension plans to share the risks of inflation indexing by converting to defined contribution plans. An examination of the intergovernmental allocation of retirement costs to determine

whether additional state aid to local governments is required might also be of great value.

#### Recommendation #5

### Permanent State Pension Review Commission

**The Commission reaffirms its stance in support of state regulation and/or state consolidation of state and local retirement systems and in support of state compensation to local government for mandated retirement costs which go beyond widely accepted tests of reasonableness. In addition, the Commission recommends that each state establish a permanent state-local pension commission with authority and resources to analyze properly the problems of state and local retirement systems on an ongoing basis and to make recommendations for state and local action aimed at resolving these problems.**

To assure timely reporting and disclosure of retirement system information to state-local pension commissions and to the public in general, the Commission recommends that any state which does not already have such information should undertake to obtain a comprehensive initial accounting and evaluation of the funding and benefit characteristics of all state and local retirement systems within the state.

18

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## FOOTNOTES

<sup>1</sup> PERISA reporting standards would require reports to be filed with a specially created federal agency, such as the employees benefit administration, detailed in Title II of the HR 6525 (1980). Reports required would include annual reports, plan descriptions, actuarial statements and actuarial analyses.

Provision of information to plan participants and the public is included under disclosure standards. Disclosure of statements of benefit rights, plan provisions and current status would be provided to participants. All documents, including annual reports, would be disclosed to the public.

Fiduciary standards are legal requirements upon those who manage or administer a pension plan or its investments.

<sup>2</sup> Advisory Commission on Intergovernmental Relations, *State and Local Government Pension Reforms*, Information Bulletin No. 79-2, Washington, DC, March 1979, pp. 11-12.

<sup>3</sup> Bruce V. DePalma and Carol M. Palczynski, "Study of 19 Governmental Units Shows Increase in Voluntary Disclosure in Three Years," *Weekly Bond Buyer-MFOA Supplement*, June 22, 1979, p. 17.

<sup>4</sup> Louis M. Kohlmeier, *Conflicts of Interest: State and Local Pension Fund Asset Management*, Report to the Twentieth Century Fund Steering Committee on Conflicts of Interest in the Securities Markets, New York, NY, The Twentieth Century Fund, 1976, pp. 58-64.

<sup>5</sup> Donald H. Seifman, *Remarks on HR 6525 at the 1980 Conference on State Pension Commissions*, Duplicated, May 9, 1980, pp. 5-6.

<sup>6</sup> *The Washington Post*, September 11, 1979.

<sup>7</sup> Advisory Commission on Intergovernmental Relations, *City Financial Emergencies: The Intergovernmental Dimension*, A-42, Washington, DC, U.S. Government Printing Office, July 1973, p. 6.

<sup>8</sup> *Ibid.*, p. 7.

<sup>9</sup> Advisory Commission on Intergovernmental Relations, *State Mandating of Local Expenditures*, A-67, Washington, DC, U.S. Government Printing Office, July 1978, pp. 10-11.

<sup>10</sup> ACIR, Information Bulletin No. 79-2, *op. cit.*, p. 9.

# The Diversity of State and Local Employee Pension Plans

Over 90% of state and local government employees are covered by state and local retirement systems. The 1977 *Census of Governments* counted 3,075 state and local government administered retirement systems, with about 11 million members (9.7 active, 1.2 other) for fiscal year 1977.<sup>1</sup>

19

## DIVERSE CHARACTERISTICS OF STATE AND LOCAL PLANS

Perhaps the most significant feature of the state-local pension universe is its basic dichotomy, as revealed in *Table 2*. On the one hand, some 91% of all members of state and local pension plans belong to only 120 large retirement systems (10,000 or more members) and 86% belong to state-administered systems, many of which include local employee groups. Most state and local retirement systems (71%), on the other hand, are small, locally administered systems with less than 100 members each, making up only 0.5% of total state-local membership.

Between these two extremes are retirement systems in the middle size range, plans between 100 and 10,000 members, which make up only 25% of total plans and only 8.5% of total membership.

Significant variation in benefits and assets are revealed in the Census breakdown of state

Table 2

**NUMBER, MEMBERSHIP, BENEFITS, AND ASSETS  
BY SYSTEM CHARACTERISTICS,**

	Systems		Membership, Last Month of Fiscal Year	
			All Members	
	Number	Percent	Number	Percent
<b>All Systems</b> .....	3,075	100.0%	10,951,194	100.0%
<b>Level of Government</b>				
State-Administered Systems .....	197	6.4	9,407,520	85.9
Locally Administered Systems .....	2,878	93.6	1,543,674	14.1
<b>Membership Size</b>				
10,000 Members or More .....	120	3.9	9,973,985	91.1
5,000 to 9,999 Members .....	52	1.7	372,269	3.4
1,000 to 4,999 Members .....	164	5.3	360,629	3.3
500 to 999 Members .....	141	4.6	100,671	0.9
200 to 499 Members .....	195	6.3	61,208	0.6
100 to 199 Members .....	222	7.2	31,424	0.3
Less Than 100 Members .....	2,181	70.9	51,008	0.5
<b>Coverage Class</b>				
Total .....	3,075	100.0	10,951,194	100.0
General Coverage, State Adminis- tered .....	62	2.0	5,760,500	52.6
General Coverage, Locally Adminis- tered .....	538	17.5	1,025,750	9.4
Limited Coverage, State-Administered	135	4.4	3,647,020	33.3
School Employees .....	22	0.7	1,647,346	15.0
Teachers Only .....	22	0.7	1,826,096	16.7
Police Only .....	21	0.7	39,810	0.4
Firemen Only .....	8	0.3	30,002	0.3
Police and Firemen Combined .....	6	0.2	64,197	0.6
Other .....	56	1.8	39,569	0.4
Limited Coverage, Locally Administered .....	2,340	76.1	517,924	4.7
School Employees .....	14	0.5	38,224	0.3
Teachers Only .....	10	0.3	134,861	1.2
Police Only .....	963	31.3	86,197	0.8
Firemen Only .....	966	31.4	62,500	0.6
Police and Firemen Combined .....	232	7.5	65,369	0.6
Other .....	155	5.0	130,773	1.2

Note: Because of rounding, detail may not add to totals.

SOURCE: U.S. Department of Commerce, Bureau of the Census, 1977 Cen-

**OF EMPLOYEE-RETIREMENT SYSTEMS  
1976-77**

Recurrent Benefits for Last Month of Fiscal Year			Total Cash and Security Holdings at End of Fiscal Year	
Number of Beneficiaries	Amount (\$1,000)	Average Per Beneficiary (dollars)	Amount (\$1,000)	Average Per Member (dollars)
2,270,932	\$677,706	\$298	\$123,481,486	\$11,276
1,660,851	478,795	288	94,912,525	10,089
610,081	198,911	326	28,568,961	18,507
1,866,135	579,683	311	110,014,122	11,030
82,910	27,389	330	5,282,275	14,189
192,093	31,707	165	4,434,133	12,296
29,503	10,293	349	1,268,644	12,602
26,089	8,373	321	849,689	13,882
12,851	4,558	355	488,706	15,552
61,351	15,703	256	1,143,918	22,426
2,270,932	677,706	298	123,481,486	11,276
986,037	228,211	231	50,179,241	8,711
379,848	95,173	251	16,235,670	15,828
674,814	250,584	371	44,733,285	12,266
280,108	82,938	296	14,404,428	8,744
354,609	152,430	430	27,287,677	14,943
6,409	2,375	371	631,129	15,854
3,093	504	163	75,874	2,529
21,765	7,946	365	1,722,589	26,833
8,830	4,392	497	611,587	15,456
230,233	103,738	451	12,333,291	23,813
9,146	2,421	265	428,595	11,213
45,185	27,956	619	3,721,199	27,593
57,952	24,106	416	2,616,070	30,350
34,077	15,866	466	1,383,384	22,134
34,861	18,887	542	2,079,345	31,809
49,012	14,503	296	2,104,699	16,094



Table 3

## NUMBER, MEMBERSHIP, AND BENEFIT OPERATIONS OF EMPLOYEE-RETIREMENT SYSTEMS, LAST MONTH OF FISCAL YEAR, 1976-77 AND 1966-67

(dollar amounts in thousands)

Item	1976-77			1966-67		
	All Systems	State-Administered Systems	Locally Administered Systems	All Systems	State-Administered Systems	Locally Administered Systems
<b>Number of Systems</b> .....	3,075	197	2,878	2,165	183	1,982
<b>Membership</b> .....	10,951,194	9,407,520	1,543,674	7,068,213	5,785,656	1,282,557
Active Members .....	9,738,345	8,264,482	1,473,863	6,465,487	5,246,885	1,218,602
Other .....	1,212,849	1,143,038	69,811	602,726	538,771	63,955
<b>Beneficiaries Receiving Periodic Benefits</b> .....	2,270,932	1,660,851	610,081	1,029,849	677,353	352,496
Persons Retired on Account of Age or Length of Service .....	1,836,904	1,456,789	380,115	844,471	587,781	256,690
Persons Retired on Account of Disability .....	152,472	96,874	55,598	77,179	40,294	36,885
Survivors of Deceased Former Members .....	281,556	107,188	174,368	108,199	49,287	58,921
<b>Recurrent Benefit Payments for the Month</b> .....	677,706	478,795	198,911	166,672	101,454	65,218
To Persons Retired on Account of Age or Length of Service .....	592,015	436,402	155,613	138,109	89,462	48,647
To Persons Retired on Account of Disability .....	51,140	24,047	27,093	15,495	6,193	9,302
To Survivors of Deceased Former Members .....	34,552	18,347	16,205	13,068	5,799	7,269
<b>Lump-sum Survivors' Benefits:</b>						
Amount .....	21,170	13,418	7,752	9,796	5,853	3,944
Beneficiaries (Number of Payees) ..	7,473	6,603	870	3,233	2,248	985

Note: Because of rounding, detail may not add to totals.

SOURCE: U.S. Department of Commerce, Bureau of the Census, 1977 Census of Governments, Vol. 6, No. 1: Employee-Retirement Systems of State and Local Governments. Washington, DC, U.S. Government Printing Office, 1978, p. 12.

and local pension plans by membership, among the large, middle, and small systems. Local systems tend to be more generous than state systems (\$326/month and \$288/month, respectively), but small local systems have the lowest benefits (\$256/month). Small plans, however, have over \$22,000 in assets per member, while large plans have only half as much per member (\$11,000); middle sized plans are in the \$12-16,000 range.

Table 2 also shows retirement systems broken down by coverage class, revealing the fact that local police and fire plans make up two-thirds of the number of all state and local plans. Local police, fire, and teachers' plans tend to be the most generous and have the most assets per member. General coverage state systems are less generous than general coverage local systems, and have roughly half the assets per member.

All of the above suggests a sometimes overlooked but quite important aspect of the state and local pension universe—its diversity. There are great differences in terms of membership, benefits, and assets between (a) large and small plans, (b) state and locally administered plans, and (c) uniformed employee and general employee plans.

Tables 3 and 4 reveal five and ten-year trends on membership and finances of state and local retirement systems. There has been about a 45% increase in the number of local systems in the last ten years, while there has only been an 8% growth in the number of state systems. Meanwhile, total state system membership has grown by 63%, whereas local membership has grown by only 20%. This indicates that the rapid growth in the number of local plans mentioned above consisted, primarily, of new, small plans while most new state and local employees became members of large state-administered systems.

The maturation of state and local retirement systems is revealed in the fact that, whereas total membership increased by less than 50% from 1967 to 1977, the number of retirees increased by over 100% and monthly benefit payments increased by over 300%.<sup>2</sup> Pension receipts and payments have grown roughly at the same rate between 1967 and 1977—receipts rose from \$6.6 to \$25 billion, payments from \$2.7 billion to \$9.8 billion, but the amount of

income in receipts was much larger than the amount of increase in benefits.

A notable development has been the increasing burden on state and local governments for the funding of pensions. While state and local expenditures for current operations rose by 232% between 1967 and 1977,<sup>3</sup> state and local contributions for retirement plans increased by 305%. In 1967 governments' contributions totaled \$3 billion. By 1977 they had grown to \$12.4 billion.

Earnings from investments have grown more rapidly than government contributions. Employee contributions, which made up about 30% of pension receipts in 1967, grew more slowly so that by 1977 they comprised only 20.6% of receipts. This decreasing share of employee contributions has occurred mainly in the last five-year period.

Fund investments shifted considerably over this same period of time—from 75.7% of the portfolios invested in nongovernmental securities in 1967 to 85.8% in 1977. Local systems tend to invest more heavily in state and local government securities (10.6%) than do state systems which invest more in mortgages and other nongovernmental securities.

## REGIONAL AND ADMINISTRATIVE PATTERNS

Table 5 provides state-by-state data on the number of systems and membership totals by plan size. Some states have numerous small pension plans such as: Pennsylvania (480), Illinois (383), Oklahoma (286), Minnesota (219), Colorado (208), Florida (170), and Michigan (151). For each state, however, well over 50% of all system members are in plans above the 10,000 size.

Of particular note are the number of states with a small number of public employee retirement systems: Hawaii (1), Nevada (2), Maine (3), Alaska (4), Delaware (4), New Mexico (4), New Hampshire (5), Utah (5), Vermont (5), Wyoming (6), Oregon (6), Ohio (6), Idaho (6), Arizona (6), South Dakota (8), South Carolina (10), North Dakota (13), Rhode Island (14), Tennessee (15), Virginia (15), Maryland (16), and Mississippi (19). Fifteen states have less than ten state and local retirement systems according to these Census figures.

Table 4  
**FINANCES OF EMPLOYEE-RETIREMENT SYSTEMS, 1976-77 PRIOR FISCAL YEARS**

Item	1976-77				Percent Change, All Systems		
	All Systems	State-Ad-ministered Systems	Locally Ad-ministered Systems	All Systems		1971-72 to 1971-72	
				1971-72	1966-67		
Receipts .....	25,347	19,287	6,059	12,620	6,580	100.0	91.8
Employee Contributions .....	5,233	4,223	1,011	3,400	1,960	53.9	73.5
Government Contributions .....	12,369	8,898	3,472	5,750	3,055	115.1	88.2
From State Governments .....	4,960	4,847	113	2,530	1,353	96.0	87.0
From Local Governments .....	7,410	4,051	3,359	3,220	1,702	130.1	89.2
Earnings on Investments .....	7,744	6,167	1,577	3,471	1,565	123.1	121.8
Percent of Receipts .....	100.0	100.0	100.0	100.0	100.0	X	X
Employee Contributions .....	20.6	21.9	16.7	26.9	29.7	X	X
Government Contributions .....	48.8	46.1	57.3	45.6	46.4	X	X
From State Governments .....	19.6	25.1	1.9	20.0	20.5	X	X
From Local Governments .....	29.2	21.0	55.4	25.5	25.8	X	X
Earnings on Investments .....	30.6	32.0	26.0	27.5	23.7	X	X
Payments .....	9,767	7,060	2,707	4,920	2,684	98.5	83.3
Benefits .....	8,455	6,048	2,407	4,121	2,103	105.2	96.0
Withdrawals .....	1,104	882	222	647	506	70.6	27.9
Other .....	208	130	78	152	75	36.8	102.7
Excess of Receipts Over Payments During Fiscal Year:							
Amount .....	15,580	12,227	3,353	7,700	3,896	X	X
Percent of All Cash and Security Holdings at End of Fiscal Year .....	12.6	12.9	11.7	11.2	10.0	X	X
Amount of Cash and Security Holdings at End of Fiscal Year .....	123,481	94,913	28,569	68,760	39,265	79.6	75.1
Cash and Deposits .....	1,701	818	883	791	432	115.0	83.1

<b>Securities</b> .....	121,780	94,094	27,686	67,960	38,832	79.2	75.0
Federal Government <sup>1</sup> .....	12,188	9,500	2,689				
United States Treasury .....	6,568	4,729	1,839	3,721	6,650	X	-44.0
Federal Agency .....	5,620	4,770	850				
State and Local Governments .....	3,628	596	3,032	2,422	2,442	49.8	-0.8
Nongovernmental Securities .....	105,964	83,998	21,966	61,827	29,740	71.4	107.9
Corporate Bonds .....	56,847	45,364	11,482	37,915	20,276	49.9	87.0
Corporate Stocks .....	27,976	21,733	6,243	12,616	2,391	121.8	427.6
Mortgages .....	10,889	10,228	661	7,001	4,847	55.5	44.4
Other Securities <sup>3</sup> .....	9,471	6,361	3,110				
Other Investments <sup>3</sup> .....	780	312	468	4,295	2,227	X	92.9
<b>Percent of Cash and Security</b>							
<b>Holdings at End of Fiscal Year</b>							
<b>Cash and Deposits</b> .....	100.0	100.0	100.0	100.0	100.0	X	X
<b>Federal Securities<sup>1</sup></b> .....	1.4	0.9	3.1	1.1	1.1	X	X
United States Treasury .....	9.9	10.0	9.4				
Federal Agency .....	5.3	5.0	6.4	5.4	16.9	X	X
State and Local Government	4.6	5.0	3.0				
<b>Securities</b> .....	2.9	0.6	10.6	3.5	6.2	X	X
<b>Nongovernmental Securities</b> .....	85.8	88.5	76.9	89.9	75.7	X	X

Note: Because of rounding, detail may not add to totals.

NA = Not Available. r = Revised. X = Not Applicable.

<sup>1</sup> United States Treasury securities and federal agency securities first presented separately in fiscal year 1973-74.

<sup>2</sup> Reflects short-term investments by New York State and New York City retirement systems.

<sup>3</sup> Other securities and other investments first presented separately in fiscal year 1973-74.

SOURCE: U.S. Department of Commerce, Bureau of the Census, 1977 *Census of Governments*, Vol. 6, No. 1: *Employee Retirement Systems of State and Local Governments*, Washington, DC, U.S. Government Printing Office, 1978, p. 12.

Table 5

**NUMBER AND MEMBERSHIP OF EMPLOYEE-RETIREMENT SYSTEMS  
BY TYPE OF ADMINISTERING**

Item	Total	Number of Systems with—						
		10,000 Members or More	5,000 to 9,999 Members	1,000 to 4,999 Members	500 to 999 Members	200 to 499 Members	100 to 199 Members	Less than 100 Members
<b>United States</b> .....	3,075	120	52	164	141	195	222	2,181
State-Administered Systems .....	197	95	15	19	14	19	15	20
Locally Administered Systems .....	2,878	25	37	145	127	176	207	2,161
Counties .....	165	5	11	46	32	26	9	36
Municipalities .....	2,420	18	19	84	75	120	181	1,923
Townships .....	194	—	—	3	19	29	15	128
School Districts .....	83	1	3	6	1	1	1	70
Special Districts .....	16	1	4	6	—	—	1	4
<b>Alabama</b> .....	23	2	—	5	3	4	3	6
<b>Alaska</b> .....	4	1	1	—	—	2	—	—
<b>Arizona</b> .....	6	1	2	2	—	—	—	1
<b>Arkansas</b> .....	42	2	1	—	—	4	5	30
<b>California</b> .....	55	11	6	19	4	3	3	9
<b>Colorado</b> .....	208	2	1	2	3	5	6	189
<b>Connecticut</b> .....	79	2	1	4	10	11	14	37
<b>Delaware</b> .....	4	1	—	1	—	2	—	—
<b>District of Columbia</b> .....	1	—	1	—	—	—	—	—
<b>Florida</b> .....	170	1	—	9	10	19	15	116
<b>Georgia</b> .....	41	4	1	9	3	6	6	12
<b>Hawaii</b> .....	1	1	—	—	—	—	—	—
<b>Idaho</b> .....	6	1	—	—	1	—	—	4
<b>Illinois</b> .....	383	9	2	2	2	5	17	346
<b>Indiana</b> .....	83	2	—	1	1	9	6	64
<b>Iowa</b> .....	87	1	—	1	1	2	11	71
<b>Kansas</b> .....	36	1	—	3	2	1	3	26
<b>Kentucky</b> .....	42	3	—	—	4	4	7	24
<b>Louisiana</b> .....	49	4	3	7	5	5	4	21
<b>Maine</b> .....	3	1	—	—	—	—	—	2
<b>Maryland</b> .....	16	3	2	2	3	1	—	5
<b>Massachusetts</b> .....	97	2	4	27	27	30	6	1
<b>Michigan</b> .....	151	5	2	12	12	27	34	59
<b>Minnesota</b> .....	219	3	1	5	5	3	2	200
<b>Mississippi</b> .....	19	1	—	—	2	—	9	7
<b>Missouri</b> .....	46	5	3	4	4	2	8	20
<b>Montana</b> .....	27	2	—	—	1	2	1	21
<b>Nebraska</b> .....	21	1	1	4	—	3	—	12
<b>Nevada</b> .....	2	1	—	—	—	—	—	1
<b>New Hampshire</b> .....	5	2	—	2	—	—	1	—
<b>New Jersey</b> .....	20	3	—	2	2	2	1	10
<b>New Mexico</b> .....	4	2	—	—	—	1	—	1
<b>New York</b> .....	40	6	1	—	—	—	—	33
<b>North Carolina</b> .....	20	2	2	1	1	1	4	9
<b>North Dakota</b> .....	13	2	—	—	—	1	4	6

**OF STATE AND LOCAL GOVERNMENTS, BY MEMBERSHIP SIZE OF SYSTEM,  
GOVERNMENT, BY STATE, 1976-77**

**Membership of Systems with—**

<b>Total</b>	<b>10,000 Members or More</b>	<b>5,000 to 9,999 Members</b>	<b>1,000 to 4,999 Members</b>	<b>500 to 999 Members</b>	<b>200 to 499 Members</b>	<b>100 to 199 Members</b>	<b>Less than 100 Members</b>
10,951,194	9,973,985	372,269	360,629	100,671	61,208	31,424	51,008
9,407,520	9,229,939	111,627	47,376	10,025	5,537	2,166	850
1,543,674	744,046	260,642	313,253	90,646	55,671	29,258	50,158
356,725	127,578	83,528	111,818	23,099	8,033	1,304	1,365
1,026,430	564,036	128,561	172,134	54,034	37,321	25,372	44,972
31,405	—	—	4,057	12,826	9,916	2,307	2,299
49,341	12,561	22,642	11,417	687	401	157	1,476
79,773	39,871	25,911	13,827	—	—	118	46
124,392	107,667	—	12,882	2,029	1,175	441	198
32,422	23,089	8,836	—	—	497	—	—
131,781	114,690	11,663	5,331	—	—	—	97
77,076	68,997	5,081	—	—	1,411	584	1,003
1,236,786	1,142,881	45,597	46,845	2,847	1,009	425	182
118,578	100,475	7,219	2,548	2,176	1,784	986	3,390
121,951	92,895	5,209	9,050	7,646	3,617	2,100	1,434
25,897	24,131	—	1,222	—	544	—	—
7,920	—	7,920	—	—	—	—	—
388,711	350,186	—	19,676	7,074	6,343	2,065	3,367
254,518	221,604	5,281	22,347	2,582	1,598	788	318
47,898	47,898	—	—	—	—	—	—
47,887	47,202	—	—	573	—	—	112
551,882	515,963	15,882	6,603	1,399	1,273	2,162	8,600
189,698	182,750	—	1,074	861	2,469	898	1,646
157,429	151,287	—	1,256	517	693	1,525	2,151
121,638	112,536	—	6,468	1,499	215	474	446
136,095	129,982	—	—	3,103	1,105	883	1,022
215,956	169,048	23,304	17,221	3,396	1,703	534	750
56,773	56,733	—	—	—	—	—	40
187,438	167,197	13,879	3,364	2,367	391	—	240
259,159	145,927	27,948	54,523	18,984	10,839	938	—
465,546	405,043	15,042	21,213	8,231	8,276	5,146	2,595
245,204	213,212	6,556	15,393	3,658	985	282	5,117
178,247	175,473	—	—	1,246	—	1,139	389
172,930	134,623	22,203	10,054	3,101	616	1,160	1,173
50,825	49,028	—	—	515	705	128	449
39,157	26,837	5,015	5,887	—	1,105	—	313
42,620	42,531	—	—	—	—	—	89
30,266	27,240	—	2,844	—	—	182	—
330,328	324,686	—	3,225	1,727	504	170	16
79,819	79,543	—	—	—	227	—	49
1,123,702	1,117,204	6,165	—	—	—	—	333
275,219	254,662	17,302	1,698	543	215	519	280
25,272	24,105	—	—	—	261	578	328

Table 5

**NUMBER AND MEMBERSHIP OF EMPLOYEE-RETIREMENT SYSTEMS  
BY TYPE OF ADMINISTERING**

	Total	10,000 Members or More	5,000 to 9,999 Members	1,000 to 4,999 Members	500 to 999 Members	200 to 499 Members	100 to 199 Members	Less than 100 Members
Ohio .....	6	4	1	1	—	—	—	—
Oklahoma .....	286	2	—	3	6	2	3	270
Oregon .....	6	1	—	3	—	1	—	1
Pennsylvania .....	480	3	2	11	15	20	29	400
Rhode Island .....	14	1	—	2	—	2	3	6
South Carolina .....	10	1	1	—	—	3	3	2
South Dakota .....	8	1	—	—	1	1	1	4
Tennessee .....	15	1	3	3	2	4	1	1
Texas .....	52	3	3	6	2	4	5	29
Utah .....	5	2	—	1	1	—	—	1
Vermont .....	5	—	1	2	1	—	—	1
Virginia .....	15	1	3	5	4	—	1	1
Washington .....	34	3	2	3	2	—	—	24
West Virginia .....	44	2	—	—	1	1	4	36
Wisconsin .....	66	4	1	—	—	—	2	59
Wyoming .....	6	1	—	—	—	2	—	3

— Represents zero or rounds to zero.

28

The breakdown of retirement system membership data, by type of administering government, is also provided in Table 5. Only 25 of the 120 large (over 10,000 members) state and local systems are administered at the local level of government (18 city plans, five county plans, and one each for school and special districts). Close to half of the 1.5 million members of local systems belong to these 25 large plans. Nevertheless, there are over 2,161 local plans with less than 100 members, and 1,923 of these are administered by municipalities.

### SUMMARY

The state-local pension universe is highly centralized in terms of membership, 90% of which is concentrated in 120 large systems, each with more than 10,000 members and most administered at the state level. In terms of number of plans, there are only a few plans in

some states, while other states permit a proliferation of small, local plans. The vast majority of local plans are city police and fire pension plans which have relatively generous benefits and relatively large assets per member.

The fiscal importance of state and local retirement systems has grown rapidly. By 1977, benefits were \$8.5 billion, government contributions were \$12.4 billion (\$5 billion from states, \$7.4 billion from localities), employee contributions were \$5.2 billion, and earnings on investments amounted to \$7.7 billion. System assets totaled \$123.5 billion.

State and local retirement systems have matured over time and, accordingly, retirement costs are growing rapidly. As funding and benefit problems emerge, there is a tendency for policymakers to look for simple, uniform solutions. The major policy influence to be drawn from this chapter, however, is that there

(continued)

## OF STATE AND LOCAL GOVERNMENTS, BY MEMBERSHIP SIZE OF SYSTEM, GOVERNMENT, BY STATE, 1976-77

Total	10,000 Members or More	5,000 to 9,999 Members	1,000 to 4,999 Members	500 to 999 Members	200 to 499 Members	100 to 199 Members	Less than 100 Members
678,738	668,591	8,853	1,294	—	—	—	—
128,095	112,735	—	5,649	4,350	542	416	4,403
112,221	106,056	—	5,843	—	223	—	99
491,742	433,548	13,865	17,217	10,512	5,934	4,135	6,531
40,997	30,707	—	9,108	—	403	479	300
240,111	229,745	9,000	—	—	927	423	16
29,956	28,936	—	—	568	240	118	94
201,977	168,551	21,772	8,856	1,354	1,277	151	16
565,442	521,785	22,348	16,878	1,308	1,352	593	1,178
70,353	66,840	—	2,578	873	—	—	62
13,886	—	7,713	5,622	518	—	—	33
232,009	198,000	18,613	12,315	2,825	—	195	61
206,620	184,482	15,604	4,545	1,783	—	—	206
101,735	99,190	—	—	506	217	532	1,290
257,436	249,294	7,399	—	—	—	274	469
28,856	28,200	—	—	—	533	—	123

SOURCE: U.S. Department of Commerce, Bureau of the Census, 1977 *Census of Governments*, Vol. 6, No. 1: *Employee Retirement Systems of State and Local Governments*, Washington, DC, U.S. Government Printing Office, 1978, p. 13.

29

is great diversity among the various types of public plans in terms of membership, benefits and finances. There is also much diversity among the various states in the composition of their respective public employee retirement system universes. This diversity makes it ex-

tremely difficult to make broad conclusions based on aggregate data covering the entire state-local sector. By the same token, this diversity makes it extremely difficult to design one set of rules to govern the entire state-local pension universe.

### FOOTNOTES

<sup>1</sup> U.S. Department of Commerce, Bureau of the Census, 1977 *Census of Governments*, Vol. 6, No. 1, *Employee-Retirement Systems of State and Local Governments*, Washington, DC, U.S. Government Printing Office, 1978, p. 11

The exact count of pension plans differs between Census estimates and the figures provided by the *Pension Task Force Report* (U.S. House of Representatives, Committee on Education and Labor, *Pension Task Force Report on Public Employee Retirement Systems*, 95th Cong., 2nd Sess., Washington, DC, U.S. Government Printing Office, March 15, 1978, p. 51). The decision to use the Census numbers in this chapter was due to the availability of Census figures dating back to 1967.

Nevertheless, the conclusions reached in this chapter are in all important respects consistent with the Task Force data.

<sup>2</sup> A pension plan is said to mature because it begins with no retirees, and in its first-year, assets (and liabilities) accumulate though benefit payouts are small or nonexistent. Only after a period of time, perhaps 20 or 30 years, does a typical system begin to have significant numbers of participants retire with vested (or earned) benefits, and typically it takes even longer for benefit payments to rise to the level of receipts, a sign of the maturity of a system.

<sup>3</sup> U.S. Department of Commerce, Bureau of the Census, 1977 *Census of Governments*, Vol. 6, No. 4: *Historical Statistics on Government Finance and Employment*, Washington, DC, U.S. Government Printing Office, 1979, Table 4, pp. 44-45.





## Problems and Practices

**E**fforts to evaluate state and local retirement plans have faced a major problem: there is considerable difference of opinion concerning the proper standards—funding, disclosure and benefit—that should apply to the numerous and diverse state and local systems. Thus, it is difficult to obtain agreement on the nature of the problems and the appropriateness of the suggested reforms.

In the past, evaluation efforts were plagued by the additional problem of insufficient data on the nation's public employee retirement systems. This problem has been alleviated somewhat with the 1978 publication of the *House Pension Task Force Report*,<sup>1</sup> which provides data on 6,000 state and local pension plans and included the results from a survey of 712 state and local retirement systems.<sup>2</sup>

The House Pension Task Force (HPTF) has been criticized for making conclusions on the basis of the total number of plans or the percent of total plans which fail to meet specified standards.<sup>3</sup> This can be quite misleading since 97% of all state and local employees covered are found in 7% of the systems, the relatively few large public pensions plans. In order to avoid such interpretive problems, this chapter emphasizes the problems and practices of the large public plans, and the differences between the large and the small pension plans.

The main focus of this chapter, however, is the lack of agreement as to the desirable stand-

ards for public sector pension plans. ERISA standards for private plans were designed with a very specific purpose in mind: to protect pensioners from employer neglect, abuse, and potential bankruptcy which could lead to the loss of the employee's pension. Public plans are fundamentally different from private plans in their conception, historical development, function, and because state and local governments have established a record as permanent, economically secure institutions with strong moral, contractual, and, in some cases, constitutional commitments backing their pension liabilities. For this reason, public pension plans face different problems which demand more complex and subtle solutions.

This chapter discusses three aspects of state and local retirement policy: funding, disclosure, and benefits. Problems and practices in these areas are analyzed in the context of the current debate over appropriate standards for public plans.

## FUNDING

The divergence of opinion over which standards should apply to state and local pensions is especially evident in the uncertainty surrounding funding objectives. Should state-local pension plans be 50% funded, 80% funded, or "fully funded"? Should funding levels be comparable to private plans, or to federal plans? Should public plans be judged on ERISA funding standards? What actuarial funding method should be used? Should funding levels and methods of state and local retirement systems be judged differently depending on the characteristics of the system, the growth dynamism of the jurisdiction, or the local fiscal situation?

The difficulty of working without clear standards is evident in the HPTF findings. The HPTF report found that a key measure of the funding status of pension plans, the assets-to-accrued liability ratio, ranged from 21% to over 90% for the 25 largest state and local plans, with the average plan in the 50%-60% range. The HPTF estimated that the average asset-to-accrued liability ratio for all state-local plans was in the 45% to 50% range. Although it is clear that these plans are not "fully" funded, the question remains whether these plans are

"adequately" funded, because there is no consensus on what constitutes an "adequate" asset-to-accrued liability ratio for public plans.<sup>4</sup>

Purists argue that public plans, like private sector pension plans, should be fully funded. ERISA requires this of private plans to protect participants in the event of firm bankruptcy, which would result in termination of the pension plans and loss of benefits to the extent that the plan is not fully funded. Public pension realists argue that full funding is not necessary for public pension systems because it is highly unlikely that governments will dissolve or go bankrupt. Robert Tilove, in his 1976 Twentieth Century Fund report, *Public Employee Pension Plans*, emphasizes this point.

... if termination is not a real danger, if a state or other unit of government can reasonably assume perpetual life and ability to pay, then achievement of a fully funded position is a questionable standard.<sup>5</sup>

Tilove argues, instead, for "a number of standards" to be used in the choice of a funding method for public plans:

1. All elements of long-term cost should be taken into account.
2. Contributions should approximate a level percentage of the payroll.
3. Additional funding should be provided only to the extent that security is needed against the possibility of future incapacity of the government to pay.
4. The funding method should provide fair and realistic cost estimates for benefit proposals.
5. The funding method should be one that can be fairly maintained in the face of political pressure and debate.<sup>6</sup>

In contrast, the "full funding" approach specified by ERISA for private plans requires all unfunded accrued pension liabilities to be funded (amortized) on a strict schedule over a 30 to 40-year period. This termination approach, while perhaps justified for private plans, would result in rapidly rising contributions as a percent of payroll and may not be a

realistic approach for the state or local government which would have to justify a rapid increase in tax rates to achieve the purist goal of full funding.<sup>7</sup>

This practical difficulty with the ERISA funding standard was underscored by a recent GAO report which analyzed 72 state and local retirement systems and found that 53 in this group failed to satisfy the ERISA funding requirements. The problem with applying the ERISA standard for public plans is especially apparent in the following observation of the GAO report:

The costs under ERISA, in addition to existing pension costs, would require the equivalent of from 0.3% to 49% more of the tax revenues of the affected jurisdictions. For example, to meet the ERISA funding standard, the Enid, OK, pension plans would require an amount equal to 65% of the city's tax revenues, compared with the 13% now going for retirement systems. According to a Pittsburgh official, funding of the city's pension plans up to the ERISA standard could lead to bankruptcy. In Reading, PA, pension funding under ERISA would take an amount equal to about 40% of taxes, compared with 15% currently. A Reading city official believed that the citizens would resist any tax increase for pension funding. Clearly, added pension costs to meet an ERISA-type amortization standard would be a devastating drain on the incomes of some jurisdictions.<sup>8</sup>

The most controversial aspect of the ERISA standards with respect to public plans is the requirement that all past service pension liabilities (i.e., those accumulated in the past) must be funded within a 30 to 40-year period. While most pension experts argue that public retirement systems' unfunded liabilities should be strictly controlled, there is considerable disagreement over the desirability and form for funding past liabilities. Should such debt be frozen and simply carried over indefinitely? If so, should there be some form of interest payment for investment earnings foregone by the pension fund due to the existence of unfunded

liability? Or should this unfunded liability be partly or fully amortized over some period in the future? Alternatively, should funding for past service unfunded liability be provided only to the extent that it is necessary to protect against government bankruptcy, a highly remote possibility for most state and local governments?

There is also the question of other political priorities which may take precedence over funding objectives. For example, should a government be forced to pay off past service unfunded liabilities on a strict amortization schedule during a severe economic recession, when strict adherence to pension funding requirements could result in substantial reductions in vital government services.

The differences between the purist "full funding" approach and the more practical approach suggested by Tilove should not be over-emphasized. Almost all public pension experts believe that some form of advance funding is desirable.<sup>9</sup> Specifically, there is general agreement that normal costs (the present value of currently accruing liabilities of a pension plan) should be currently funded. This approach has two principal advantages: (1) it forces a government to save currently to meet peak future liabilities and thereby helps to prevent uncontrollable and undesirable growth of pension debt, and (2) it encourages accountability by directing the attention of taxpayers to the costs of current employee compensation policy.

In order to assure that normal costs are adequately taken into account, actuarial funding methods are recommended for public as well as private plans. The HPTF survey found that large public systems are most likely to be actuarially funded (over 70%), and most provide for full funding of normal cost plus some form of amortization of past service unfunded liabilities. Medium size systems are also mostly actuarially funded (60%), and about half of all small systems in the HPTF sample were actuarially funded (49%).

Despite the fairly extensive breakdown of funding methods shown in Table 6, it fails to depict the full significance of funding methods because the outcome under each method depends largely on actuarial assumptions for benefit changes, investment returns, rates of inflation, and other factors. These components

Table 6

**METHODS OF FUNDING STATE AND LOCAL GOVERNMENT**  
(percent of defined benefit plans)

System Category	Pay-as you-go	Terminal Funding	Em- ployer Match- ing or Other Nonactuarial	No Un- funded Past Service Liability	Amor- tized Over 30 Years or Less	Actuarial Past Service Liability	
						Amor- tized Over 31-40 Years	Amor- tized Over More Than 40 Years
<b>By Size of System:</b>							
A. Large	15.7	1.2	10.0	5.2	25.2	19.8	3.1
B. Medium	28.1	.6	10.2	6.3	19.8	13.0	1.5
C. Small	15.2	—	28.9	11.3	12.8	11.3	—
<b>Level of Administration:</b>							
A. State Administration:							
State Government	12.7	—	.8	6.3	41.1	17.4	4.0
Police and Fire	12.5	2.5	17.5	2.5	10.0	25.0	—
Teachers	9.7	3.2	3.2	—	29.0	25.8	3.2
Local Government	16.6	4.2	8.3	4.2	50.0	12.5	—
Teachers (higher education)	73.4	—	1.9	1.9	—	1.9	—
Subtotal	23.1	1.2	4.5	4.1	28.5	16.5	2.2
B. Local Administration							
Local Government	17.6	—	5.6	10.8	23.8	14.1	.9
Police and Fire	16.6	.1	31.3	10.4	10.9	11.3	.2
Teachers	12.5	—	6.3	—	43.8	12.5	—
Other	—	—	14.7	4.7	51.3	14.7	—
Subtotal	16.6	.1	26.0	10.4	14.0	11.8	.3
<b>State and Local Totals by System Coverage Type:</b>							
A. State and Local Government	16.3	.1	5.5	9.8	27.7	14.6	1.1
B. Police and Fire	16.6	.2	31.2	10.3	10.8	11.4	.2
C. Teachers (including higher education)	42.1	1.1	3.3	1.1	17.0	11.4	1.1
<b>Total</b>	<b>17.0</b>	<b>.2</b>	<b>24.7</b>	<b>10.1</b>	<b>14.7</b>	<b>12.1</b>	<b>.5</b>

SOURCE: U.S. House of Representatives, Committee on Education and Labor, *Pension Task Force Report on Public Employee Retirement, Systems*, 95th Cong., 2nd Sess.,

Washington, DC, Government Printing Office, March 15, 1978, derived from Table 52, pp. 292-93.

## DEFINED BENEFIT RETIREMENT SYSTEMS

following each funding method)

**Basis:**  
**Calculated**  
**Cost Paid**

Interest Only Paid	Less Than Full Interest	Actuarial Basis: Past Service Liability Not Calculated				Unknown	Total
		Less Than Full Normal Cost Paid	Normal Cost Paid Under Aggregate of Other Method	Less Than Full Normal Cost Paid			
2.6	4.0	4.0	6.6	.5	2.0	100	
2.1	.6	6.1	8.2	1.5	2.1	100	
—	.8	4.8	7.1	.8	7.1	100	
.8	2.4	6.3	3.1	4.0	.8	100	
2.5	—	12.5	12.5	—	2.5	100	
—	9.7	9.7	3.2	—	3.2	100	
—	—	4.1	—	—	—	100	
—	—	1.9	—	—	19.0	100	
.8	2.6	6.7	3.7	1.8	4.5	100	
.7	.8	1.0	17.0	.5	7.2	100	
.4	.9	5.8	5.2	.8	5.9	100	
—	6.3	6.3	12.5	—	—	100	
2.4	—	—	—	—	12.1	100	
.4	.9	4.8	7.5	.8	6.2	100	
.7	.9	1.6	14.2	1.0	6.4	100	
.4	.9	5.9	5.3	.8	5.8	100	
—	4.1	5.2	3.3	—	10.3	100	
.5	.9	4.9	7.3	.9	6.1	100	

vary from one system to another, thereby precluding categorical acceptance or rejection of the soundness of pension plans adhering to any given funding method.

The most controversial issue with respect to public pension funding is the question of what should be done about substantially underfunded retirement systems. If the jurisdiction involved is growing and in good fiscal health with relatively low taxes, amortization of part or all of the unfunded, accrued liabilities is a reasonable policy to pursue. But what about the high tax community experiencing economic decline? What can such community be expected to do about large unfunded pension liabilities?

There is growing concern that many state and local retirement systems face potentially serious funding problems in this regard. An example may be found in Massachusetts which has confronted funding problems in the 1970s. Massachusetts had run essentially a pay-as-you-go state-local retirement system for many years. The maturation of the system, in combination with liberalized benefits, static or declining population, and high state and local taxes produced concern for the plan's viability and the financial capability of the governments involved. Future expectations of rising taxes and financial uncertainty related to pension funds were viewed with alarm by state officials because they might cause taxpayers to leave the jurisdiction, public employees to demand higher wages, and investors to demand higher interest rates.

A more aggressive funding program is one obvious way to attempt to cure this kind of problem. While Massachusetts has not explicitly adopted any strict funding method, it has taken action in recent years to improve its funding position by: (1) making substantial, discretionary increases in contributions to the fund, (2) reducing certain pension liabilities by limiting costly, automatic cost-of-living benefits, (3) working to halt adverse demographic and economic trends, and (4) providing and encouraging the flow of information and study of its pension situation.

Whether Massachusetts has turned the tide in pension funding is still somewhat in doubt. There are signs—such as improved credit ratings and demographic trends—indicating that

its strategy will prove successful. Critics point out, however, that as long as no statutory funding requirement is legislated, there is a danger that the situation could once again deteriorate.<sup>10</sup>

For the nation as a whole, concern over the adequacy of pension funding may have diminished somewhat in the last year or two following a peak reached during the 1975 recession and the New York City financial emergency.<sup>11</sup> This may reflect the view that public retirement systems are doing better than was previously thought to be the case. Nevertheless, as long as there are economically troubled cities with substantial unfunded pension liabilities, serious problems can arise in the future. Now is the time to work on the development of standards for public pension funding, to refine funding models for the varying governmental situations in our nation, and to undertake analyses that will illuminate the long-term implications of various funding methods. Until such standards are formulated, it is very difficult to judge what changes in public pension funding are needed.<sup>12</sup>

## DISCLOSURE

The public pension disclosure process involves actuarial analyses, audits, financial reports, bond market disclosure, pension fiscal notes, and reporting to governments, employees and the public. Controversy about disclosure practices has arisen because there is disagreement over what information should be made known, in what form it should be given, and who should receive it. Because pension information can be expensive to produce, it is essential to make careful decisions concerning which types of disclosure are worthwhile.

Heretofore, most information about public pensions reflected the actual or perceived needs of those in a position to demand it. Recently, the growing importance of the pension in the total employee compensation package, the New York City financial emergency, and the passage of ERISA have stimulated more general interest in pension information.

Cost plays an important part in public pension disclosure practices; because there are economies of scale in pension information costs, the larger systems generally provide

more kinds of information, and more precise information than smaller systems.<sup>13</sup> Many small local systems, however, may not be able to afford to provide certain kinds of actuarial information.

*Actuarial analysis* represents the bedrock of public pension information because it is the source for financial data used in most annual reports and audits of pension plans and these analyses undergird fiscal notes on the cost of proposed plan changes. The frequency and quality of the actuarial analysis therefore has a good deal to do with the accuracy and value of all forms of financial disclosure for pension plans.

The HPTF estimates that 93% of all large retirement systems in the state and local sector have had at least one actuarial valuation in the last ten years. *Table 7*. The majority of these systems have annual valuations, and 75% have regular valuations at least once every three years.

The "large systems" category in the HPTF survey terminology, refers to systems with 1,000 or more members. This includes 379 systems with approximately 97% of all state and local employees covered by pensions. About two-thirds of these "large" systems are relatively small compared to the 124 systems with 10,000 or more members which contain 88% of all covered state and local employees.<sup>14</sup>

The HPTF does not specifically show in its tables this "very large" category, but one can speculate based on the pattern shown that almost all of these very large plans have had recent actuarial valuations, and, perhaps, as many as 95% of all covered state-local employees are in systems with fairly regular valuations. These figures suggest that actuarial analysis, the basic ingredient for pertinent information on public pension plans, is common practice.

As for the "small" plans, those with fewer than 100 members, the HPTF found that 44% had valuations annually and over 70% had valuations in the last ten years. Data on funding indicate that about half of the small plans are funded based on actuarial estimates of pension costs. All such actuarially funded plans might therefore have fairly regular valuations. For small plans which are not actuarially funded, about half of these had actuarial valuations.

Audits, in combination with annual reports, provide information to the investor in the state and local bond market. One of the ways in which one may judge whether a severe pension funding problem exists is to examine a government's bond rating for any noticeable increase in risk. Presumably, those who rate state and local bonds are beginning seriously to examine pension data in the context of the overall financial situation facing governments. Audits are also used by governments to monitor state and local pension plan activity and are essential to any effort to make retirement systems cost efficient and accountable to the political process.

HPTF data reveal that 99% of all large state and local systems are audited—96% for small systems. *Table 8*. Over 60% of large systems are audited annually, mostly by independent, outside auditors.

*Plan reports for employees* were another facet of public pension plans surveyed by the HPTF. The survey asked about four types of information—plan description, plan amendments, statement of employee contributions, and accrued benefits. Facts of this nature are most useful in informing employees of vesting provisions and contributions. They are important where an employee contemplates, or is subject to, withdrawal from the plan. More generally this information is important to employees for planning for their retirement. The HPTF survey reveals that for large plans 95% provide plan descriptions, 92%—plan amendments, 98%—statements of contribution, and 92%—accrued benefit information. The large majority of small systems furnish similar information. *Table 9*.

*Plan reports for public policymakers* do not provide the same information as reports to employees. While the HPTF survey dealt extensively with reporting to employees, it offers little information on reporting to government officials. Such reporting occurs in two principal ways; the first is regular financial or actuarial reports to state legislatures or agencies and local political bodies. Regular reports should provide public decisionmakers with a variety of information relating to the funding, benefits, and investments of the retirement



Table 7

## FREQUENCY OF DEFINED STATE AND LOCAL GOVERNMENT BENEFIT RETIREMENT SYSTEM ACTUARIAL VALUATIONS

Percent of Defined Benefit Plans<sup>1</sup>

System Category	None in Last Ten Years	Valua- tion Made But Not on a Regular Basis	Every Year	Every Two Years	Every Three Years	Every Four Years	Every Five Years or More	Total
<b>By Size of System:</b>								
A. Large	7.0	8.5	55.0	12.0	8.2	2.3	7.0	100
B. Medium	10.4	24.3	43.7	9.7	4.9	—	6.9	100
C. Small	28.2	14.5	43.6	4.3	3.4	3.4	2.6	100
<b>By Level of Adminis- tration:</b>								
A. State Administration:								
State Government	4.2	9.2	40.7	35.3	4.0	.8	5.8	100
Police and Fire	15.3	12.8	36.5	30.5	—	—	4.9	100
Teachers	3.2	3.2	74.2	9.7	3.2	—	6.5	100
Local Government	—	—	87.8	4.1	—	—	8.1	100
Teachers (higher education)	2.6	82.0	7.7	2.6	2.6	—	2.6	100
<b>Subtotal</b>	5.2	19.1	43.5	23.7	2.7	.4	5.5	100
B. Local Administration:								
Local Government	14.2	18.3	51.0	4.9	4.4	.8	6.4	100
Police and Fire	28.2	14.6	42.6	4.4	4.1	3.6	2.5	100
Teachers	—	—	49.2	6.1	—	6.1	38.6	100
Other	10.5	10.5	71.6	4.9	2.5	—	—	100
<b>Subtotal</b>	25.1	15.2	44.6	4.5	4.1	3.0	3.4	100
<b>State and Local Totals by System Coverage Type:</b>								
A. State and Local Government	12.4	16.3	51.5	8.7	4.2	.7	6.1	100
B. Police and Fire	28.1	14.6	42.5	4.7	4.0	3.5	2.6	100
C. Teachers (including higher education)	2.3	38.2	39.4	5.8	2.3	1.2	10.8	100
<b>Total</b>	23.9	15.5	44.5	5.7	4.0	2.8	3.6	100

<sup>1</sup> The percentage unknown (defined benefit plans only) is 1.1% of plans in the large strata, 2% of plans in the medium strata, and 7.1% of plans in the small strata.

SOURCE: U.S. House of Representatives, Committee on Education and Labor, *Pension Task Force Report on Public Employee-Retirement Systems*, 95th Cong., 2nd Sess., Washington, DC, U.S. Government Printing Office, March 15, 1978, derived from Table 53, p. 294.

Table 8

## AUDITING PRACTICES FOR STATE AND LOCAL GOVERNMENT RETIREMENT SYSTEMS

System Category	Percent of Plans								
	Audited Every Year				Audited But Not Annually				
	Not Audited (1)	By Government Agency (2)	By Independent Accountant (3)	Audited by (2) or Both <sup>1</sup> (4)	By Government Agency (5)	By Independent Accountant (6)	Audited by (2) or Both <sup>1</sup> (7)	Other Total <sup>2</sup> (8)	Total <sup>2</sup> (9)
<b>By Size of System:</b>									
A. Large	1.3	29.8	38.9	63.0	27.1	11.3	32.4	3.3	100
B. Medium	7.3	19.0	34.6	51.4	16.2	16.7	30.7	10.6	100
C. Small	4.4	29.4	50.7	70.6	13.2	9.6	18.4	6.6	100
<b>By Level of Administration:</b>									
A. State administration:									
State government	—	28.3	21.0	48.5	50.0	3.0	50.7	.8	100
Police and fire	—	59.4	2.5	59.4	29.9	18.1	40.6	—	100
Teachers	—	35.5	16.1	51.6	48.4	6.5	48.4	—	100
Local government	3.9	56.9	19.6	76.5	19.6	7.8	15.7	3.9	100
Teachers (higher education)	4.7	57.5	17.2	71.8	9.7	4.7	10.1	12.4	100
<b>Subtotal</b>	2.9	48.9	17.0	64.0	24.3	5.6	25.4	7.7	100
B. Local Administration:									
Local government	8.3	17.4	46.2	56.7	19.5	4.1	23.0	12.0	100
Police and fire	3.5	28.6	52.5	71.4	12.3	12.8	19.7	5.4	100
Teachers	—	—	65.3	65.3	11.6	23.2	34.7	—	100
Other	14.3	—	40.3	40.3	—	35.5	35.5	9.9	100
<b>Subtotal</b>	4.8	25.3	50.9	67.4	13.6	11.4	20.9	6.9	100
<b>State and Local Totals:</b>									
A. State and local government	7.8	18.0	42.5	54.9	21.2	6.5	26.8	10.5	100
B. Police and fire	3.5	28.9	52.0	71.3	12.5	12.9	20.0	5.2	100
C. Teachers (including higher education)	4.1	52.5	19.5	69.6	13.3	5.8	14.9	11.4	100
<b>Total</b>	4.6	27.8	47.4	67.0	14.7	10.8	21.4	7.0	100

<sup>1</sup> The columns labeled "by government agency" and "by independent accountant" may not add to the subtotal, since a plan may be audited by both a government agency and an independent accountant.

<sup>2</sup> Total column (9), equals columns (1) plus (4) plus (7) plus (8).

SOURCE: U.S. House of Representatives, Committee on Education and Labor, *Pension Task Force Report on Public Employee Retirement Systems*, 95th Cong., 2nd Sess., Washington, DC, U.S. Government Printing Office, March 15, 1978, derived from Table 11, p. 210.

Table 9

## STATE AND LOCAL RETIREMENT SYSTEM DISCLOSURE TO MEMBERS, BY SIZE OF SYSTEM

State and Local Plans, by Size of System	Percent of Plans				Total
	Never	Automat- ically	Upon Request Only	Unknown	
<b>Participants Furnished Statement of Employee Contributions (if contributions made)</b>					
Large	2.1	81.9	13.1	2.7	100
Medium	7.0	72.1	19.8	1.2	100
Small	9.1	40.5	39.7	10.8	100
<b>Participants Furnished Information on Accrued Benefits</b>					
Large	8.2	33.8	55.9	2.1	100
Medium	14.3	40.1	45.1	.5	100
Small	21.0	21.0	48.3	9.8	100
<b>Participants Furnished Plan Description</b>					
Large	4.5	71.5	22.4	1.6	100
Medium	15.4	65.4	18.7	.5	100
Small	23.8	40.6	27.3	8.4	100
<b>Participants Furnished Plan Amendments</b>					
Large	8.4	55.4	33.2	2.9	100
Medium	11.0	57.1	28.0	3.8	100
Small	21.0	42.7	26.6	9.8	100

SOURCE: U.S. House of Representatives, Committee on Education and Labor, *Pension Task Force Report on Public Employee-Retirement Systems*, 95th Cong., 2nd Sess., Washington, DC, Government Printing Office, March 15, 1978, derived from Table 12, pp. 211-12.

system so that officials are aware of the current status of retirement systems. Annual reports are often designed for the public as a general all-purpose disclosure device.

The second form of reports are fiscal notes—estimates, in most cases, actuarially based—of the cost of proposed pension legislation. Fiscal notes are important because pension costs are ultimately determined by benefit provisions, and benefit formulas are usually set by state legislatures, or other state or local government bodies. Accountability of retirement systems to the taxpayers requires close scrutiny

of all pension legislation and the fiscal note is an essential part of the process.

The importance of the fiscal note is underscored by the observation that in the past many legislatures had no accurate estimate of the expected cost of increased benefit provisions—the source of much of today's unfunded pension liabilities. No funding method alone offers protection against the creation of pension debt, but the fiscal note represents a readily available method for assuring that potentially increased pension costs are recognized.

Data on practices in the various states con-

cerning fiscal notes, annual reports, and other forms of state disclosure and reporting policy are provided in *Chapter 4* of this report, *Tables 10 and 11*.

The public pension disclosure issue also concerns the specifics of disclosure, and not simply whether disclosure takes place. The specifics involve such items as actuarial assumptions, reporting format, the frequency of reports, and the degree of availability of the information. In addition, the public pension disclosure issue includes the question of disclosure standards and whether different standards should apply to public as contrasted to private sector plans.

As in the case of the funding issue, state and local government pension disclosure—via audits and financial reports—is based on actuarial and accounting procedures related to an ongoing activity. The possibility that governments will collapse or dissolve is not accounted for in the design of prevailing reporting and disclosure practices in the public sector. Public pension liabilities are generally expressed as the present value of accrued liabilities, based on the best estimate of expected future developments—such as expected wage rate increases in the future. Similarly, assets valuation is based on the best estimates of expected future developments. This approach is generally accepted as the only practical way to measure liabilities and assets in the public sector.

Some argue, however, that public sector plans should estimate liabilities and assets at a given “point in time” and ignore future events entirely. ERISA requires this for private plans, which are commonly subject to termination at any time.<sup>15</sup> If an actuary is able to manipulate freely assumptions on future events it is possible for him to overestimate intentionally the value of assets, which could result in underfunding the pension plan. It is argued that the termination approach, by avoiding the use of assumptions about the future, will result in more uniform and useful information for the purpose of making funding and investment experience comparisons from one plan to another.

This disagreement over disclosure approaches is crucial since the termination approach creates a clear bias which underesti-

mates liabilities for any ongoing concern. Experience suggests that it is a practical certainty in the public sector that most all expected future events increase the present value of accrued pension liabilities. Some changes, such as future increases in the number of employees vested, can only raise liabilities. Realistically, nominal wages would be expected to rise in the future, thereby increasing pension benefits and liabilities. By ignoring these practically certain developments, the termination approach to disclosure underestimates liabilities for fairly permanent institutions, whether private or public, and hence overestimates the assets-to-accrued liabilities ratio, a key measure of the degree of funding.

A practical result would follow from the implementation of the termination approach for public plans. The debt of public plans (unfunded accrued past service liabilities) would suddenly appear less than is currently disclosed, causing much confusion. This in turn could slow the effort to improve funding levels in plans with fund deficiencies.<sup>16</sup>

Several additional questions of more general importance in evaluating pension disclosure are:

1. How does one measure the costs and benefits of various types of pension disclosure?
2. How does one best communicate to the layman—whether he be taxpayer, employer, retiree, or government official—the complex issues of which he should be aware?
3. Are there any unresolvable conflicts between pension disclosure and the legal rights to privacy prevalent in many states?
4. To what extent does pension disclosure require outside, independent verification to insulate public pension policy from potential bias of a political or bureaucratic nature?
5. What disclosure practices are required for collective bargaining procedures?

Funding and disclosure reforms can be characterized as important “process” reforms. Systematic funding of currently accruing pen-

sion liabilities and disclosure of employee benefit rights and costs are valuable tools for creating an environment in which pension costs will be recognized and kept within manageable limits.

## BENEFITS

42 At the heart of public pension policy is the question of pension benefits. How high should pension benefits be? Should everyone have uniform pension provisions? Should pensions be modified in order to take into account rising Social Security benefits or rising inflation rates? These could be called questions of substance, as opposed to process questions, and they have a bearing on whether federal or state governments should seek to regulate or impose certain uniform vesting and benefit levels (including Social Security benefits) upon state and local retirement systems. This section deals with problems in assessing pension benefits, what they are designed to achieve, and how benefit levels should be determined.

One of the most serious questions faced in the pension disclosure area concerns information on pension benefits. To make considered judgments about pensions, state and local policymakers and taxpayers need information on "benefits" to the public of proposed changes and not solely on "costs" to the public. Cost-benefit analyses of pension provisions, however, can quickly be complicated by an attempt to determine what function pensions perform in the compensation package of state and local governments.

Public pensions began as a mutually beneficial arrangement between governments and their employees. The first retirement systems in the United States were city police and firefighter plans. The disability, vesting, and benefit provisions of these plans were designed to support and retain loyal employees and the limited number of superannuated individuals who could no longer perform in a productive capacity in these essential, high-risk jobs. For teachers and other employees, pensions were for the retired who often had been paid relatively low wages during their working years. Thus, pensions were viewed originally as well deserved and necessary wage supplements, and could be analyzed on this basis.<sup>17</sup>

In the last 50 years, however, the analysis of public pension benefits has become more complex. Plan coverage has been expanded to general employees and benefit levels have risen. The income tax advantages of pensions as contrasted to current compensation, may have encouraged their growth.<sup>18</sup> The extension of Social Security benefits to public employees, the establishment of early retirement, and the inclusion of cost of living provisions all add complexity to benefit analysis. The changed nature of pensions makes it all the more imperative to evaluate the contribution of various pension provisions to the overall cost of employee compensation in the public sector.

In cases where benefits have been analyzed, the methods used are subject to criticism. For example, the most commonly cited statistic in the analysis of pension benefits is the wage-replacement percentage which describes in percentages (e.g., 20%, 50%, 100%) the degree to which pensions replace wages. This statistic has been used, erroneously perhaps, to compare pension levels among jurisdictions and among functions. As a practical matter, the ratio should differ among various classes of employees and among jurisdictions depending on the role pensions play as compensation in the case involved.

Another type of analysis of benefits uses the wage-replacement percentage for comparison with social need. This ignores entirely the role of pension as compensation and attempts to determine an absolute level of wage-replacement acceptability for retirement welfare. The resulting percentage is intended to apply equally to all employees, public and private, after certain refinements are made for cost of living, employee contributions, and Social Security. The main problem with this approach is that its objective is to set a welfare standard arbitrarily, thereby changing the pension into just another form of Social Security.

Historically, public pensions have been beneficial to governments because they could be adapted to the particular characteristics of a jurisdiction or a class of employees. As increasing attention is drawn to the differences in public plans, and as political and analytical problems emerge from efforts to evaluate public pension plans, there is a danger that policymakers may resort to establishing arbitrary,

uniform, welfare-based standards. This approach could eliminate much, though perhaps not all, of the advantage pension benefits have in providing a mutually beneficial compensation package for both government and public employees.

The issue of how to evaluate public pension benefits is growing in importance as policymakers and the public recognize the true costs of pensions. Discussion is gradually turning from funding problems to "excessive" benefits. "Double dipping" has become a common term to describe the case of employees receiving more than one public pension. Other provisions common to public plans, such as cost of living adjustments, generous disability benefits, and early retirement, have contributed to a growing public awareness of the particularly high costs involved in some public pensions.<sup>19</sup> Because of legal and political barriers to reducing these benefits, more discussion is being directed toward phasing out the existing rigid systems in favor of new, less generous, but more flexible systems for future employees. This approach may be the only reasonable solution to the very real problem of growing pension costs.<sup>20</sup>

## CONCLUSION

Before moving on to the state regulation and reform movement, several points should be illuminated concerning the nature of state and

local pension problems. First, it should be clear from this discussion of funding, disclosure, and benefits that public plans face problems much different from those which have plagued private sector plans. For this reason, ERISA-type standards, imposed upon public plans, would be inappropriate and probably counterproductive.

Second, the lack of well developed standards for public plans should not be overemphasized. While there may be conceptual and practical problems with current standards, in practice most states have developed and implemented standards. The House Pension Task Force tables show that the large majority of state and local employees are in plans which have actuarial funding methods, fairly regular actuarial evaluation and audits, and various forms of disclosure of pension information.

Finally, although there may be substantial conceptual and analytical hurdles to overcome in the development of more appropriate standards for public systems, the heightened interest in pensions in recent years has stimulated numerous studies which are expected to help unravel the complexity of these issues and enable a more rational definition of public pension standards in the future. Some of these studies have already resulted in reform models which are beginning to be adopted by state and local governments, and it is this activity which will be highlighted in the next chapter.

43

## FOOTNOTES

<sup>1</sup> U.S. House of Representatives, Committee on Education and Labor, *Pension Task Force on Public Employee Retirement Systems*, 95th Cong., 2nd Sess., Washington, DC, U.S. Government Printing Office, March 15, 1978.

<sup>2</sup> The House Pension Task Force Report data on state and local retirement systems shows a much larger number of pension plans than counted by the Census (6,000 vs. 3,000). For an explanation of the discrepancy between these figures, see U.S. Department of Commerce, Bureau of the Census, *1977 Census of Governments*, Vol. 6, No. 1, *Employee-Retirement Systems of State and Local Governments*, Washington, DC, U.S. Government Printing Office, 1978, pp. 5-6.

<sup>3</sup> Ronald L. Haneberg, "Public Employee Pension Plans: A New Era of Regulation?" *Governmental Finance*, Vol. 8, No. 1, Chicago, IL, Municipal Finance Officers Association, March-June 1979, p. 5.

<sup>4</sup> House Pension Task Force, *op. cit.*, p. 164.

<sup>5</sup> Robert Tilove, *Public Employee Pension Funds, A Twentieth Century Fund Report*, New York, NY, Columbia University Press, 1976, p. 165.

<sup>6</sup> *Ibid.*, p. 164.

<sup>7</sup> Critics of ERISA argue that the ERISA funding requirement is excessively strict even for private plans. See Dennis E. Logue, *Legislative Influence on Corporate Pension Plans*, AEI Studies 234, Washington, DC, American Enterprise Institute for Public Policy Research, 1979, pp. 69-75.

<sup>8</sup> The Comptroller General of the United States, *Funding of State and Local Government Pension Plans: A National Problem*, HRD 79-66, Washington, DC, U.S. General Accounting Office, August 30, 1979, p. 9.

<sup>9</sup> The exception is that some have argued that small local plans should be run on a pay-as-you-go basis to avoid the prohibitive costs of actuarial funding. See Donald Alston Wolf, "Funding Pensions for Public Employees: The Argument for Pay-As-You-Go," *Public Personnel Review*, July 1969, pp. 155-59. See also Gene E. Mumy, "The Economics of Local Government Pensions and Pension Funding," *Journal of Political Economy*, Vol. 86, No. 31, Chicago, IL, The University of Chicago, 1978, p. 519.

- <sup>10</sup> For a more detailed description of the case of Massachusetts, see Alice H. Munnell and Ann Connolly, "Financing Public Pensions," *New England Economic Review*, January-February 1980, p. 40.
- <sup>11</sup> Lynn E. Browne and Richard F. Syron, "The Municipal Market Since the New York City Crisis," *New England Economic Review*, July -August 1979, p. 21.  
George E. Peterson, *Transmitting the Municipal Fiscal Squeeze To A New Generation of Taxpayers: Pension Obligations and Capital Investment Needs*, Washington, DC, The Urban Institute, mimeo, March 1979, p. 12.
- <sup>12</sup> The Urban Institute is currently doing a HUD-financed study of various aspects of state and local pension plans, including funding standards. This study should help to clarify future funding strategies for public pensions.
- <sup>13</sup> For a discussion of economies of scale, see Price, Waterhouse, and Co., *Final Report Assessment of the Impact of ERISA on the Administrative Costs of Small Retirement Plans*, prepared for the U.S. Department of Labor, mimeo, November 22, 1977, pp. III-7 to III-10.
- <sup>14</sup> House Pension Task Force, *op. cit.*, pp. 347-51.
- <sup>15</sup> Financial Accounting Standards Board, *Accounting and Reporting By Defined Benefit Pension Plans*, July 9, 1979, Revision of Exposure Draft issued April 14, 1977, Stamford, CN, Financial Accounting Foundation, 1979, pp. iii-vii.
- <sup>16</sup> For more detailed discussion of disclosure issues, see John E. Petersen, *Public Pension Fund Financial Disclosure*, research prepared under the HUD/Urban Institute Public Pension Research Project, Washington, DC, mimeo, revised draft, April 1980.
- <sup>17</sup> The unique historical development of public pensions is detailed in William C. Greenough and Francis P. King, *Pension Plans and Public Policy*, New York, NY, Columbia University Press, 1976, pp. 49-52.
- <sup>18</sup> See Daniel M. Holland, "Pension Fund Growth and Its Economic Implication," *Tax Impacts on Compensation*, Symposium, conducted by the Tax Institute of America, October 3-4, 1968, Princeton, NJ, Tax Institute of America, 1969, pp. 3-12.
- <sup>19</sup> Alicia H. Munnell and Ann M. Connolly, *Pensions for Public Employees*, Washington, DC, National Planning Association, 1979, pp. 89-91.
- <sup>20</sup> An example of one such phase-in approach is explained in Committee on Public Pensions, Citizens League of St. Paul-Minneapolis, *A Risk-Shared Basis for Pensions*, Minneapolis, MN, Citizens League, December 13, 1978.

## State Regulation and Reform

**T**he states have approached their public employee retirement issues in different ways. Many states have brought most of their state and local employees into one or a few large retirement systems. As a result, their retirement policy is either set forth in statutes by the legislature or in administrative regulations by the major state retirement boards. Other states are characterized by one or more large state-wide systems for state and local employees, plus a fairly substantial group of locally administered systems. In some states certain types of local governments may have extensive if not complete discretion in the conduct of their own retirement systems, at least for certain employee groups. Still other states pass legislation allowing locally-administered retirement systems, and these statutes regulate the specifics of the local system's practices. This diversity in the intergovernmental pattern of state pension regulation makes any study of state pension policy extremely difficult.

45

To enable this Commission to obtain a good grasp of existing state regulatory policy, the ACIR, with the help of the National Conference of State Legislatures (NCSL), developed and conducted a survey of the 50 states. Surveys were sent out to most of the states in the summer of 1979. States which did not respond by mail were contacted over the phone.

An attempt was made to send surveys to the most knowledgeable pension source in each



*Table 10*  
**STATE REPORTING AND DISCLOSURE REQUIREMENTS FOR MAJOR  
 STATE-ADMINISTERED SYSTEMS**  
 (based on ACIR-NCSL survey, 1979)

States	Regular*	Regular*	Regular*	Regular Reports To State and/or Local Regular Reports Available to Employees	Fiscal Notes	EXHIBIT** Percent of Total State-Local Employees Covered by Local- Administered Systems
	Actuarial Valuation (Frequency Required, If Not Annual)	Audit (Frequency Required, If Not Annual)	To State (Frequency Required, If Not Annual)			
Alabama	Yes	Yes <sup>1,2</sup> (2 yr)	Yes	Yes <sup>3</sup>	Yes	89%
Alaska	Yes <sup>4</sup> (2-5 yr)	No <sup>2</sup>	Yes <sup>5</sup>	—	Yes	98
Arizona	Yes <sup>6</sup> (1-2 yr)	Yes <sup>7</sup>	Yes <sup>7</sup>	Yes <sup>8</sup>	— <sup>9</sup>	92
Arkansas	Yes(2 yr)	Yes <sup>1</sup>	Yes	—	Yes <sup>10</sup>	97
California	Yes	Yes	Yes	—	Yes	78
Colorado	Yes <sup>11,12</sup>	No <sup>11,13</sup>	Yes <sup>11</sup>	Yes <sup>11,14</sup>	Yes <sup>11</sup>	78
Connecticut	Yes <sup>15</sup> (2-5 yr)	Yes <sup>1</sup>	Yes	Yes <sup>16</sup>	Yes	81
Delaware	Yes <sup>17</sup> (2 yr)	Yes <sup>1,17</sup>	Yes <sup>17</sup>	Yes <sup>17,3</sup>	Yes <sup>18</sup>	93
Florida	Yes(3 yr)	Yes <sup>19</sup>	Yes	Yes <sup>3</sup>	Yes <sup>20</sup>	90
Georgia	Yes <sup>21</sup>	Yes <sup>21</sup>	Yes <sup>21</sup>	Yes <sup>21</sup>	Yes	84
Hawaii	Yes	No	Yes	Yes	No	100

\* The frequency required by statute may not be the same as that which prevails in practice. Moreover, several states are recorded as having no statutory requirement, though in practice they have regular actuarial valuations, audits, and reports, as indicated in the footnotes. In many cases the information refers only to a subset of the total of local-administered retirement systems—though in most cases, the major local-administered systems are included. As a result of these caveats, one must be very careful in interpreting this information.

\*\* Percent refers to all local administered systems, while survey data may pertain only to a subset of such systems.

<sup>1</sup> By state auditor or auditing committee.

<sup>2</sup> In practice, annual, independent audits are performed.

<sup>3</sup> Information sent or distributed to employees, annually.

<sup>4</sup> Refers to Alaska Public Employees' Retirement System (PERS), every two years; teachers' system, every five years.

<sup>5</sup> Refers to Alaska PERS.

<sup>6</sup> Refers to Arizona State Retirement System (ASRS), annually; and public safety system, every two years.

<sup>7</sup> Refers to ASRS and the public safety system.

<sup>8</sup> Refers to ASRS.

<sup>9</sup> Required for ASRS, not for public safety system, but it provides cost estimates as a matter of practice.

<sup>10</sup> In practice, some controversial measures "sneaked through" without fiscal note.

<sup>11</sup> Refers to PERA.

<sup>12</sup> Judicial division exempted by law but follows law in practice.

<sup>13</sup> Reports must be filed, however, with legislative audit committee, and in practice, the retirement board provides annual, independent audits.

<sup>14</sup> In practice, two reports are sent annually to each employee, though there are no requirements.

<sup>15</sup> The frequency required varies among the systems.

<sup>16</sup> Refers to state employees' retirement system.

<sup>17</sup> Refers to the public officers' and employees' pension plan.

<sup>18</sup> Benefit improvements must also be accompanied with first year full funding in appropriations.

<sup>19</sup> State auditor conducts ongoing audit.

<sup>20</sup> Public hearing is also required prior to enactment.

<sup>21</sup> Refers to the Employees' Retirement System of Georgia.

Table 10 (continued)

**STATE REPORTING AND DISCLOSURE REQUIREMENTS FOR MAJOR  
STATE-ADMINISTERED SYSTEMS**  
(based on ACIR-NCSL survey, 1979)

States	Regular* Actuarial Valuation (Frequency Required, If Not Annual)	Regular* Audit (Frequency Required, If Not Annual)	Regular* Reports To State and/or Local (Frequency Required, If Not Annual)	Regular Reports Available to Employees	Fiscal Notes	EXHIBIT** Percent of Total State-Local Employees Covered by Local- Administered Systems
Idaho	Yes <sup>22</sup>	No <sup>22,23</sup>	No <sup>22,23</sup>	Yes <sup>22,24</sup>	Yes <sup>22</sup>	100%
Illinois	Yes	Yes <sup>25</sup> (3 yr)	No <sup>26</sup>	No <sup>23</sup>	Yes	74
Indiana	Yes <sup>27</sup> (5 yr)	No	Yes <sup>28</sup>	Yes <sup>24</sup>	No <sup>23</sup>	97
Iowa	Yes <sup>23,30</sup> (2 Yr)	— <sup>31</sup>	Yes <sup>29</sup> (2 Yr)	Yes <sup>32</sup>	Yes	96
Kansas	Yes	Yes <sup>33</sup>	Yes	Yes	Yes <sup>34</sup>	95
Kentucky	Yes <sup>35</sup> (1-2 Yr)	No <sup>23</sup>	— <sup>36</sup>	— <sup>36</sup>	No <sup>23</sup>	96
Louisiana	Yes <sup>37</sup>	No <sup>38</sup>	Yes(2 Yr)	—	Yes <sup>39</sup>	90
Maine	Yes <sup>40</sup>	Yes <sup>40,41</sup>	Yes <sup>40</sup>	—	Yes	100
Maryland	Yes (2 Yr)	Yes <sup>33</sup>	—	Yes <sup>24</sup>	Yes	81
Massachusetts	No <sup>42</sup>	Yes <sup>43</sup> (3 Yr)	Yes	Yes <sup>44</sup>	No <sup>45</sup>	57
Michigan	No <sup>45</sup>	Yes <sup>46</sup> (3 Yr)	No	No	No	84

<sup>22</sup> Refers to PERS.

<sup>23</sup> Not by statute, but in practice, yes.

<sup>24</sup> Information sent or distributed to employees, annually.

<sup>25</sup> All systems have independent audits, except Downstate Fire and Police System which is audited by State Insurance Department.

<sup>26</sup> No requirement for annual report, except for actuarial valuations which are reported to the Department of Insurance.

<sup>27</sup> Refers to the two largest systems, PERF and the teachers' fund (TRF). They are also required to have actuarial investigations. PERF prepares actuarial valuations for all other systems at its own discretion.

<sup>28</sup> All systems report annually to PERF, which summarizes reports to the legislature and Governor.

<sup>29</sup> Refers to the Iowa PERS, and the public safety system. Note required of the judicial system, by statute.

<sup>30</sup> The judicial system has biennial actuarial valuations as a matter of practice.

<sup>31</sup> Required for Iowa PERS, not specified for other systems. PERS audited by state auditor or private CPA.

<sup>32</sup> Reports are public information. PERS must report specifically to employees.

<sup>33</sup> By state auditor.

<sup>34</sup> Includes local police and fire charter ordinances.

<sup>35</sup> Kentucky Employees' Retirement System (KERS), and the state system for police and county employees (SPRS and CERS) must have annual valuations, teachers' system (KTRS) is biennial. Regular valuations not required of judicial system (JRS).

<sup>36</sup> KERS, CERS, and SPRS are required to issue annual reports available to the public. KTRS and JRS are not required to do so.

<sup>37</sup> Survey information insufficient to determine frequency, and some state systems, if not actuarially funded, may be excluded from requirement.

<sup>38</sup> Limited audits performed by legislative auditor's staff.

<sup>39</sup> By legislature's in-house actuarial staff.

<sup>40</sup> Refers to the Maine State Retirement System.

<sup>41</sup> Annual audit by state auditor, independent audits every four years.

<sup>42</sup> In practice, yes—every three years.

<sup>43</sup> By state Division of Insurance.

<sup>44</sup> Includes information distributed or sent to employees annually.

<sup>45</sup> In practice, yes.

<sup>46</sup> By legislative auditor.

Table 10 (continued)  
**STATE REPORTING AND DISCLOSURE REQUIREMENTS FOR MAJOR  
 STATE-ADMINISTERED SYSTEMS**  
 (based on ACIR-NCSL survey, 1979)

States	Regular*	Regular*	Regular*	Regular Reports Available to Employees	Fiscal Notes	EXHIBIT** Percent of Total State-Local Employees Covered by Local- Administered Systems
	Actuarial Valuation (Frequency Required, If Not Annual)	Regular* Audit (Frequency Required, If Not Annual)	Regular* Reports To State and/or Local (Frequency Required, If Not Annual)			
Minnesota	Yes <sup>47</sup>	Yes <sup>46</sup> (1-3 Yr)	Yes	Yes <sup>44</sup>	No <sup>45</sup>	91%
Mississippi	Yes <sup>48</sup>	No <sup>48</sup>	Yes <sup>48</sup>	—	Yes <sup>48</sup>	99
Missouri	Yes <sup>49</sup>	Yes <sup>49,50</sup>	Yes <sup>49,51</sup>	Yes <sup>49,51</sup>	Yes <sup>49</sup>	75
Montana	Yes (2 Yr)	—	—	—	Yes	99
Nebraska	Yes <sup>52</sup>	Yes	Yes <sup>52</sup>	Yes	Yes	70
Nevada	Yes (2 Yr)	Yes (2 Yr)	Yes	Yes <sup>44</sup>	Yes	100
New Hampshire	Yes <sup>53</sup>	No <sup>53,54</sup>	Yes <sup>53</sup>	Yes <sup>53,54</sup>	Yes <sup>53</sup>	99
New Jersey	Yes <sup>55</sup>	Yes <sup>50</sup>	Yes	Yes	Yes	99
New Mexico	No <sup>56,57</sup>	Yes <sup>57</sup>	Yes <sup>57</sup>	—	Yes <sup>57</sup>	100
New York	Yes <sup>58</sup>	Yes <sup>58,59</sup>	Yes <sup>58</sup>	Yes <sup>58</sup>	Yes <sup>60</sup>	73
North Carolina	Yes <sup>61</sup>	Yes <sup>62</sup>	No <sup>63</sup>	No <sup>63</sup>	Yes	99
North Dakota	Yes <sup>64</sup> (3 Yr)	Yes <sup>65</sup>	Yes	Yes <sup>66</sup>	Yes	96
Ohio	Yes <sup>67</sup> (5 Yr)	No <sup>68</sup>	No <sup>56</sup>	No <sup>56</sup>	Yes	99
Oklahoma	Yes <sup>69</sup>	Yes <sup>62,69</sup>	Yes <sup>69</sup>	Yes <sup>66,69</sup>	Yes	89
Oregon	Yes <sup>70</sup> (4 Yr)	Yes <sup>62,70</sup>	Yes <sup>70</sup>	Yes <sup>66,70</sup>	No <sup>56,70</sup>	95

<sup>47</sup> Excluding several small state plans.

<sup>48</sup> Refers to the two major systems, PERS and the highway and safety patrol system (MHSPRS).

<sup>49</sup> Refers to the Missouri State Employees Retirement System.

<sup>50</sup> By state auditor.

<sup>51</sup> Refers to actuarial report.

<sup>52</sup> Refers to the five major systems administered by the Nebraska Public Employees Retirement Board.

<sup>53</sup> Refers to New Hampshire Retirement System.

<sup>54</sup> Currently undergoing first comprehensive audit, periodic audits are expected in future.

<sup>55</sup> Some state systems may not be required by law, but in practice, they have annual valuations.

<sup>56</sup> Not by statute; but in practice, yes.

<sup>57</sup> Refers to PERA.

<sup>58</sup> Refers to state employees system and state police and fire system.

<sup>59</sup> Annual independent audit, beginning 1980. Quinquennial audit by State Insurance Department.

<sup>60</sup> If requested, fiscal notes must be supplied.

<sup>61</sup> Refers to all systems administered by the Retirement and Health Benefits Division.

<sup>62</sup> By state auditor.

<sup>63</sup> Reports are made on specific request, except for actuarial reports which are annual. All information open to public.

<sup>64</sup> Annual valuations—in practice.

<sup>65</sup> Teacher system audited by state auditor, other are independent audits.

<sup>66</sup> Information sent or distributed to employees.

<sup>67</sup> Annual valuations are not required by statute, except for the police and fire fund (PFDPF). Experience studies, every five years, are required. In practice, annual valuations are required by board action.

<sup>68</sup> In practice, by state auditor once every one or two years.

<sup>69</sup> Refers to the two largest systems, PERS and teachers.

<sup>70</sup> Refers to PERS.

Table 10 (continued)  
**STATE REPORTING AND DISCLOSURE REQUIREMENTS FOR MAJOR  
 STATE-ADMINISTERED SYSTEMS**  
 (based on ACIR-NCSL survey, 1979)

States	Regular*	Regular*	Regular*	Regular Reports Available to Employees	Fiscal Notes	EXHIBIT** Percent of Total State-Local Employees Covered by Local- Administered Systems
	Actuarial Valuation (Frequency Required, If Not Annual)	Audit (Frequency Required, If Not Annual)	and/or Local To State (Frequency Required, If Not Annual)			
Pennsylvania	Yes <sup>71</sup>	Yes <sup>72</sup> (1-2 Yr)	Yes <sup>73</sup>	Yes <sup>71</sup>	Yes	78%
Rhode Island	Yes	—	Yes	Yes <sup>66</sup>	Yes <sup>74</sup>	87
South Carolina	Yes	No <sup>75</sup>	Yes	Yes <sup>66</sup>	Yes	99
South Dakota	Yes (2 Yr)	Yes (2 Yr)	Yes <sup>76</sup> (2-4 Yr)	No <sup>77,78</sup>	Yes	97
Tennessee	Yes <sup>79</sup> (2 Yr)	Yes <sup>79,80</sup>	Yes <sup>79</sup>	Yes <sup>78,79</sup>	Yes <sup>79</sup>	83
Texas	Yes <sup>81</sup>	— <sup>82</sup>	Yes <sup>83</sup>	Yes <sup>83</sup>	Yes	92
Utah	Yes <sup>84</sup> (6 Yr)	— <sup>85</sup>	Yes	No <sup>77</sup>	Yes	100
Vermont	Yes	Yes <sup>86</sup>	Yes	—	No <sup>77</sup>	96
Virginia	Yes <sup>87</sup> (2 Yr)	Yes <sup>80,87</sup>	Yes <sup>87</sup>	—	Yes <sup>87</sup>	85
Washington	—	—	—	—	—	94
West Virginia	Yes <sup>88</sup> (5 Yr)	No	Yes <sup>88</sup>	—	Yes	98
Wisconsin	Yes <sup>89</sup>	Yes <sup>89,80</sup>	Yes <sup>89</sup>	Yes <sup>89,78</sup>	Yes <sup>89</sup>	90
Wyoming	Yes <sup>90</sup> (6 Yr)	Yes <sup>80</sup>	Yes <sup>91</sup>	—	Yes	100

<sup>71</sup> Refers to state employees' and public school employees' systems.  
<sup>72</sup> Municipal system independently audited annually; state employees' and public school systems, every two years by state auditor.  
<sup>73</sup> Refers to state employees', public school, and municipal systems.  
<sup>74</sup> All regulations changing benefits must include funding as well.  
<sup>75</sup> Infrequent audits.  
<sup>76</sup> Actuarial and audit reports to legislature every two years; investment performance reports every four years.  
<sup>77</sup> Not by statute, but in practice, yes.  
<sup>78</sup> Information distributed or sent to employees.  
<sup>79</sup> Refers to the Tennessee Consolidated Retirement System.  
<sup>80</sup> By state auditor.  
<sup>81</sup> Refers to four major statewide systems, including state employees (ERS), teachers (TRS), municipal employees (TMRS), and county and district employees (TCDRS). Judicial system excluded from requirements.  
<sup>82</sup> ERS, TRS, and judicial systems are audited regularly, at discretion of state auditor. All other systems required to have annual independent audits.  
<sup>83</sup> Annual reports required of all systems except judicial system.  
<sup>84</sup> In practice, every two years.  
<sup>85</sup> Frequency of audits unclear from survey answer. State auditor has performed audits in part. Independent audits expected next two years.  
<sup>86</sup> By state auditor or by independent CPA.  
<sup>87</sup> Refers to the Virginia Supplemental Retirement System—the major statewide retirement system.  
<sup>88</sup> Refers to PERS and teachers' systems.  
<sup>89</sup> Refers to major state retirement system.  
<sup>90</sup> Actuarial investigations are required every two years, valuations every six years.  
<sup>91</sup> Reports sent to legislative management council every month.

SOURCE: ACIR compilation, based on answers to ACIR-NCSL survey, Summer 1979; Source for EXHIBIT is U.S. Department of Commerce, Bureau of the Census, 1977 *Census of Governments*, No. 6, No. 1: *Employee-Retirement Systems of State and Local Governments*, Washington, DC, U.S. Government Printing Office, 1978.

**Table 11**  
**STATE REPORTING AND DISCLOSURE REQUIREMENTS FOR LOCAL**  
**ADMINISTERED SYSTEMS**  
**(based on ACIR-NCSL survey, 1979)**

States	Regular* Actuarial Valuation (Frequency Required, If Not Annual)	Regular* Audit (Frequency Required, If Not Annual)	Regular* Reports To State and/or Local (Frequency Required, If Not Annual)	Regular Reports Available to Employees	Fiscal Notes	EXHIBIT** Percent of Total State-Local Employees Covered by Local- Administered Systems
California	Yes	Yes	Yes	— <sup>1</sup>	Yes	22%
Florida	Yes (3 Yr)	Yes <sup>2</sup>	Yes <sup>3</sup>	Yes <sup>4</sup>	Yes <sup>5</sup>	10
Illinois	Yes	Yes	Yes <sup>6</sup>	No <sup>7</sup>	Yes	26
Indiana	No <sup>8</sup>	No <sup>9</sup>	Yes <sup>8</sup>	No <sup>10</sup>	No <sup>7</sup>	3
Iowa	Yes <sup>11</sup> (5 Yr)	No	Yes <sup>12</sup>	—	Yes	4
Kansas	No <sup>13</sup>	—	Yes <sup>14</sup>	—	Yes <sup>15</sup>	5
Kentucky	Yes <sup>16</sup> (3-5 Yr)	No <sup>17</sup>	Yes <sup>18</sup>	Yes <sup>19</sup>	No <sup>20</sup>	4
Louisiana	—	—	Yes <sup>21</sup> (2 Yr)	—	Yes	10
Michigan	— <sup>22</sup>	No	— <sup>22</sup>	— <sup>22</sup>	No	16
Minnesota	Yes <sup>23</sup> (1-4 Yr)	— <sup>24</sup>	Yes	Yes <sup>25</sup>	Yes	9
Pennsylvania	Yes <sup>26</sup> (2-4 Yr)	— <sup>27</sup>	— <sup>28</sup>	—	Yes	22
Rhode Island	Yes	—	—	—	—	13
Tennessee	No	No	No	No	No	17
Texas	Yes (3 Yr)	Yes	Yes	Yes	Yes	8

\* The frequency required by statute may not be the same as that which prevails in practice. Moreover, several states are recorded as having no statutory requirement, though in practice they have regular actuarial valuation, audits, and reports, as indicated in the footnotes. In many cases the information refers only to a subset of the total of state-administered retirement systems—though in most cases, the major state-administered systems are included. As a result of these caveats, one must be very careful in interpreting this information.

\*\* Percent refers to all state administered systems, while survey data may pertain only to a subset of such systems.

SOURCE: ACIR compilation, based on answers to ACIR-NCSL survey, Summer 1979. Source for EXHIBIT is U.S. Department of Commerce, Bureau of the Census, 1977 *Census of Governments*, No. 6, No. 1: *Employee-Retirement Systems of State and Local Governments*, Washington, DC, U.S. Government Printing Office, 1978.

*Table 11 (continued)*

**STATE REPORTING AND DISCLOSURE REQUIREMENTS FOR LOCAL  
ADMINISTERED SYSTEMS  
(based on ACIR-NCSL survey, 1979)**

**Footnotes**

- <sup>1</sup> Annual report of finances of systems is published by state comptroller.
- <sup>2</sup> Independent audits required from all city systems, monitored by state auditor (including special districts).
- <sup>3</sup> Comprehensive actuarial reports required to be submitted to Department of Administration, Division of Retirement, which reports annually to the legislature.
- <sup>4</sup> Information distributed or sent to employees, annually.
- <sup>5</sup> Actuarial impact study prepared prior to required public hearing before any change of benefits. Full funding is also required of benefit changes.
- <sup>6</sup> Refers to actuarial report, which is sent to Department of Insurance, Pension Division.
- <sup>7</sup> Not by statute, but in practice, yes.
- <sup>8</sup> All local systems report to PERF, which perform actuarial valuations at its discretion for these systems. PERF summarizes reports to State Legislature.
- <sup>9</sup> Only the reports referred to in footnote 8.
- <sup>10</sup> Most voluntarily supply employees with information.
- <sup>11</sup> Refers to local police and fire systems, which must have actuarial investigations every five years.
- <sup>12</sup> Local police and fire must report annually to city council. Quinquennial actuarial analyses reported to state commissioner of insurance.
- <sup>13</sup> Local systems must report annually to the KPERS board (which presumably performs actuarial analyses).
- <sup>14</sup> Local systems report to city clerk, annually.
- <sup>15</sup> Local police and fire charter ordinances cannot be changed until there is an actuarial analysis. Fiscal notes performed by Budget Division of Department of Administration, based on information supplied by KPERS.
- <sup>16</sup> Second class city and urban county police, fire, and civil service systems are required to have actuarial valuations every five years. Third class city police and fire—every three years; third class city civil service—required but indefinite frequency. First class city, police, and fire—no statutory requirement.
- <sup>17</sup> The exceptions include second class city police and fire and urban county police and fire systems, which must have annual audits by "competent" accountant.
- <sup>18</sup> Urban county and second and third class city police and fire systems report annually to county or city councils. Urban county and second class city civil service systems report to Mayor, quarterly. First class city systems—no requirement.
- <sup>19</sup> Urban county and second class city systems must publish synopsis of report for distribution among members, or must post copies where members report. No other requirements.
- <sup>20</sup> Not by statute, but in practice, General Assembly purchased actuarial analyses of all local proposals in 1978 session.
- <sup>21</sup> Retirement systems supported by public funds must submit financial statements before each legislative session.
- <sup>22</sup> Not for all local systems, possibly for county systems.
- <sup>23</sup> First class cities have annual valuations; local police and salaried fire systems—every two years; volunteer fire systems—every four years.
- <sup>24</sup> Most are audited, either by statute or by practice, on a regular basis, including police and fire funds which must have annual, independent audits to qualify for state aid.
- <sup>25</sup> Synopsis required to be sent to employees.
- <sup>26</sup> Plans with less than 50 members—every four years; plans with more than 50 members—every two years.
- <sup>27</sup> Police and fire plans using subsidy are audited; other local systems have no such requirement.
- <sup>28</sup> Only reports required are actuarial reports, which go to the Community Affairs Department.

state. Thus, for 17 states with permanent pension commissions or legislative review committees on pensions, the surveys were sent to these institutions. For other states, surveys were sent to state pension administrators. Though some survey answers were somewhat ambiguous, we believe accurate information was obtained on the whole. Each survey question asked whether there was any state requirement on a particular aspect of pension policy, which systems (both state and local) were regulated, and what were the specifications of the regulation.

Hence, the ACIR-NCSL survey was designed to complement the House Pension Task Force survey findings, which provided information on pension practices, mainly by level of government and membership size of plan. The ACIR-NCSL survey, in contrast, provides information on pension policy (state regulation and reform), by state.<sup>1</sup> Moreover, where the HPTF survey concentrated mainly on comparing public pensions with ERISA-type standards for private pensions, the ACIR-NCSL survey was directed more to the concerns of the governments and taxpayers, as well as employees.

52

### **MAJOR SURVEY FINDING— EXTENSIVE REPORTING AND DISCLOSURE REQUIREMENTS**

The single most important ACIR-NCSL survey finding can be summarized as follows: **State reporting and disclosure requirements are extensive for the large state-administered systems which contain about 90% of all state and local pension participants.** *Table 10.*

The large majority of states require regular actuarial valuations, audits, reporting to states and to employees, and fiscal notes. For those states which did not require these disclosure practices by statutes, they were clearly required by established board policy. These findings raise questions about the House Pension Task Force claim that there is a "lack of public pension policy" for regulating state and local pension plans.

The table reveals that much of the diversity in the regulatory approaches is to be found in such distinctions as independent audits vs. state audit; frequency of valuations, audits, and

reports; and statutory vs. established board policy. Care should be observed in this last distinction because it was assumed that the regulations indicated in the survey answers were statutory in nature unless otherwise indicated. Board regulation was not counted as a "yes" answer in the table proper, but was indicated in the footnotes. Another reason for caution is that some of the responses were qualified to exclude certain systems, or to refer only to one or two major systems. With one or two exceptions, the qualifications were of relatively minor importance in that most of the employees of large, state-administered systems were covered by the survey answer.

ACIR-NCSL survey findings on state regulation of local-administered systems are shown in *Table 11*. Five of the 14 states responding, including Florida, Kentucky, Illinois, Minnesota, and Texas, have completely regulated almost all of their local-administered systems in the five disclosure fields; only one of the 14 indicated no regulation relating to any of the disclosures; and the remaining states showed mixed degrees of statutory regulation.

There is one primary factor that explains the low state survey response with respect to local-administered pension plans. In many cases, local-administered plans account for such a small percentage of total state-local employees that the respondents at the state level simply did not think it was worth their valuable time and effort to research this question. This is understandable, given that many of the respondents were administrators of major state retirement systems, who have been flooded with numerous surveys this year. Thus, the one-third response rate was about what was expected under these conditions.

As far as regular actuarial analyses, reports to state or local governments, and fiscal notes were concerned, these 14 reporting states chalked up a good regulatory performance. Only one state, Tennessee, reported no actuarial valuations for its local-administered systems, or requirements for pension reports to state or local governments. Tennessee, however, has recently consolidated most of its local systems into the Tennessee Consolidated Retirement System, which is regulated by the state. In 1980, Tennessee's legislative Council on Pensions will formally consider the need for

regulating any remaining local-administered systems.

On the other two categories, there was a good deal of ambiguity or lack of response. There were only eight responses on audits and seven on reports to employees. Of those responding, only two states indicated regular audits were required of local systems. The performance was somewhat better on reports to employees—four of the seven respondents required them.

### MAJOR SURVEY FINDING—RECENT UPSURGE IN REFORM ACTIVITY

In this section evidence is set forth that both clearly establishes the fact that there has been a recent upsurge in state-local pension reform activity, and provides basis for questioning the recent GAO finding that “pension reform at the state and local levels is moving slowly, and the prospects for significant improvement in the foreseeable future are not bright.” The ACIR-NCSL survey provided quite a few responses indicating that pension reform of one kind or another had recently been enacted or is being considered for the near future. A brief list follows:

- California** —last year passed legislation requiring all public systems to report annually to state comptroller.
- reform pending which would allow local agencies to reduce benefits to new members.
- Delaware** —1976 legislation achieved major revision of all benefits, vesting, participating, and funding standards for state system, including full funding requirement for all benefit changes, and benefit integration with Social Security.
- Florida** —extensive regulations in legislation of last two years require of all public systems (including home rule localities) strict actuarial reporting, local fiscal note process including public hearings, notes, and other

disclosure and reporting items, plus full funding and amortization.

- Georgia** —discussion during last two years of enacting full funding requirement for all future benefit proposals.
- also discussion of employee contribution “pick-up” by employer.
- Idaho** —1979 legislation merged fireman’s system with the major state system, PERS.
- Indiana** —Pension Study Commission appointed for 1979.
- 1977 act revised reporting requirements.
- Iowa** —consideration recently given to consolidating all local police and fire systems.
- Kentucky** —proposed legislation would comprehensively reform state regulations for city pension systems.
- pension commission study proposed establishment of state investment pool for local pension funds.
- possibility that future reform may require fiscal notes for local pension changes.
- Maryland** —major reform creates new state retirement systems, integrated with Social Security effective July 1, 1979.
- Massachusetts** —plans to recodify all pension statutes (mainly concerning relatively minor details).
- Michigan** —in process of creating public pension commission which would start process of reform in the state.
- Minnesota** —five proposals dealing with consolidation of local police and fire systems, the “double-dip issue,” and in-



- vestment standards being considered.
- Montana** —interim committee to study inflation and consolidation issues.  
—attempt to create pension committee.
- New Jersey** —considering legislation which would have state assume costs of all liberalized benefits for local police and fire systems.  
—recently completed one-time, actuarial analysis of all major local systems by office of legislative services, for the 1975-78 period.
- 54 **New York** —state studying simulated “offset” plans for new employees.
- North Dakota** —created legislative retirement committees in 1977 in response to “leap frogging.”  
—consideration of “noncontributory” state system.  
—funding requirement “probable” in the future.
- Oklahoma** —special study commission recently made actuarial study of all local police and fire systems for 1979 session.  
—some discussion of change from “20 years and out” pension provision to age 55 retirement (presumably for local police and fire systems).
- Pennsylvania** —retirement study commission to study local retirement systems and make recommendations.
- Rhode Island** —recent legislation increased funding of state system.
- South Dakota** —no change since major consolidation in 1974, except for emphasis on improving funding ratios.

- Tennessee** —legislative council on pension and retirement will study need for state regulation of local systems in 1980.
- Texas** —state pension review board enacted this year.
- Wisconsin** —consideration of legislation which would carry out merger of Wisconsin retirement fund, state teacher retirement system, and Milwaukee Teachers Retirement Fund which were “merged in theory” during 1975 session.  
—consideration of legislation to have legislative monitoring of agency action and retirement board rules which have fiscal impact.

The above list should not be taken as a comprehensive list of pension legislation since the ACIR-NCSL survey only asked for reform measures designed to affect state pension regulation which were “currently” pending or under consideration. Some of these responses went beyond what was requested, mentioning major consolidations, changes in funding, and other nonregulatory changes, both pending and recently enacted. Others left out reforms which we know are taking place or have recently taken place, some of which we have added to the list. Moreover, there has been activity by various local governments that our survey was not designed to gather.

In reviewing these reforms, it can be concluded that the states have responded well since the 1975 New York fiscal emergency highlighted the public pension problem and opened the nation’s eyes to the need for reforms, and it is reasoned that reform efforts will continue in the future. However, any such judgment is open to debate and the record to date can also be viewed as too little and too slow. In final analysis it must be recognized that major pension reform is a very complicated matter, and cannot be rushed because such changes tend to have large and lasting impacts. Moreover, state-local pension problems tend to be long run in nature, hence rush solutions may well be unwise.

## FORCES BEHIND STATE AND LOCAL PENSION REFORM

The ACIR-NCSL survey showed that many state and local governments are making great strides in an effort to improve their public plans. To claim that these activities have been primarily motivated by philosophical principles of enlightenment or "good government" would be misleading. Rather the forces of self-interest, political and economic, are the prime movers behind state-local pension reform activity. Rapidly rising pension costs have raised the ire of taxpayers, causing much attention to be placed on cost and disclosure aspects of public pension policy. The role of pensions in city financial emergencies has stimulated a considerable response on the part of the private sector investment community, resulting in reform of bond market disclosure practices for state and local government pensions. Perhaps the most important factor behind pension reform is the threat of PERISA, which would establish federal regulation of state and local pensions, and has moved states and localities to seek more comprehensive state regulation of public pensions in order to avoid the loss of authority to the federal government.

The role of federal initiatives, such as 1974 passage of ERISA and the current debate on PERISA, in motivating state and local retirement reform activity is underscored by the testimony of Howard Winklevoss during hearings on the 1978 version of PERISA (HR 14138).

I have observed a phenomenon which has led me to conclude that the laudable objectives of HR 14138 [the 1978 version of PERISA] can be achieved without the passage of the bill. The phenomenon has been the flurry of activity among public pension plans to upgrade themselves to ERISA-type standards since the passage of ERISA. In part, this has been caused by the greater awareness with respect to pension plans and their potential problems and shortcomings in the minds of taxpayers, plan participants, administrators, and nonfederal policymakers as a result of the passage of ERISA. Perhaps the more significant factor,

however, is the threat of federal legislation. For many public plans, this has been a strong motivating factor.

I feel confident that if the data collected by the Pension Task Force on public pension plans were updated, the results would show a substantial improvement in those that were found to be deficient and I feel that such improvements will continue.<sup>2</sup>

State regulation and reform has come about through the support of key policymaking organizations at both the state and local levels. Perhaps the most significant has been the role played by the National Conference of State Legislatures' Task Force on Pensions.

... the National Conference of State Legislators has been working hard to improve public pension plans and has adopted a set of pension planning principles that will undoubtedly have a significant effect on such plans. Nearly all conference and association meetings during the past few years which involve individuals associated with public pension plans have considered at length the need to upgrade these plans to ERISA-type standards, and such deliberations are indeed having a positive impact.<sup>3</sup>

The National Governors' Association (NGA) has also recommended pension reform regulating state and local retirement systems. The NGA Subcommittee on Public Retirement Systems is currently drafting guidelines for pension reform which would "improve the design, operation, and soundness of state and local retirement systems." Many of the NGA recommendations correspond closely to ERISA-type standards. NGA recommendations include the following:

- 1) use of appropriate methods of reporting and disclosure;
- 2) regular independent financial audits conducted by an auditor not employed by the retirement system;
- 3) regular actuarial evaluations, using accepted and current assumptions;
- 4) adequate funding of benefit costs;
- 5) reexamination of current benefit provi-

sions and revision where necessary to ensure that abuses of the system are eliminated;

- 6) establishment of guidelines for the conduct of fiduciary responsibilities, particularly those related to the selection of investment advisors, brokers and custodians, and investment policies;
- 7) encouragement, where feasible, of plan consolidation; and
- 8) encouragement, where feasible, of portability of membership.<sup>4</sup>

Even local government organizations, whose traditional interests might be expected to be opposed to strengthened state controls, have backed state regulation of local retirement systems. In recent testimony before the President's Commission on Pension Policy, officials representing the National League of Cities and the National Association of Counties argued that federal regulation, if it ever takes place, would be detrimental to local governments, because it would conflict with various state restrictions. For example, federal funding standards may require substantial local tax increases which may not be possible under existing state-mandated pensions, and tax limits.<sup>5</sup> To avoid conflicting restrictions, and recognizing that improved regulation is desirable, local officials here turned to the state as the most appropriate level of government for regulation of pensions.

Though the threat of federal regulation has certainly been a strong motivating force behind state regulation activity, the rising tax burdens associated with pension costs have been of equal importance. The emphasis on governmental accountability to taxpayers in the conduct of pension policy is evident in NCSL's checklist for improved state oversight and regulation of public pensions, which focuses on reporting and disclosure to the state, fiscal notes to estimate costs of legislation, advance funding, double dipping, disability, and cost-of-living provisions.<sup>6</sup> Exhibit 1.

Following the New York City financial emergency, private sector concerns over public sector pension policy has been another force leading toward pension reform. In the case of Massachusetts, discussed in more detail in Chapter 3, the investment community expressed its concern over inadequate pension

funds by raising interest costs of public borrowing, which in turn strengthened efforts to improve the funding of Massachusetts' retirement systems.

Empirical evidence of state and local pension reform progress caused by private sector concerns comes from a 1979 study of disclosure for the municipal bond market by Bruce V. DePalma and Carol M. Palczynski. Their study tried to determine the degree of compliance to municipal bond disclosure guidelines designed by the Municipal Finance Officers Association in 1976 for the purpose of satisfying the information needs of the market. Based on a sample of 19 governmental units issuing general obligation debt in both 1975 and 1978, their findings indicated that, in general, disclosure practices improved considerably. In particular,

... there was a strong response on the part of issuers to reveal pension fund information. Specifically, pension fund detail disclosure increased from 11% to 74% over the three year period of the study. Also reflecting this increase was the improvements in the reporting of those items regarding the method of pension funding and the extent of unfunded past service. The former showed a moderate increase from 11% to 47% in 1978 while the latter improved significantly from a poor disclosure level of 11% in 1975 to 74% in 1978.<sup>7</sup>

The response on the part of individual governments to the underlying forces of pension reform appear to vary widely depending on which problems are perceived to be most important. Large and rapidly growing Sunbelt states such as Florida and Texas, for example, have recently adopted preventive, "process-type" regulations, including strict funding, disclosure, fiscal notes for pension legislation, and increased state oversight. State and local governments which have relatively mature economies and retirement systems with generous benefits, (i.e., California, New York, Massachusetts, and Maryland) have undertaken major reforms to limit or reduce benefit levels and integrate their benefits with Social Security, at least for future state-local employees.

Other major state reform actions include

Exhibit 1

**NCSL CHECKLIST**

Check yes if the following criteria apply in your state, no if they do not

	Yes	No
<b>The legislature has established a permanent body with staff and actuarial assistance with responsibility for recommending legislative action.</b>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Public pension systems report annually to the legislature.</b>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Only the legislature may make changes in pension benefits or contributions.</b>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Collective bargaining on public pension benefits and contributions is prohibited.</b>	<input type="checkbox"/>	<input type="checkbox"/>
<b>There has been resistance to efforts to lower the normal retirement age.</b>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Thorough fiscal notes are prepared on all proposed pension legislation.</b>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Pension loopholes that permit retirees to take unfair advantage of state and local pension plans have been closed.</b>	<input type="checkbox"/>	<input type="checkbox"/>
<b>The disability rolls are monitored and thorough medical evaluation of claims is required.</b>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Front end funding of increases in pension benefits is required.</b>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Pension benefits and Social Security are integrated.</b>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Cost of living adjustments are independently funded and have a ceiling on the percentage of increase for a single year.</b>	<input type="checkbox"/>	<input type="checkbox"/>

SOURCE: National Conference of State Legislatures, *A Legislator's Guide to Public Pensions*, Denver, CO, National Conference of State Legislatures, July 1978, p. 2.

statewide consolidation of retirement systems in Tennessee and South Dakota, and New England's regional approach to disclosure of pension information. Pennsylvania has completed an extensive accounting of its retirement systems and is presently examining possibilities for consolidation. Such diverse and innovative responses to pension problems indicate that the federal system appears to be responding as it should to the diverse problems facing state and local retirement systems.

The prospects for future state and local pension reform will obviously depend on the continuing importance of the factors discussed in this section: the threat of federal regulation,

rising pension costs, and continuing concern over city financial emergencies. Unless federal regulation occurs, it would appear that all these will continue to be effective in motivating pension plan improvements in the future. One must be careful, however, not to underestimate the possible barriers to pension reform. Some have argued that inflation, tax revolt, and limitations on state and local revenue may harm state-local pension funding progress. There may be increasing pressure to target pension investments to areas with lower returns, also hurting pension funding. Federal tax and Social Security policy could add to the costs of state and local government.

Perhaps the key challenge facing public progress in the future relates to the legislative decisionmaking process in which state regulation and reform must take place. The last section of this chapter concentrates on this aspect of pension policy, and specifically, on the potential of state pension commissions.

## STATE PENSION COMMISSIONS

Several important differences between public and private pensions have been highlighted earlier in this report, yet the most difference lies in the institutional decisionmaking process in which pension policy is formulated. As Thomas P. Bleakney explained in his 1972 study:

A private company's self-interest is best served if proposals for the establishment or change of a retirement plan for the company are evaluated by competent actuaries and reviewed by the company's financial officers before action is taken. . . . In contrast, the level or kind of benefits to be provided in public employee retirement systems are subject to decisions made under pressure in a political atmosphere.<sup>8</sup>

Problems related to the political environment are most striking where special interest groups or political bias create undesirable distortions in pension policy. In some cases public employee unions exert overwhelming political pressure to secure overgenerous pension benefits, often with the sympathy of the electorate. Conversely, some jurisdictions are dominated by taxpayer groups and conservative political philosophy which oppose "liberalization" of benefits to such an extent that pensions are inadequate.

Less striking but equally troublesome are political difficulties related to the complexity of pension policy. The long-term, deferred nature of pension benefits can lead to severe funding problems if the electorate is only interested in short-run objectives and is indifferent to or ignorant of accumulating unfunded pension liabilities. Even where the public is sufficiently concerned with maintaining reasonable benefit and funding levels, a lack of sufficient expertise or interest in such fine

points as actuarial assumptions may lead to excessive benefit costs and/or underfunding of pension plans.

Finally, the problem of overlapping governmental responsibilities and intergovernmental accountability among federal, state, and local governments adds to the confusion in public pension policymaking. Some public employees belong to state-administered systems, with various state funding, disclosure, and fiduciary requirements, but with pension benefits determined at the local level. Others may belong to local-administered systems with local funding standards but with benefit levels mandated by the state. Added to this is the complexity of federal Social Security, with its tax and benefit levels determined by the federal government, and the related problem of double dipping. Besides the resource allocation problem which occurs whenever one level of government mandates benefits and another pays the costs,<sup>9</sup> there is the more basic problem of fragmented overall pension policy which has "taken shape through the addition of a patchwork of laws and programs, creating complexity and confusion."<sup>10</sup>

The state pension commission (sometimes called a pension review or oversight committee) represents the most effective means of countering these unique difficulties of state-local pension policy. A recent survey counted 20 state pension oversight units in 1979 which, compared to only eight in 1969, signifies the increased popularity and widespread acceptance of this state-level approach to solving pension problems.<sup>11</sup>

A key to the success of a state pension oversight unit is the makeup of the commission, which ultimately determines whether it will be able to avoid political bias. Ideally, the commission should consist of state and local government officials, taxpayers, and active and retired public employees. Though such a composition will inevitably result in a certain degree of conflicting objectives, a "balance" of objectives is necessary for "effectiveness and survival."<sup>12</sup>

Another important key to success is the ability of the commission to take on the most important pension policy challenge on an ongoing basis. This means it must be a permanent commission with sufficient staff, financing,

and functional flexibility to review all relevant pension legislation, estimate actuarial costs for fiscal notes, study various state and local pension problems, and make recommendations to the legislature.<sup>13</sup> Also important is the need to stimulate public interest and disclose relevant information to all interested parties. Various means of publicity, including public hearings and disclosure to employee labor representatives and to government officials are suggested to eliminate confusion over complex issues and to build a broad base of interest in pension commission recommendations.<sup>14</sup>

Finally, the commission should address itself not only to benefit and funding levels, but also to intergovernmental questions. It should, therefore, also be a "state-local" commission which should look into issues related to state consolidation of local systems, state-mandated benefits, funding and fiduciary regulations for local governments, and financial assistance to local governments. Obviously, a necessary first step toward such an analysis would be a comprehensive initial accounting and disclosure for all locally administered systems.

Success in the establishment of continuing policy through a standing commission rests ultimately on the acts of statesmanship—working out a set of principles, securing their implementation, knowing both what is ideal and what is possible and how they can be blended with integrity. The individual abilities of a commission's membership are obviously important ingredients.<sup>15</sup>

Though the record of state pension commissions thus far is certainly uneven and the prospects for future success uncertain, they are strongly supported by many state-local pension experts, and the National Conference of State Legislatures has been instrumental in promoting their creation. The one analysis of their impact found that most pension commissions "are able to point to improvements in the level of funding," and there has been much activity in the areas of benefit reform and plan consolidation. As a result, pension commissions "are apparently enjoying great success as government agencies go. . . ."<sup>16</sup>

59

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## FOOTNOTES

<sup>1</sup> It should be noted that the HPTF survey covered numerous aspects of state and local pensions and the report contains valuable analysis of various pension practices. In addition, it provides a brief summary description of the major statewide systems, by state. U.S. House of Representatives, Committee on Education and Labor, *Pension Task Force Report on Public Employee Retirement Systems*, 95th Cong., 2nd Sess., Washington, DC, U.S. Government Printing Office, March 15, 1978.

<sup>2</sup> U.S. House of Representatives, Committee on Education and Labor, Subcommittee on Labor Standards, "Statement of Howard E. Winklevoss," *Hearing on H.R. 14138*, 95th Cong., 2nd Sess., held in Wheaton, IL, on November 15, 1978, Washington, DC, U.S. Government Printing Office, 1979, pp. 199-200.

<sup>3</sup> *Ibid.*, p. 199.

<sup>4</sup> National Governors' Association, *NGA Policy Positions, 1979-80*, Executive Management and Fiscal Affairs, adopted February 1979, Washington, DC, duplicated, 1979.

<sup>5</sup> President's Commission on Pension Policy, *Roundtable Discussion on State and Local Retirement Issues*, Study Group II Hearing, October 19, 1979, unpublished.

<sup>6</sup> National Conference of State Legislatures, *A Legislator's Guide to Public Pensions*, Denver, CO, National Conference of State Legislatures, July 1978, p. 2.

<sup>7</sup> Bruce V. DePalma and Carol M. Palczynski, "Study of 19 Governmental Units Shows Increase in Voluntary Disclosure in 3 Years," *Weekly Bond Buyer-MFOA Supplement*, June 22, 1979, p. 17.

<sup>8</sup> Thomas P. Bleakney, *Retirement Systems for Public Employees*, Homewood, IL, Richard D. Irwin, Inc., 1972, p. 13.

<sup>9</sup> Norman Walzer and David Beveridge, "Municipal Employee Benefits: The Intergovernmental Dimension," *National Tax Journal*, Vol. XXX, No. 2, June 1977, p. 135.

<sup>10</sup> House Pension Task Force, *op. cit.*, p. 63.

<sup>11</sup> Citizens Research Council of Michigan, *A Survey of State Pension Oversight Bodies*, Memorandum 237, Detroit, MI, Citizens Research Council of Michigan, July 1979, p. 7.

A state-by-state description of these oversight units is also provided by Edward H. Friend & Co., *Report on State Pension Commissions, 1979*, Washington, DC, Pension Commission Clearinghouse of Edward H. Friend & Co., 1979.

<sup>12</sup> Citizens Research Council of Michigan, *op. cit.*, p. 20.

<sup>13</sup> National Conference of State Legislatures, *op. cit.*, p. 3.

<sup>14</sup> Charles H. Weston, Jr., director of Ohio Retirement Study Commission, speech given at Edward Friend & Co. Conference on State Pension Commissions, Washington, DC, unpublished, May 8, 1980.

<sup>15</sup> Robert Tilove, *Public Employee Pension Funds, A Twentieth Century Fund Report*, New York, NY, Columbia University Press, 1976, p. 259.

<sup>16</sup> Citizens Research Council of Michigan, *op. cit.*, p. 19.



# Summary of the Major Provisions of The Public Employee Retirement Income Security Act of 1980 and The Employee Benefit Administration Act of 1980

## PURPOSES

**T**he proposed legislation (HR 6525) has two titles: Title I is the "Public Employee Retirement Income Security Act of 1980;" Title II is the "Employee Benefit Administration Act."

The purposes of Title I, the Public Employee Retirement Income Security Act of 1980 (PERISA), are to protect the interests of participants and beneficiaries in public employee pension benefit plans and the interests of the federal government and the general public in the operation of such plans and to minimize the possible adverse impact of the operation of such plans on federal revenues and expenditures and the national securities markets:

- 1) by requiring the disclosure and reporting to participants and their beneficiaries, employers, employee organizations, and the general public, of financial and other information about such plans;
- 2) by establishing standards of conduct and responsibility for fiduciaries of public employee pension benefit plans;
- 3) by providing for appropriate remedies, sanctions, and access to the federal courts; and
- 4) by clarifying the application of the Internal Revenue Code to the public pension



plans and extending the tax benefits of qualified plan status to such plans.

The purposes of Title II, the Employee Benefit Administration Act of 1980, are to foster the orderly growth and maintenance of employee benefit plans and enhance the free flow of commerce, to protect more effectively the interests of participants and their beneficiaries in such plans, and to promote the establishment of effective mechanisms for providing adequate retirement income to a greater number of persons through the development of a national policy:

- 1) by establishing a single independent agency, the Employee Benefit Administration (EBA), to effectuate a rational and coordinated policymaking and regulatory system for private as well as public pensions plans; and
- 2) by consolidating in this agency the administration of laws relating to employee benefit plans, including the *Employee Retirement Income Security Act of 1974*, the "Public Employee Retirement Income Security Act of 1980," and certain provisions of the *Internal Revenue Code of 1954* relating to employee benefit plans.

62

Title I  
**PUBLIC EMPLOYEE RETIREMENT  
INCOME SECURITY ACT OF 1980**

**Coverage**

All public employee pension benefit plans are covered by this act except those plans which are:

- 1) covered under section 4(a) of the *Employee Retirement Income Security Act of 1974* and not exempt under section 4(b)(1) of that act;
- 2) unfunded plans maintained by the employer primarily to provide deferred compensation for select management or highly compensated employees;
- 3) severance pay plans;
- 4) coverage agreements entered into pursuant to section 218 of the *Social Security Act*;
- 5) individual retirement accounts or an-

nities within the meaning of section 408 of the Code or retirement bonds within the meaning of section 409 of the Code;

- 6) plans described in section 401(d) of the *Internal Revenue Code*;
- 7) 403(b) annuity plans;
- 8) eligible state-deferred compensation plans within the meaning of section 467(b) of the *Internal Revenue Code*.

**Exemption For Plans Meeting  
Minimum State Standards**

The bill provides an exemption from the reporting, disclosure, bonding and certain related criminal and civil enforcement provisions of the act if a state has established or establishes substantially equivalent requirements for public employee pension plans within its jurisdiction. The determination as to whether state requirements meet such test is made by the Employee Benefit Administration.

**The reporting and disclosure which must be made by a public employee pension plan include the following:**

The plan administrator must provide an accurate description and comprehensive summary of their rights and obligations under the plan to participants and beneficiaries. The summary must be written so that the average plan participant will understand it.

The initial summary plan description must be updated at least once every ten years by integrating the changes made within that period.

Upon written request (but not more than once a year) a statement must be furnished within 60 days providing a participant or beneficiary with information as to total accumulated contributions, pension benefits, and vesting status.

Information as to a participant's pension benefits and rights is to be furnished a participant who terminates, makes a benefit election or receives a benefit or return of contribution payments.

**Disclosure must be made to the public and other interested parties in the following ways:**

Copies of the summary plan description, an-

nual report, bargaining agreement, and other plan documents are to be available for examination in the principal office of the administrator and in other locations; copies of such documents, for which a reasonable charge may be made, must be provided to any participant, beneficiary, employee organization which represents covered employees, or resident of any state which establishes, or a political subdivision of which establishes the plan, within 60 days after a written request. Copies of the summary plan description and annual report must be filed with the Employee Benefit Administration.

The plan administrator must prepare an annual report for each year, which is to be filed with the Employee Benefit Administration.

**The annual report must include the following information:**

A financial statement and schedule, including a statement of assets and liabilities, revenues and expenses, and party-in-interest transactions; and actuarial statement and information on terminated vested participants.

A plan must engage an enrolled actuary to perform an actuarial valuation at least once every three years. The enrolled actuary must utilize assumptions and techniques which represent his or her best estimate of anticipated experience under the plan; the Employee Benefit Administration is given the sole authority to determine the scope, form and content of the disclosure of plan liabilities.

A plan must engage an independent qualified public accountant to audit the plan and render an opinion as to whether the financial statements are presented fairly and in accordance with generally accepted accounting principles.

The EBA is to provide for simplified annual reports for plans with less than 100 participants.

Filings may be rejected by the administration if they are incomplete or there is a material qualification in the accountant's opinion or actuary's statement required as part of the annual report. The plan administrator may have 45 days to cure a filing which has been rejected. After that time, the administration may order a plan audit, bring a civil action, or take any other action authorized under the act.

## **Fiduciary Standards**

The act establishes standards of conduct in the operation and administration of a plan for persons who have discretionary control over a plan or its assets.

Every plan must be established and maintained pursuant to a written instrument. Plan assets must be held in trust and used for the exclusive benefit of participants and beneficiaries.

A fiduciary is defined as any person who exercises any discretionary authority or control with respect to the management of a plan or the disposition of its assets, who renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of a plan, or who has any discretionary authority or responsibility in the administration of a plan. However, a person acting in his or her governmental capacity is not a fiduciary with respect to actions taken in that capacity regarding the establishment of plan benefit levels, funding and eligibility standards. A legislator acting in his or her legislative capacity is not a fiduciary with respect to legislative actions taken in connection with a public plan.

Fiduciaries must discharge their duties with the skill, care, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use in a similar situation under the circumstances then prevailing. Certain types of transactions between the plan and a party-in-interest are specifically prohibited.

Plan trustees and other fiduciaries may delegate their responsibilities. However, a fiduciary remains liable for the illegal acts of a co-fiduciary if the fiduciary knowingly participates in or conceals such illegal acts. A fiduciary is personally liable to the plan for any breach of a fiduciary or co-fiduciary duty or obligation.

The act protects plans against loss by reason of fraud or dishonesty by requiring fiduciaries who handle funds to be bonded.

## **Internal Revenue Code Qualifications**

The act removes the ambiguity of the *Internal Revenue Code* provisions as they presently

relate to public pension plans. A plan which is determined by the Employee Benefit Administration to meet the requirements of the act is a qualified plan without regard to the requirements of section 401(a) of the *Internal Revenue Code*.

### **Enforcement**

Criminal sanctions are provided for persons who willfully violate the reporting and disclosure provisions of the bonding requirements of this act.

Civil actions may be brought by specified persons to enjoin or redress violations or otherwise enforce provisions of the act. Failure to comply with a request for information which is required by the act to be furnished upon request may result in personal liability for the plan administrator. Failure to file a required form with the administration upon notification and demand may result in a \$10 per day penalty, not to exceed \$5,000.

Exclusive federal court jurisdiction is provided for violations of the fiduciary provisions of the act and for suits against the Employee Benefit Administration. Concurrent state and federal jurisdiction is retained for other types of actions, including actions brought under any provision of state law which has been deemed by the Employee Benefit Administration to be substantially equivalent to the federal standards.

If the plaintiff in a civil action prevails or substantially prevails, the court must award attorney's fees, unless an affirmative finding of good faith on the part of the defendant is made and the court determines that such an award would not further the purposes of the act. If the defendant prevails or substantially prevails, the court may award attorney's fees.

### **Advisory Council**

An 11-member Advisory Council on Governmental Plans is established to advise the Employee Benefit Administration. The council is required to establish voluntary guidelines for public employee pension benefit plans with respect to funding and vesting. The council must work with employers, employee organizations, employees, administrators, and other interested persons to establish these guidelines.

### **Preemption**

The fiduciary provisions preempt all state laws insofar as they relate to the subject matter of such provisions. All other state laws would remain unaffected except to the extent that they relate to the subject matter of the other provisions of the act as applied to public plans.

### **Effective Dates**

Generally the provisions of the act are to take effect at the beginning of the second calendar year following the establishment of the Employee Benefit Administration.

## **Title II EMPLOYEE BENEFIT ADMINISTRATION ACT OF 1980**

### **Employee Benefit Administration**

Title II of the act establishes an independent agency, the Employee Benefit Administration in which are consolidated existing functions of the Departments of the Treasury and Labor with respect to employee benefit plans.

The Employee Benefit Administration is governed by a board of directors consisting of a special liaison officer to the Secretary of Labor, a special liaison officer to the Secretary of the Treasury, and three other members appointed by the President with the advice and consent of the Senate. The executive director of the administration, a presidential appointee, serves as the board's chairperson.

Policymaking as well as other specific functions of the Secretaries of Labor and the Treasury under the *Employee Retirement Income Security Act of 1974* (ERISA) and the *Internal Revenue Code of 1954* are transferred to the administration. The Pension Benefit Guaranty Corporation retains its corporate identity under the jurisdiction of the Employee Benefit Administration.

The Employee Benefit Administration has the authority to determine the qualified status of a plan. The enforcement functions under both Title I and Title II of ERISA are transferred to the administration. Exercise of the enforcement remedies under Title II will be coordi-

nated with the civil remedies under Title I of ERISA.

All regulations and rulings previously issued by the Department of the Treasury, the Internal Revenue Service, the Department of Labor, and the Pension Benefit Guaranty Corporation remain in effect, although the Employee Benefit Administration has the authority to repeal, waive, or modify them prospectively and to issue its own regulations. Any other federal agency or department issuing regulations affecting employee benefit plans is required to consult with the Employee Benefit Administration prior to issuing those regulations.

The President is directed to transfer to the Employee Benefit Administration such officers and employees in the national and field offices of the Department of Labor and the Department of the Treasury (including the Internal Revenue

Service) as may be necessary to assure continuity and efficient and expert administration of the functions transferred to it.

Although most of the Department of the Treasury's employee benefit plan responsibilities are transferred to the EBA, the Department will still retain certain other functions. Because of this, special procedures to insure coordination of activities between the EBA and the Department of the Treasury are established. The purposes of these procedures are to facilitate exchanges of information, while maintaining confidentiality, and to provide for more effective administration of retirement income laws.

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SOURCE: *Congressional Record*, February 13, 1980, Washington, DC, U.S. Government Printing Office, pp. H-896-897.



## 4.201 Establishment of a Consolidated State-Administered Pension System

Consolidation of small retirement systems has been advocated for many years both in the private and public sectors. The pension reform legislation enacted by the Congress in the early 70s took several steps to encourage private system consolidation. In the public sector, a number of organizations have proposed merging small, locally administered systems into one or a few consolidated statewide systems. The Advisory Commission on Intergovernmental Relations in its 1973 report on *City Financial Emergencies* stated:

The Commission concludes that underfunded, locally administered retirement systems hold an emerging threat to the financial health of local governments. The Commission recommends, therefore, that the locally administered system be strictly regulated by the states, or alternatively, be consolidated into a single state administered system. At a minimum, states should require substantial funding for all local systems based on a reliable computation of full funding requirements.

Retirement systems of state and local governments have become a huge fiscal undertaking over the past

quarter century. According to the House Pension Task Force, there were 12.5 million state-local retirement systems in 1975. Of these 554 were state-administered systems embracing 10.4 million members and 5,234 locally administered systems embracing 2.1 million members. There were 1,413 separate state and local systems in Pennsylvania of which 1,304 had less than 100 members (total employed, inactive, and retired). Other states having substantial numbers of separate systems were (1) Minnesota 638; (2) Illinois 465; (3) Oklahoma 435; (4) Texas 398; (5) Colorado 343; and (6) Florida 335.<sup>2</sup> Given such large numbers of retirement systems, many of which have fewer than 100 members, there is reason to believe that consolidation of retirement systems can enable a state to achieve economies of scale in administrative costs and in investment returns. The findings of our 1973 report stated "A state-administered system has many advantages; among them are the possibilities for more professional management of the larger system, as well as removal of the political temptation to give unfunded benefits."<sup>3</sup> Additionally, the report noted—

...it is essential that the states assume at least two responsibilities. First, the state should require an accurate and current valuation of all local systems. Second, the state should require realistic funding

<sup>1</sup>Derived from Advisory Commission on Intergovernmental Relations, *City Financial Emergencies: The Intergovernmental Dimension*, A-42, Washington, DC, U.S. Government Printing Office, July 1973; and ACIR, *Transferability of Public Employee Retirement Rights Among Units of Government*, A-16, Washington, DC, U.S. Government Printing Office, March 1963. See also, James Jarrett and Jimmy E. Hicks, *Retirement System Consolidation: The South Dakota Experience*, Lexington, KY, The Council of State Governments, 1976

<sup>2</sup>Committee on Education and Labor, House of Representatives, 95th Congress, 2nd session, *Pension Task Force Report on Public Employee Retirement Systems*, Washington, DC, U.S. Government Printing Office, March 1978.

<sup>3</sup>ACIR, A-42, *op. cit.*

based on such valuation. A well administered state system could provide for both these requirements, and is perhaps the best solution over the long term.<sup>4</sup>

However, difficult problems may be faced in consolidation, especially if an effort is made to get all public employees into a single system. These problems include: (1) making sure that particular care is taken in the process of consolidation in order to maintain "qualified" IRS status (given the current lack of clear IRS guidelines, any act of consolidation may run the risk of violating future IRS standards); (2) the potential that mandatory consolidation may be impossible in states with constitutional guarantees of public employee pension rights; (3) voluntary consolidation that requires a "leveling up" of benefits may be very expensive if there is a wide disparity in current benefits. Alternatively, "hold harmless" or "grandfathering" approaches may be costly and inequitable; and (4) state consolidation removes local control over personnel policies related to pensions and, therefore, the state must assume responsibility for maintaining a quality retirement system. This responsibility can be affected by instances where local governments are hard pressed in meeting state funding standards. The Commission has recently recommended that states assume financial responsibility for raising benefit levels and costs beyond widely accepted tests of reasonableness.<sup>5</sup>

Nevertheless, experience has shown that despite the foregoing problems, gains can be achieved through consolidation. Major state consolidation actions that have been drawn upon in formulating the draft legislation that follows include: Ohio, *Police and Firemen's Disability and Pension Fund*;<sup>6</sup> South Dakota, *Retirement Consolidation Act*;<sup>7</sup> Tennessee, *Consolidated Retirement System*;<sup>8</sup> New Mexico, *Retirement of Public Officers and Employees*;<sup>9</sup> Washington, *Statewide City Employees' Retirement*;<sup>10</sup> Oregon, *Public Employees, Retirement Generally*.<sup>11</sup>

The draft legislation that follows draws upon

different parts of each of the foregoing statutes. For purposes of brevity and manageability the draft legislation does not provide suggested language for the detail of benefit formulas, establishment of prior service credit, authorized types of investments by retirement system boards, social security integration, disability and death benefits, or any other parts of any public employee retirement system containing a variety of considerations in their formation. The draft legislation concentrates on those aspects that are central to, or impacted directly and significantly by, the process of consolidation. At several points in the draft bill, alternate sections are set forth; at other points, parenthetical or footnoted comments indicate the advantages and disadvantages of going in a particular direction.

*Section 1* gives the short title of the bill.

*Section 2* of the draft bill states legislative findings and the purpose of the act.

*Section 3* lists the variety of technical terms used which need to be defined in any comprehensive consolidation statute.

*Section 4* provides for the creation of a new, consolidated, statewide retirement system—the public employees' retirement system building upon an already existing system for state government employees. The new system is to absorb and supersede existing retirement systems maintained by local units of government for their employees.

*Section 5* establishes a board of trustees, providing for membership, appointment, terms of office, filling of vacancies, compensation, meetings, and for officers of the board, including treasurer, legal advisor, and actuary.

*Section 6* sets forth the powers and duties of the board and limits the personal liability of board members.

*Section 7* providing for the absorption and supersession of existing local systems by the public employees' retirement system, is presented in two alternate versions. The first alternative provides for a mandatory takeover on a specified date of all existing local systems, preceded by an actuarial valuation by the board of each superseded system including its general condition, assets, and liabilities, and the amount of accrued liabilities payable to the consolidated system under a time schedule set forth in a subsequent section.

The second alternative *Section 7* provides for the voluntary merger and absorption into the consolidated system of local systems created prior to a specified date. Each merger is conditioned upon approval by the local government governing body,

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<sup>4</sup>*Ibid.*

<sup>5</sup>*The Advisory Commission on Intergovernmental Relations, State Mandating of Local Expenditures*, A-67, Washington, DC, U.S. Government Printing Office, July 1978.

<sup>6</sup>*Ohio Revised Code Annotated*, Chap. 742.

<sup>7</sup>*1974 South Dakota Session Laws*, Chap. 35.

<sup>8</sup>*Tennessee Code Annotated*, Chap. 39.

<sup>9</sup>*New Mexico Statutes Annotated*, Sec. 5-5-1, et. seq.

<sup>10</sup>*Revised Code of Washington Annotated*, Chap. 41.44.

<sup>11</sup>*Oregon Revised Statutes*, Chap. 237.

and two-thirds of its retirement system members; completion of an actuarial evaluation of the local system; agreement by the local government to the system contribution rate and any accrued liabilities; and approval by the system board of trustees.

*Section 8* prescribes in moderate detail the nature and composition of the actuarial valuation that must precede the absorption of any system, regardless of whether a mandatory or voluntary approach has been selected in *Section 7*.

*Section 9* provides for the transfer of rights, assets, and liabilities from superseded systems to the consolidated system.

*Section 10* sets forth a time schedule for the liquidation by participating local governments of the accrued liabilities established in the actuarial valuation.

*Sections 11* provides for the establishment of a contribution rate to be levied by the board upon the participating public employers.

*Section 12* provides for the establishment of an employee contribution rate upon two alternate approaches—(a) “notching” up or down the rate used in the superseded system, and (b) establishment of a “normal” rate based on sex and age that, together with the employer contribution, assure a given level of benefit upon retirement.

*Section 13* provides for a transitional contribution to the system from the state government in order to facilitate orderly financial planning, mitigate hardship situations created through a mandatory consolidation, or to provide added inducement to merger in the event a voluntary approach is being used.

*Section 14* provides a “hold harmless” benefit basis for retired persons absorbed into the consolidated system from superseded systems and extends such a guarantee to employees of superseded systems within

(five) years of retirement. A number of other optional courses of action are suggested in parenthetical language attached to the section. In addition, *Section 14* lists by description, but not in detail, the variety of items that must be taken into account in benefit levels and computations under any retirement system irrespective of consolidation.

*Section 15* provides for the crediting by the consolidated system of prior employee service under superseded systems.

*Section 16* provides authority for local governments to make supplemental contributions to the system for the purpose of correcting identified inequities faced by its employees incident to their system merger and absorption.

*Section 17* provides for the “portability” of all benefit rights among the participating public employers making up the system.

*Section 18* lists, but does not describe, the matters pertaining to the withdrawal of contributions by nonvested employees resigning or otherwise terminating employment that must be treated in any retirement system irrespective of consolidation.

*Section 19* provides for the investment of system funds and other liquid assets; most of the items in the section are not peculiar to consolidation. One subsection deals with the disposition of investments acquired from superseded systems.

*Section 20* provides for an annual report to the Governor and legislature by the system board of trustees, including an actuarial review of the system, status of accrued liabilities arising from superseded systems, investment holdings, and income, and any recommendations for executive or legislative action.

*Sections 21 and 22* provide for separability and effective date clauses respectively.



Suggested Legislation

**[ESTABLISHMENT OF A CONSOLIDATED STATE-ADMINISTERED PENSION SYSTEM]**

(Comprises draft provisions to cope with major aspects of the consolidation of a number of separate public employee pension systems into a single system; as for example the merging of many individual city and county systems into a single state-administered system for all local government employees.)

*(Be it enacted, etc.)*

1 SECTION 1. *Short Title.* This act may be cited as the “Consolidated State-Administered Pension  
2 System Act.”

3 SECTION 2. *Findings and Purpose.*

4 (a) The [*legislature*] finds that:

5 (1) a number of retirement systems established and administered by local governments in this  
6 state are encountering serious problems of rising costs and underfunding of benefit liabilities, caused in  
7 part by the lack of sufficient members to provide a sound basis for computing contribution requirements  
8 and levels of benefits over an extended period of time;

9 (2) divergent provisions among systems hinder the opportunity of public employees to  
10 transfer from one jurisdictional employer to another; and

11 (3) the anticipated gains from consolidation are found to exceed expected costs.

12 (b) It is the purpose of this act to provide for consolidation of individual local government  
13 systems into a statewide and state-administered system of a size, scope, and structure that will assure

14 (1) fiscal and actuarial stability;

15 (2) an adequate and certain level of financial security protections for public employees;

16 (3) a properly funded system;

17 (4) an economy of scale in administrative costs;

18 (5) improved employee mobility;

19 (6) a pooled and prudent investment of assets; and

20 (7) machinery for an orderly and equitable transfer of assets and liabilities from superseded  
21 systems into the new system.

22 SECTION 3. *Definitions* [*A number of terms would need to be defined in a comprehensive statute*  
23 *that covered both the process of consolidation and the specification of the many details of the new*  
24 *system. This draft, dealing only with the consolidation process has been structured so as to define terms*  
25 *within the respective sections in which they first appear.*

26 *These terms include:*

27 (a) *accumulated contributions;*

- 1           (b) *actuarial requirements, survey, and valuations;*  
2           (c) *accrued liabilities (of superseded systems);*  
3           (d) *assets;*  
4           (e) *board;*  
5           (f) *employees, special classes of employees (e.g., uniformed, teacher, general);*  
6           (g) *member, member contributions, member benefits, membership service, prior member, prior*  
7 *superseded system member;*  
8           (h) *public employer, participating unit;*  
9           (i) *retirement in superseded system, retirant;*  
10          (j) *system; and*  
11          (k) *superseded system.]*

12           [*Additionally, other definitions necessary to provide the detailed structure and funding of any new*  
13 *or consolidated system would include:*

- 14          (a) *benefit computation;*  
15          (b) *contribution computation, refunds to terminating nonvested employees;*  
16          (c) *credited service, prior service;*  
17          (d) *disability—total, permanent, partial;*  
18          (e) *employer, employee;*  
19          (f) *final compensation (high three, high five, etc. of regular annual pay, not including overtime);*  
20          (g) *funding ratio;*  
21          (h) *normal retirement age;*  
22          (i) *Social Security integration level;*  
23          (j) *vesting; and*  
24          (k) *investment of fund, fiduciary responsibilities of board.]*

25           SECTION 4. *Creation of System. [This bill assumes an existing system for state employees that is*  
26 *converted into a state-local system through accession and supervision of all or most other public*  
27 *employee systems in the state. Only the nonstate employee aspects are treated in the bill. In some cases*  
28 *it might be desirable to provide a separate fund for local government employees, while assuring*  
29 *consolidated, unified administration.]*

30           There is hereby created the [*insert state*] Public Employees' Retirement System, hereinafter  
31 referred to as the "system." Subject to the terms and conditions set forth in this act, the system [shall]  
32 [may] absorb and supersede retirement systems maintained by local units of government for their  
33 employees and created prior to, and existing as of [the effective date of this act] [*other specified date*].

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<sup>1</sup>This sentence relevant only if a previously existing system is to be used as the "core" of the new, consolidated system (see *New Mexico Statutes, Annotated*, Sec. 5-5-1, et. seq.,) as amended by Chap. 751, *Laws of 1975*.)

1 SECTION 5. *Board of Trustees—Establishment.*

2 (a) There is hereby created a governing authority of the system to comprise a board of trustees,  
3 hereinafter referred to as the “board.” The board shall consist of 15 members as follows:

4 (1) [ [Two] state government members [*comptroller, treasurer, or other chief fiscal officer;*  
5 *attorney general; insurance commissioner, etc.,*] ]

6 (2) [ [One] [an] elected official[s] of a participating city [appointed by the Governor]  
7 [appointed by the Governor from among three nominated by the state association of municipal  
8 officials,] ]

9 (3) [ [One] [an] elected official[s] of a participating county [*method of appointment as in*  
10 *paragraph (2) above,*] ]

11 (4) [*An elected official from any other major types of local units of general government*  
12 *embraced by the system; towns, townships, boroughs, etc.,*]

13 (5) [*Depending upon number of units and employees in relation to total system membership,*  
14 *similar representation from school districts and/or other special units of local government,*]

15 (6) [Three] members known as employee members all of whom shall be members of the  
16 system and [one] of whom is an employee of a participating city, [one] of whom is an employee of a  
17 participating county, [one] of whom is an employee of the state government, [other employee members,  
18 depending upon other public employer members under (5) above] and to be [elected by ballot by  
19 members of the sytem in the respective public employer categories] [nominated by unions or other  
20 public employee organizations] [elected by respective public employer categories of members at the time  
21 of the annual meetings of the system and conducted according to election rules and regulations adopted  
22 by the board of trustees of the system].

23 (7) [ [Three] members known as retirant members, all of whom shall be members of the  
24 system, and one each of whom is a retired former employee respectively, of a participating city, county,  
25 and the state government, and to be [chosen in the same manner as in paragraph (6) above].]

26 (8) [Five] members to be known as public members, none of whom shall be members of the  
27 system, appointed by the Governor [and confirmed by the [*senate*].<sup>3</sup> Public members shall be chosen to  
28 represent the overall public interest, as distinguished from interests associated with the management of  
29 any particular level or branch of government, or employee, or retirants thereof.

30 (b) In the event that an employee member of the board ceases to be a member, or any member of  
31 the board no longer serves in the capacity that qualified him for membership on the board, he shall be

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<sup>2</sup>For varying methods of selecting or electing employee members, see *Ohio Revised Code Annotated*, Sec. 742.03; *Revised Code Annotated of Washington*, Sec. 41.44.1070; and *New Mexico, Statutes Annotated*, Sec. 5-5-2.

<sup>3</sup>Confirmation by the upper house of the legislature, or other confirmation arrangement used in the particular state, would provide opportunity for considering any questions or objections relating to objectivity, management-employee balance, or other qualifications of public member appointees.

1 considered to have resigned from the board, and [the board shall select a member to fill the unexpired  
2 term] [an interim replacement shall be chosen in the same manner as provided in subsection (a) above].

3 (c) Original terms of office of members of the board [except for state officials serving ex officio]  
4 shall be for [one, two, and three years [*insert appropriate language for allocating original terms among*  
5 *categories of representation*]]; thereafter terms shall be for [three] years duration. [Appointments]  
6 [election] to fill vacancies other than those caused by expiration of a term shall be for the unexpired  
7 term. Members shall serve until successors have been chosen and qualified.

8 (d) Members of the board shall serve without compensation, but shall be reimbursed for such  
9 necessary and actual expenses, pursuant to [*cite statute governing per diem and other expenses of*  
10 *persons serving on state boards*], as may be incurred in the performance of their official duties. An  
11 employee member of the board shall suffer no loss of wages or benefits or penalty whatsoever because  
12 of absence from regular employment while engaged in official duties as a member of the board.<sup>4</sup>

13 (e) The board shall meet at least [four] times annually. [*Other provisions as desired regarding*  
14 *written notice; compliance with sunshine laws; recording of proceedings*]. Annually, dating from the first  
15 officially recorded meeting, the board shall elect a chairman, vice-chairman, and secretary. [Eight]  
16 members shall constitute a quorum, [except that no action having the effect of increasing the rate of  
17 required contribution or of decreasing the amount of retirement benefits payable shall be taken without  
18 [ten] affirmative votes].

19 [(f) [The [*attorney general*] shall be the legal counsel of the board; at his discretion and with the  
20 approval of the board, special counsel may be engaged for a specific purpose]. The board, at its  
21 discretion, may employ special counsel to supplement the legal assistance provided by the [*attorney*  
22 *general*].]<sup>5</sup>

23 (g) The [*chief state fiscal officer*], [*state fiscal officer serving as state government representative on*  
24 *the board*] shall be the treasurer of the system and the custodian of its funds.<sup>6</sup> His general bond to the  
25 state shall cover all liability for his acts as treasurer of the system. He shall cause all monies of the  
26 system received by him to be credited to the proper system fund, and he shall transmit monthly to the  
27 board a detailed statement of all such amounts so received and credited by him. The said treasurer shall  
28 make [*insert appropriate language conforming to state disbursement procedures; e.g., disbursement from*  
29 *system funds only upon warrants issued by the [state auditor], based upon vouchers signed by the*  
30 [*executive secretary*], or vouchers signed by the [*state treasurer*] for purpose of investment]. No  
31 [warrant] [voucher] shall be drawn on system funds unless the same has been previously authorized by,  
32 or pursuant to, a resolution adopted by the board.

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<sup>4</sup>Ohio Revised Code Annotated, Sec. 742.08.

<sup>5</sup>This subsection should be in conformity with any general statute governing the employment of legal counsel by state agencies and the role, if any, of the attorney-general in such employment.

<sup>6</sup>State will wish to assure consistency between this provision and those of Section 19 concerning investment of system funds.

1 (h) The board shall designate an [outside] [independent] actuary who shall be the technical adviser  
2 to the board on matters regarding the operation of the various funds of the system and who shall  
3 perform such other duties as are required in connection therewith. The performance of the actuary shall  
4 be subject to periodic review by the board [and at intervals no greater than [two] years the question of  
5 retention or change in the board's actuary shall be considered and decided by the board].

6 SECTION 6. *Board of Trustees—Powers.*

7 (a) The board may sue and be sued, contract and be contracted with [*pursuant to state civil*  
8 *service or other personnel statutes*], employ and fix the compensation of an administrator and such  
9 technical, clerical, and administrative employees and assistants as it deems necessary for the proper  
10 administration and management business of the system.

11 (b) The board shall, from time to time, adopt such rules and regulations as it deems necessary for  
12 administering the Public Employee's Retirement System pursuant to [*cite state administrative*  
13 *procedures act, open meetings act, and other appropriate statutes*].

14 [*Any additional or special provisions regarding prior notification of certain kinds of rule changes;*  
15 *delivery and posting of notification to participating public employers and employees.*]

16 (c) The board shall be responsible for all other aspects of administering the retirement system  
17 created by this act; such powers shall include, but not be limited by, the responsibility to

18 (1) keep in convenient form such data as shall be deemed necessary for actuarial valuation  
19 purpose, including but not limited to information required for benefit computation; and age,  
20 employment, service, contribution, compensation and other data for active, inactive, and retired  
21 members and beneficiaries;

22 (2) [from time to time] [at least once every [three] years] through its actuary make an  
23 actuarial investigation into the mortality and service experience of the beneficiaries under this act and  
24 the various accounts created for the purpose of showing the financial status of the funds of the system;

25 (3) adopt for the system the mortality tables and such othe as shall be deemed necessary;

26 (4) certify annually the rate of employee contribution and the amount of appropriation  
27 which each participating local unit of government shall pay into the system in the next fiscal year, with  
28 such certification being at such a time as will provide the local authorities the opportunity to include  
29 such expense in the budget;

30 (5) provide for investment, reinvestment, deposit, and withdrawal of funds;

31 (6) prepare and publish annually a financial statement showing the condition of the system  
32 funds and the various accounts thereof [including the principal amount and annual interest credited  
33 thereto] and furnish a copy to each participating unit of local government and to each employee  
34 member upon request;

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<sup>7</sup>See Oregon Revised Statutes, Sec. 237.263; New Mexico, Statutes Annotated, Sec. 5-5-2(7).

1 (7) make available to any local government considering participation in the system, the  
2 services of the actuary employed by the board for the purpose of ascertaining the probable cost of such  
3 participation with the cost of any such calculation or valuation being paid to the system by the  
4 requesting local government;

5 (8) fix the amount of interest to be credited at a rate which shall be based upon the net  
6 annual earnings of the system's funds for the preceding 12-month period and, from time to time, make  
7 any necessary changes in such rate.

8 (d) No member of the board shall be liable for the negligence, default, or failure of any employee  
9 or of any other member of the the board to perform the duties of his office, and no member of the  
10 board shall be considered or held to be an insurer of the funds or assets of the retirement system but  
11 shall be liable only for his own personal default or individual failure to perform his duties as such  
12 member and to exercise reasonable diligence to provide for the safeguarding of the funds and assets of  
13 the system.<sup>8</sup>

14 [Alternative A]

15 [SECTION 7. *Absorption and Supersession of Existing Systems.*

16 *(Mandatory supersession and absorption as of a given date of existing local government pension systems*  
17 *and funds by the statewide Public Employees' Retirement System.)<sup>9</sup>*

18 (a) As of [insert date], any and all retirement systems and funds established and maintained by  
19 local units of government in this state [, except [list systems and funds if any, to be excluded from  
20 takeover] ] shall be transferred to the system. Subsequent to the effective date of this act, no local unit  
21 of government in this state [list any exceptions] may establish any retirement plan or fund for its  
22 employees except through participation in the system as provided by this act.

23 (b) On [insert takeover date] the assets and liabilities of each local government retirement fund,  
24 established under [cite state enabling statute(s)] or local charter pursuant thereto, shall be transferred to  
25 the system. The value of the assets shall consist of cash, plus any accrued interest on investments, the  
26 par value or unpaid balance of all unmatured or unpaid investments requiring the payment of a fixed  
27 amount at payment date, and the cost price of all other investments. The decision of the board in  
28 determining the value of such assets shall be final.

29 (c) As [inset date] [one year prior to takeover date] the board shall initiate through its actuary a  
30 valuation of each local government system and fund to be superseded. The expense of this valuation  
31 shall be paid by the system. The actuary shall file a report with the board prior to [insert takeover date]  
32 showing the

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<sup>8</sup>Revised Code of Washington Annotated, Sec. 41.44.080. Many states may find it preferable to provide only for the expense of reasonable diligence in safeguarding assets—the “prudent person” theory, and leave the rest to judicial determinations.

<sup>9</sup>This alternative section taken largely from *Ohio Revised Code Annotated*, Chap. 742, “Police and Fireman’s Disability and Pension Fund.”

- 1 (1) general condition of each superseded system;  
2 (2) a valuation of its assets and liabilities; and  
3 (3) the accrued liabilities of the specified system to be payable to the Public Employees'  
4 Retirement System under the time schedule set forth in this act.]

5 [Alternative B]

6 [SECTION 7. *Absorption and Supersession of Existing Systems.*  
7 (*Voluntary merger, absorption, and supersession of existing local government pension systems.*)]<sup>10</sup>

8 (a) Any retirement system established and maintained by a unit of local government in this state  
9 and created prior to [insert date], may continue to operate such system until or unless accepted into the  
10 Public Employees' Retirement System under the terms and conditions set forth in this act. [Subsequent  
11 to same date] no local unit of government [list any exceptions] may establish any retirement plan or  
12 fund for its employees except through participation in the system as provided in this act.

13 (b) The absorption and merger of such existing system shall require, among other conditions all of  
14 the following:

15 (1) approval by a [two-thirds] majority of members of the existing system in an election  
16 conducted by the board;

17 (2) a duly passed resolution of the governing body of the local unit of government under  
18 which the existing system is operating declaring its desire and intent to merge the existing system into  
19 the Public Employees' Retirement System;

20 (3) completion by the actuary employed by the board of a valuation of the assets, liabilities,  
21 and general financial condition of the existing local system, including an estimate of the net accrued  
22 liabilities, if any, of the system that would need to be paid by the public employer to the Public  
23 Employee' Retirement System as a condition of participation;

24 (4) agreement by the public employer to pay to the system, in addition to the specified  
25 regular contribution rate established pursuant to Section 10 of this act, the amount of accrued liability  
26 estimated under subsection (3) above under the terms and time schedule set forth in this act; and

27 (5) approval by the board of an application for participation and membership respectively of  
28 the public employer and its employees.]

29 SECTION 8. *Actuarial Valuation of Systems to be Superseded.*

30 (a) Prior to the [insert takeover date] [submission to the board of an application for participation  
31 and membership]<sup>11</sup> as provided in Section 7 above, the board shall cause its actuary to value the assets  
32 and liabilities of the system being proposed for merger and supersession. The expense of this valuation  
33 shall be paid by the [system] [requesting unit of local government].<sup>11</sup>

<sup>10</sup>This alternative section taken largely from South Dakota, *Compiled Laws Annotated*, Secs. 65-68, *Retirement Act of 1974*.

<sup>11</sup>Depending upon whether consolidation is mandatory or voluntary.

1 (b) The actuary shall compute the present value, as of a special date, of the liabilities on account  
2 of employees in the active service of the employer, and on account of retirants and those receiving other  
3 benefits on the membership rolls of the system being examined.<sup>12</sup> The liability on account of each active  
4 service employee of the employer shall include an amount equal to the present value of such member's  
5 accumulated contributions having been deducted from his salary or wages, in addition to an amount  
6 equal to the present value of the employer's contributions on behalf of such member, were such  
7 contributions to have been made over the past service years of such members. The liability on account  
8 of each retirant or each person receiving other benefits on the rolls of the system being examined shall  
9 be an amount equal to the present value of benefits to be paid in the future of such retirant or such  
10 other person currently receiving benefits;

11 (c) The liabilities on account of all employees in the active service of the employer and the  
12 liabilities on account of all retirants and those receiving other benefits on the rolls of the system being  
13 examined shall be added to such fund. The amount remaining shall be known as the "accrued liability"  
14 of such system, and shall, [if the application for participation and membership is accepted  
15 subsequently,]<sup>13</sup> become the "accrued liability" of that participating public employer.

16 SECTION 9. *Transfer to Board of Rights, Assets, and Liabilities of Superseded Systems.*

17 (a) Upon the transfer to the system of the assets of a superseded system, the board shall be the  
18 successor to the [board of trustees] [other governing body of such superseded system] as to all rights,  
19 interest, and ownership in all of such assets.

20 (b) On the date that the assets and liabilities of a given superseded system are transferred to the  
21 Public Employees' Retirement System, the monies and securities to the credit of such superseded system,  
22 not exceeding an aggregate amount equal to the employer's accrued liability arising from such fund,  
23 shall be transferred to the system. Such assets shall be applied toward the satisfaction of the public  
24 employer's accrued liability arising from such superseded system. If the aggregate amount of money and  
25 securities to the credit of any such superseded system exceeds the public employer's accrued liability  
26 arising from such system, such excess amount shall be credited to such employer [, and to the employees  
27 and retirants of such employer in proportion to the respective accumulated contribution of each].<sup>14</sup>

28 SECTION 10. *Payment of Public Employer's Accrued Liability.*<sup>15</sup>

29 (a) The employer's accrued liability, as determined pursuant to Section 8 above, shall be paid to  
30 the system. Payments shall be credited to the particular employer's fund in the system, until such time

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<sup>12</sup>Some states may prefer to leave the establishment of a uniform measure of accrued liability to the discretion of the actuaries engaged for the consolidation process; others may prefer the kind of statutory specification presented here or some other kind of specific statutory formulation.

<sup>13</sup>Applicable to voluntary consolidation.

<sup>14</sup>Necessary if the superseded system involved employee contributions. In case of a fully funded, joint contributory system being superseded, additional specification may be needed as to the computation of credits and the issuance of any refunds.

<sup>15</sup>Taken from *Ohio Revised Code Annotated*, Sec. 742.30.



1 as the employer's accrued liability on account of retirants and those receiving other benefits on the rolls  
2 of the respective superseded system is satisfied. Thereafter, payments shall be credited to the employer's  
3 fund in the system, until such time as the employer's accrued liability on account of prior deductions  
4 made from the compensation of employees is satisfied. Thereafter, payments shall be credited to the  
5 employer's fund in the system until such time as the employer's total accrued liability is satisfied.

6 (b) That part of the employer's accrued liability remaining unpaid [as of [30 days] following the  
7 effective date of participation in the system] shall be paid by the employer at not less than the following  
8 rates per year: [2%] in [current year], [2%] in [year following current year], [3%] [following year], [4%]  
9 in [following year], [5%] per annum beginning in following year], and each year thereafter for [*insert*  
10 *proper number of years depending on length of time allowed and interest rate to be charged*] years.

11 Payments shall be fixed annually and paid on dates fixed by the board.<sup>16</sup>

12 (c) Each employer shall promptly pay the amount due on the accrued liability on the dates fixed  
13 by the board. Upon certification by the board that payment of an employer's accrued liability has not  
14 been paid within [30] days following the date a payment is due, a penalty of [7%] of the amount due  
15 shall be assessed against such employer. If the payment and penalty have not been paid within [90] days  
16 following the date a payment is due, annual interest at [8%] shall be assessed against the payment and  
17 penalty from the date that the payment is due.

18 (d) Upon certification by the board of the [*state fiscal officer*] of an amount due from any  
19 employer by reason of such employer's delinquency in making payments on the accrued liability, the  
20 amount due shall be withheld from the employer from [state aid or other entitlements] to be distributed  
21 to the employer. Upon receipt of the certification from the board, the [*state fiscal officer*] shall issue a  
22 [warrant] against such funds in favor of the system for the certified amount due and any penalty and  
23 interest thereon.

24 (e) As a part of its [annual] report to the Governor and the [*legislature*] as required in Section 20  
25 of this act, the board shall include information as to progress in liquidating the accrued liabilities of  
26 public employers and make such recommendations, upon the advice of its actuary, as it deems necessary  
27 for the proper funding of such liabilities.

#### 28 SECTION 11. *Public Employer Contributions.*<sup>17</sup>

29 (a) Each employer shall pay [quarterly] on such dates as the board shall require, from the [general  
30 fund] of the public employer an amount certified by the secretary of the board, which shall be a certain  
31 per cent of the compensation of each member employee. The rate of such contribution shall be fixed by  
32 [the board on the basis of periodic actuarial valuations conducted as provided in this act] [the

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<sup>16</sup>Many states may prefer to require the liquidation of accrued liabilities at a level, rather than varied rate.

<sup>17</sup>Taken from *Ohio Revised Code Annotated*, Sec. 742.32.

1 [legislature], after taking into account the recommendation of the board]. [A rate of contribution  
2 established by the board shall become effective at the end of a [insert number] day period during which  
3 the [legislature] is in session unless the [legislature] has proceeded by legislative act to establish a  
4 different rate.]

5 (b) Each public employer shall pay its employer's contribution promptly after such amount is  
6 certified by the secretary of the board. [Ninety] days after such a billing is submitted, any amounts  
7 which remain unpaid are subject to a penalty for late payment in the amount of [7%]. In addition,  
8 interest on past due accounts and penalties may be charged at the rate of [8%] per annum.

9 SECTION 12. *Employee Contributions.*<sup>18</sup>

10 *(Alternate approaches to adjusting contributions to the actuarial requirements of the new system are*  
11 *provided in the two subsections (a) below. The first, probably most appropriate when a small number of*  
12 *superseded systems are involved, deals with a homogeneous group of personnel (e.g., uniformed or other*  
13 *special class). Based on actuarial requirements, the new contributions are notched up or down from the*  
14 *preceding contribution rate. In the second alternative, "normal" employee contributions are set on the*  
15 *basis of what is necessary to achieve a specified level of benefits. In turn, public employer contributions*  
16 *as provided in Section 11 are keyed to the same actuarial base. If a legislative review of board*  
17 *determinations of such "normal" rates are desired as in Section 11—then appropriate language should*  
18 *be inserted).*

19 [Alternative A]<sup>19</sup>

20 (a) From the date that the assets of a superseded section are transferred to the system,  
21 as provided in Section 9 of this act, each employee who previously contributed an amount equal  
22 to [insert percent] of his salary or wage to a superseded system shall contribute an amount equal to  
23 [insert percent] of his salary or wage to the system. *[Insert additional contribution changes needed to*  
24 *meet actuarial requirements of the consolidated system.]*

25 [Alternative B]<sup>20</sup>

26 [(a) (1) The normal rates of contributions of members shall be based on sex and age at  
27 time of entry into the system, which age shall be the age at the birthday nearest the date of such  
28 entry. *[Insert additional language as benchmarks for normal retirement age, normal length of service,*  
29 *and ratio of benefit amount to final compensation.] [Insert additional contribution changes needed to*  
30 *meet actuarial requirements of the consolidated system.]*

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<sup>18</sup>This section assumes the system to be contributory for both employer and employees. The section would not be required in a noncontributory system.

<sup>19</sup>From *Ohio Revised Code Annotated*, 742.32.

<sup>20</sup>From *Revised Code of Washington Annotated*, 41.44.130.

<sup>21</sup>The question of contribution or benefit differentiation on the basis of sex as related to longer life expectancy of females has come under judicial scrutiny. See *City of Los Angeles vs. Manhart*, No. 76-1810 (1978), in which the Supreme Court held that such a differentiation was precluded by the provisions of the Title VII of the *Civil Rights Act of 1964*.

1           (2) The normal rates of contribution for general personnel shall be so fixed as to provide an  
2 annuity which, together with the contribution provided by the public employer shall produce as nearly  
3 as may be, a retirement allowance at the age of [62] [65] years, of [one and two thirds] [other] percent  
4 of the final compensation multiplied by the number of years of service of the retiring employee.<sup>22</sup>

5           (3) (a) The normal rates of contribution for uniformed personnel shall be so fixed as to  
6 provide an annuity which, together with the contribution provided by the public employer, shall  
7 produce as nearly as may be, a retirement allowance at the age of [50] [55] years after [25] years of  
8 service, of [2%] of the final compensation multiplied by the number of years of service of the retiring  
9 employee.]

10           (b) Subject to the provisons of this act, the board shall adopt rules and regulations governing the  
11 making of deductions from the compensation of employees and shall certify to the proper officials of  
12 each public employer the normal rate or rates of contribution for each member or categories of  
13 members provided for in subsection (a) of this section. Such officials shall apply such rate or rates to  
14 the full compensation of uniformed personnel and general personnel and shall certify to the board on  
15 each and every payroll the total amount to be contributed and shall furnish immediately to the board a  
16 copy of each and every payroll; and each of said amounts shall be forwarded immediately to the board  
17 and the board shall credit the deduction shown on such payroll to individual accounts of the members  
18 represented on such payrolls.

19           (c) The contribution deduction shall be made notwithstanding any minimum compensation  
20 provided by law.<sup>23</sup>

21           (d) Every member shall be deemed to consent and agree to the contribution made and provided  
22 for herein, and shall receive it in full for his salary or compensation. Payment less said contributions  
23 shall be a full and complete discharge of all claims and demands whatsoever for the service rendered by  
24 such person during the period covered by such payment, except his claim to the benefits to which he  
25 maybe entitled under the provisions of this act.

26           (e) Any member may elect to contribute in excess of the contributions provided for in this section  
27 in accordance with rules to be established by the board for the purpose of providing additional benefits,  
28 but the exercise of this privilege shall not place on the participating public employer any additional  
29 financial obligation. The board shall have authority to fix the rate of interest to be paid or allowed  
30 upon the additional contributions and, from time to time, make any necessary changes in said rate.  
31 Refunds of additional contributions shall be governed by the same rules as those covering normal  
32 contributions unless the board shall establish separate rules therefor.

33           (f) Following the date of transfer of the assets of a superseded system, the fiscal officer of the

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<sup>22</sup>This formulation on the average would provide 50% of gross pay after 30 years' service and 75% to 80% combined with Social Security.

<sup>23</sup>Needed only if a minimum salary rate or schedule stated in dollars per time period for any classes of employees covered by new system has been established by statute (e.g., teachers, policemen, etc.).

1 public employer shall transmit promptly to the secretary of the board a report of member deductions at  
2 such intervals and in such form as the board requires. Such reports shall show all deductions for the  
3 system made pursuant to this act and shall be accompanied by [warrants] checks covering the total of  
4 such deductions. The secretary of the board, after making a record of all such receipts and crediting  
5 each member's individual account with the amount deducted from his salary, shall deposit them with the  
6 [state treasurer] for use as provided by Section 19 of this act. Where a public employer fails or refuses  
7 to deduct contributions for any member and to transmit such amounts to the system, the board may  
8 make a determination of the employee's liability for contributions and certify to the employer the  
9 amounts due for collection in the same manner and subject to the same penalties as payments due the  
10 system from employer's contributions.

11 SECTION 13. *Transitional State Contribution.*<sup>24</sup>

12 (a) It is the intent of the [legislature] of the State of [insert state] to provide improved retirement  
13 security for [members] [already retired members] of the superseded system being consolidated in the  
14 Public Employees' Retirement System by this act and to assist in providing the financial resources  
15 necessary to pay for such improvements.<sup>25</sup>

16 (b) The [state treasurer] [chief state fiscal officer] shall pay in [January] [insert year] and in each  
17 [January] thereafter ending with the payment in [January] [insert year] from appropriations made for such  
18 purposes, to system [insert number] dollars, which shall be known as the "Transitional State Contribution."  
19 Upon receipt of such state contribution, the board shall place it in the [fund] of the system. The [legislature]  
20 shall appropriate sufficient funds to provide for such transitional state contributions.

21 SECTION 14. *Benefit Liabilities and Payments.*<sup>26</sup>

22 (a) The board shall adopt rules for the management of system funds and for the disbursement of  
23 benefits as set forth in this section.

24 (b) Nothing in this act, nor any action taken pursuant to it, shall reduce or impair the benefits of  
25 employees, who are receiving benefits from, or who are within, [five] years of retirement, in a retirement  
26 system superseded by this system.<sup>27</sup>

27 (c) Persons who were receiving benefit payments from a superseded system at the time the assets  
28 of such system were transferred to the system, as provided in Section 8 of this act, shall receive benefit

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<sup>24</sup>For use in those cases where the state elects to make one or more special payments into the consolidated system in order to (a) provide time and a cash supplement to allow necessary fiscal and actuarial planning, (b) mitigate hardship situations involving substantially increased contributions or reduced future benefits in order to meet actuarial requirements of the consolidated system, or (c) provide added inducement to separate system governing bodies or members to come voluntarily into the consolidated system or to acquiesce in a mandatory consolidation as provided in Section 6(a).

<sup>25</sup>1974 South Dakota Session Laws, Chap. 35.

<sup>26</sup>From Ohio Revised Code Annotated, Chap. 742.

<sup>27</sup>This is a key section with basic policy and legal overtones. The legal question is the time at which a specified benefit amount or level becomes a contractual right, if such a right exists at anytime, immune to decrease through legislative or administrative action; is it the date of retirement, a date somewhere in the later phase of active service, completion of probationary period, or entry dating? Court decisions on this question vary from state to state.

1 payments from the system in the same amount and subject to the same conditions as such payments  
2 were being made from such superseded system on the date of such transfer.

3 *(The foregoing subsections (b) and (c) maintain the status quo benefit-wise for present retirants of, or*  
4 *those nearing retirement from, superseded systems. The legislature might wish to provide some benefit*  
5 *supplementation financed through a state contribution as outlined in Section 12 or provide that any*  
6 *future adjustment in retirement allowances, such as cost of living increases, apply equally to retirants*  
7 *whose benefits are fixed under the former rules of superseded systems.)*

8 (d) A member of a superseded system, upon transfer of assets from such system to the Public  
9 Employees' Retirement System becomes a member of the later system and henceforth eligible for  
10 benefits under the terms and conditions set forth in this section.

11 *(Under this wording, employees, in contrast to retirants, are not held harmless from some future benefit*  
12 *impairment as a result of coming into the consolidated system. While, in general as a practical matter,*  
13 *the benefit structure under the new system would be expected to equal or exceed that prevailing under*  
14 *all or most of the superseded systems, there could well be individual cases or groups of cases where*  
15 *certain features of the new benefit structure would be less preferable from the employees' point of view.*  
16 *In the case of a voluntary consolidation, employees elect by a specified majority to come into the*  
17 *system, but the adversely affected employees probably would be a small minority of those voting.*

18 *The legislature might wish to provide other categories of personnel to be "held harmless" in*  
19 *addition to those provided in subsection (b). So long as the cost of such a hold harmless provision can*  
20 *be calculated with reasonable accuracy and so long as that cost can be apportioned with reasonable*  
21 *equity among the responsible participating employers on the one hand and the system as a whole on the*  
22 *other, their inclusion serves the objectives of system consolidation, actuarial soundness, and individual*  
23 *fairness.)*

24 (e) Basic benefit formulas, terms and conditions [*(listed by title; full language not provided;*  
25 *benefit design considerations listed here are not all inclusive.)*]

26 (1) Retirement for service,

27 (i) compulsory retirement age if any,

28 (A) general personnel,

29 (B) uniformed personnel,

30 (C) other personnel classes,

31 (ii) minimum age (60, 62, etc.),

32 (iii) years of service and vesting requirements,

33 (A) vesting period (e.g., 1, 3, 5, 10 years) all personnel,

34 (B) years of service—general,

35 (C) years of service—uniformed.

1                   (2) *Calculation of retirement allowance,*

2                   (i) *definition of "final compensation" (high 5, 3, etc.),*

3                   (ii) *percentage multiplier (e.g. 1, 1-1/2, 1-2/3, 2,) times, years of service times final*  
4 *compensation,*

5                   (A) *general personnel,*

6                   (B) *uniformed personnel,*

7                   (C) *teacher and other personnel,*

8                   (iii) *penalty in percentage points for each year below, minimum age for early*  
9 *nondisability retirement,*

10                  (iv) *ceiling [80%] of final year(s) of compensation.*

11                  (3) *Disability retirement qualification (may be differentiated throughout as between*  
12 *uniformed and general personnel),*

13                  (i) *required years of service,*

14                  (ii) *examination procedure,*

15                         (A) *severity: total, partial, whether or not in line of duty,*

16                         (B) *scope: for job held, for any comparable job, for any job,*

17                         (C) *periodic re-examination subsequent to retirement as to fitness for return to*  
18 *duty; age ceiling for re-examination,*

19                         (D) *interrelationship with veterans and other disability categories, workmen's*  
20 *compensation, etc.*

21                  (4) *Disability retirement allowance.*

22                         (i) *percent of final compensation—differentiated or not as to length of service,*

23                         (ii) *ceiling in relation to final compensation.*

24                  (5) *Re-entry into service,*

25                         (i) *from regular retirement,*

26                         (ii) *from disability.*

27                  (6) *Death and survivor benefits,*

28                         (i) *employees; death in line of duty,*

29                         (ii) *retirants,*

30                         (iii) *retirement allowance options relating allowance to extent of survivor benefits.*

31                  (7) *Retirement allowance payments,*

32                         (i) *frequency (monthly, other),*

33                         (ii) *cost of living adjustments,*

34                         (iii) *immunity from legal process,*

35                         [(iv) *entitlements of divorced spouses,]*

- 1                   (v) *waiver of retirement rights or amounts,*  
2                   (vi) *enforcement of benefit rights through action in mandamus,*  
3                   (vii) *reduction or adjustment of retirement allowances because of dual benefits.]*

4           SECTION 15. *Prior Service and Creditable Service.*<sup>28</sup>

5           (a) Each member of the system shall receive membership service credit for all service rendered  
6 since he became a member or since he last became a member in the event of a break in his membership  
7 on account of which contributions are made by the member.

8           In addition, each member who, on the day preceding the date of transfer of assets provided in  
9 Section 9 above, shall have been a member of a superseded system shall receive prior service credit for  
10 all service with which he shall have been credited under the provisions of any superseded system as of  
11 the day preceding the date of asset transfer. Any such member shall be entitled to receive credit for any  
12 service prior to the date of asset transfer provided that he makes application therefor to the board on a  
13 form prescribed by the board. As soon as practicable, the board shall issue to each member entitled to  
14 prior service credit a certificate certifying the aggregate length of service rendered prior to the date of  
15 asset transfer. Such certificate shall be final and conclusive as to prior service, unless hereafter modified  
16 by the board, upon application of the member.

17           [(b) Any member of the Public Employee Retirement System who served in a position covered by  
18 a superseded system but who elected not to join said system, and who has remained in employment with  
19 a participating public employer continuously since his period of nonelection shall now be able to claim  
20 all prior service upon proper documentation as required by the board provided said member does not  
21 have credit for such service in any other public employee retirement system. Such member shall pay to  
22 the system in a lump sum an amount equal to the amount he would have contributed had he been a  
23 member of the system, plus [6%] interest per annum.]<sup>29</sup>

24           (c) Creditable service at retirement on which the retirement allowance of a member shall be based  
25 shall consist of his membership service plus any prior service creditable to him pursuant to subsection(s)  
26 (a) [and (b)] of this section. The board shall fix and determine by appropriate rules and regulations how  
27 much service in any year is equivalent to a year of service, but in no case shall more than [one] year of  
28 service be creditable for all service in [one] calendar year, nor shall the board allow credit as service for  
29 any period of more than [one] month's duration during which the member was absent without pay,  
30 except as hereinafter provided. Creditable service for service as a part-time employee shall be based on  
31 an actual percentage of time the individual worked as compared to the work schedule of a regular full-  
32 time employee.

33           [(d) Upon retirement, any member who is a general or uniformed employee of any public

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<sup>28</sup>Taken largely from *Tennessee Code Annotated*, Chap. 39, "Consolidated Retirement System."

<sup>29</sup>Needed only if any categories of elective instead of mandatory membership existed in any of the superseded systems.

1 employer and who has unused accumulated sick leave shall be credited with such accrued leave as  
2 creditable service; provided, however, that the employer shall certify on a form prescribed by the board  
3 the number of those accumulated sick leave days to the credit of such member at the time of his  
4 retirement for which member has not received compensation; the employer shall certify that the accrued  
5 sick leave claimed is substantiated by agency records compiled during the course of employment for  
6 which the leave was earned [and not from records compiled solely for purposes of establishing  
7 retirement credit]. Each [20] days of accumulated sick leave shall equal a month, or any time less than  
8 [20] days, a fractional part thereof.]

9 [(e) Any member who left service with a public employer after completing any required  
10 probationary period, in order to perform military duty in the armed forces of the United States, and  
11 who is relieved or discharged from such duty under conditions other than dishonorable, and is  
12 reemployed by a public employer within [six] months after he is relieved of military duty shall have the  
13 option to establish retirement credit for military service in the armed forces of the United States, not to  
14 exceed an aggregate of [four] years; provided, however, any person receiving retirement credit in any  
15 other retirement system for his military service shall not be allowed to claim military service under this  
16 system established by this act, nor shall any member be allowed to establish credit for military service  
17 until the member has accrued full vested service.

18 [If the period of military service in the armed forces of the United States was during a period of  
19 armed conflict as defined by the board, such service shall be credited without charge to the member.]  
20 Any [other] member establishing military service shall make the employee contributions he would have  
21 made had he remained in service at his last earnable compensation during his absence for military  
22 service. Any member shall have [*insert time period*] to make application for retirement credit under this  
23 subsection. Credit may be granted conditionally upon the member completing the required vesting  
24 period. Prior to vesting, retirement credit for military service may not be used in determining any rights  
25 under this act.]

26 [(f) Subject to the approval of the board of trustees, any member who is on leave of absence from  
27 service for any purpose which might tend to increase the efficiency of the member to his employer may  
28 make monthly contributions to the retirement system on the basis of his earnable compensation in effect  
29 immediately prior to the commencement of such leave of absence and any such period for which he  
30 makes contributions shall be included in his creditable service.]

31 [(g) Any member who is a teacher who renders a year of service but who is paid other than on a 12-  
32 month basis is to receive credit equivalent to [a full year] of service. Any member who is employed by a  
33 local or state district educational agency or institution and renders a school year of service but who is  
34 paid other than on a 12-month basis is to receive credit equivalent to a [a full year] of service. Any  
35 membership service and prior service for such member shall be adjusted to provide creditable service



1 equivalent to [a full year] of service for each year in which he rendered such service. Any funds needed  
2 to meet the costs of the benefits provided herein shall be paid by the public employer.]

3 SECTION 16. *Supplemental Contributions and Benefits.*

4 In order to correct identified inequities attending the consolidation and absorption of superseded  
5 system provided under this act, a participating public employer is hereby authorized to propose, and the  
6 board is authorized to accept a plan for supplemental contributions or benefits to be paid to its present  
7 or future retirants provided:

8 (a) such supplemental contributions are paid to, and such supplemental benefits are paid from, the  
9 system, with a full accounting maintained thereof,

10 (b) supplemental benefits and attendant administrative costs to the system are borne in full by the  
11 public employer; and

12 (c) such supplemental benefits do not exceed [10%] of the retirement allowance authorized and  
13 payable under Section 14 of this act.

14 SECTION 17. *Transfer Among Participating Public Employers.*<sup>30</sup>

15 No transfer following the effective date of this act by a member of the system from the service of  
16 one participating public employer to another such employer shall impair any rights or deprive the  
17 member of any credits accruing to him as a result of his membership and prior to such transfer.

18 SECTION 18. *Termination, Withdrawal of Contributions.*

19 *(The following are standard provisions in most public employee retirement systems and for purposes of*  
20 *brevity are shown here in outline form.)*

21 *[(a) Separation—if not vested,*

22 *(1) absence from service of more than [insert number] years,*

23 *(2) withdrawal of contributions—with or without interest.*

24 *(b) Separation—if vested,*

25 *(1) annuity of actuarial equivalent of accumulated contributions and interest,*

26 *(2) retirement allowance at retirement age but reduced on basis of actual service,*

27 *(3) additional prior service pension,*

28 *(4) withdrawal of contributions, with or without contributions.<sup>31</sup>*

29 *(c) Re-entry to service after withdrawal of contributions,*

30 *(1) restoration of [full] retirement rights upon payment of withdrawn amount [plus*  
31 *accumulated interest].]*

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<sup>30</sup>For transfer of retirement rights among participating and nonparticipating public employers within the state, see suggested legislation, ACIR, *State Legislative Program*, Vol. 4, 4.203, "Transferability of Public Employee Retirement Rights," 1975, p. 9. To the extent that the number of systems is decreased through consolidation, the problem of intrastate reciprocity is lessened commensurately.

<sup>31</sup>States may wish to provide partial retirement rights based only on employers' contribution for vested employees who withdraw their own contributions.

1           SECTION 19. *Investment of System Funds.*

2   *(Section (a) is presented in two alternate versions. First, where an already existing state agency handles*  
3 *investment of system funds in accord with existing statutory and policy guidelines and, second, where*  
4 *the board would invest according to guidelines established in this act.)*

5           [(a) The [state investment council or other board or agency charged with investing other state  
6 funds] shall be responsible for the investment of the assets of the system. The [council, board, or  
7 agency] is hereby authorized to pool the several funds of the system for investment purposes.]

8           [(a) The board may invest system funds in any bonds, notes, certificates of indebtedness, mortgage  
9 notes, stocks, shares, debentures, or other obligations or securities described below: [(1), (2), (3). etc., list  
10 types of investments to be authorized].

11           [(b) Delivery, custody safekeeping of securities [insert desired provisions].

12           (c) [Provisions for inclusion of data on investment holdings, income, acquisitions, dispositions,  
13 and other pertinent items in system's report to the Governor and legislature specified in Section 20  
14 below.]

15           (d) If any of the assets transferred to the Public Employees' Retirement System from superseded  
16 systems as provided in Section 9 of this act comprise securities or other types of investment not  
17 authorized [in alternate subsection (a) above] [under the policies and regulations of the state investment  
18 council, board or agency] the board shall; over time and in accordance with prudent investment practice  
19 and market conditions, endeavor through dispositions and acquisitions to reduce the extent of such  
20 holdings. The board shall include information as to progress in this matter in its periodic reports to the  
21 Governor and [legislature] provided herein.

22           SECTION 20. *[Annual] Report.*

23           During [January] of [each] year, beginning [January], [19   ], the board shall submit a report to  
24 the governor, the [legislature,] [participating public employers,] and [upon request] [employees],  
25 [employee representatives,] and [retirees of the system] as to the general condition of the [insert state]  
26 Public Employees' Retirement System. Such report shall be written in layman's language to facilitate  
27 comprehension by all involved parties. Such report shall be available to the public and shall include, but  
28 not be limited to the following;

29           (a) An actuarial valuation of the system, including

30                   (1) the latest actuarial valuations of the individual local government accounts within the  
31 system;

32                   (2) demonstration of the relationship of the current member and employer contributions,  
33 expressed as a percentage of payroll, to the actuarial requirement;

34                   (3) the current year's funding ratio as well as the ratios from the prior actuarial valuation;

35                   (4) a finding as to the extent to which contribution rates held steady at the current level will

1 pay all promised benefits when due over the indefinite future; and

2 (5) a finding as to extent to which current system assets are sufficient to cover respectively:  
3 employee contributions on deposits, future benefits to present retirants, and future benefits to former  
4 employees with vested benefit rights.

5 (b) Status of accrued liabilities of public employers arising from superseded systems.

6 (c) Investment holdings and income, including holdings in unauthorized investment types acquired  
7 from superseded systems.

8 (d) Recommendations for executive and legislative action.

9 SECTION 21. *Separability.* [*Insert separability clause.*]

10 SECTION 22. *Effective Date.* [*Insert effective date.*]

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## 4.202 State Standards, Review, and Assistance Regarding Local Retirement Systems<sup>1</sup>

State and local governments confront a growing need to assure sound management of their retirement systems and other fringe benefit packages. In this era of expanding collective bargaining in the public sector and a growing citizen concern about rising taxes and expenditures, the public must be assured of sound management practices regarding long-range fiscal commitments. Many existing retirement systems are paying the price for the lack of sound management practices in the past and, as indicated in studies of financial emergencies, may be faced with overwhelming prior commitments which impede the ability of the government to respond to present concerns. The proposed legislation would place the state government in the picture not only to monitor local programs but also to provide assistance whenever necessary.<sup>2</sup>

According to the 1972 *Census of Governments*, state and local governments employed, at that time, about 11 million persons (state, 3.0; county, 1.3; city, 2.4; township, 0.3; school districts, 3.6; and other special districts, 0.3). As of October 1972, only 2.1% of full-time state and local employees were reported as without retirement coverage of any kind;

<sup>1</sup>Derived from Advisory Commission on Intergovernmental Relations, *Transferability of Public Employee Retirement Rights Among Units of Government*, A-16, March 1963, and *City Financial Emergencies: The Intergovernmental Dimension*, A-42, Washington, DC, U.S. Government Printing Office, July 1973.

<sup>2</sup>See also the legislation on *Establishment of a Consolidated State-Administered Pension System; State Intervention in Local Government Financial Emergencies; and Improved and Standardized Accounting, Auditing, and Reporting*.

7.6% were covered only by social security; 73.5% were covered by a state or locally administered retirement system; 13.7% were unreported.<sup>3</sup>

In fiscal year 1971-72, there were 8.4 million state-local employees listed as current contributors to 2,304 separate state-local retirement systems. Of these, 176 were state-administered systems embracing 6.9 million of the contributing members and 2,128 locally administered systems embracing the other 1.5 million. Of the 2,128 locally administered systems, 534 were general coverage; of the special coverage systems, 1,275 were for police and firemen. A great many of the locally administered systems are extremely small. Of the 1,818 municipal systems, for example, 1,308 had less than 100 members.<sup>4</sup> Many of these small systems present serious problems of fiscal and actuarial soundness and constitute difficult barriers to employee mobility in transferring from one public employer to another.

The dual role of state supervision and assistance proposed in the following model legislation follows action taken in several states. The central instrument for state activity is a continuing pension system review board, commission, or agency, divorced from responsibilities for retirement system administration. Illinois and Wisconsin have had state pension commissions since 1945, and more recently Massachusetts, Minnesota, New York, Ohio, and Washington

<sup>3</sup>1972 *Census of Governments, Topical Studies*, Vol. 6, No. 1, *Employee Retirement Systems of State and Local Governments*, December 1973, pp. 1-5.

<sup>4</sup>*Ibid.*, p. 11

have established such bodies. Michigan and Pennsylvania considered such legislation in 1977-78, and the suggested legislation that follows was drawn partially from the Michigan bill.

*Section 1* states the title of the act.

*Section 2* sets forth the findings and purpose of the legislation.

*Section 3* defines certain terms.

*Section 4* establishes a state pension review commission, consisting of seven members appointed by the Governor for staggered terms.

*Section 5* sets forth the powers and duties of the commission including technical assistance to local pension systems, maintenance of information con-

cerning the condition of retirement systems in the state, periodic reports to the Governor and legislature, and mandatory review and comment on proposed changes in state or local systems.

*Section 6* mandates a periodic actuarial review of each local system, specifies the nature and scope of the review, and provides for submission of the review to the Commission.

*Section 7* provides optional methods of obtaining a summary of the fiscal impact of any proposed changes in benefits of a local or state retirement system.

*Section 8 and 9* provide for separability and effective date clauses, respectively.

## Suggested Legislation

# [AN ACT TO PROVIDE FOR STATE STANDARDS, REVIEW, AND ASSISTANCE IN LOCAL RETIREMENT SYSTEMS]

(Be it enacted, etc.)

1 SECTION 1. *Short Title.* This act may be cited as the “[State] Public Pension Review Act.”

2 SECTION 2. *Findings and Purpose.* The [legislature] finds a need to:

3 (a) ascertain the actuarial and fiscal condition of the various public employee retirement systems  
4 in the state in order that the solvency of such systems may be buttressed and assured, in the interests  
5 alike of active and retired employees and taxpayers;

6 (b) provide for periodic public reports on the actuarial status of these systems; and

7 (c) establish procedures whereby significant changes in the level of benefits or in other fiscally  
8 sensitive features of retirement systems are subjected to an actuarial review to be submitted, as appro-  
9 priate, to the [legislature], retirement system [board of trustees], local government governing body  
10 and the general public prior to the effectuation of such fiscal changes.

11 SECTION 3. *Definitions.* As used in this act:

12 (a) “[Commission]” means the [state pension review commission] created by Section 4 of  
13 this act.

14 (b) “Employee” means a full-time employee of an agency or unit of local government in this state  
15 [and shall further include certain temporary employees who are on loan from another agency]. [If  
16 the [state retirement system] is to be treated in the legislation, the definition should be modified to em-  
17 brace state employees].

18 (c) “Person” means a natural person, partnership, public or private corporation, or other legal  
19 entity.

20 (d) “Unit of local government” means any county, municipality, school district, or special district of  
21 the state, or any agency or subdivision thereof [and shall further include any nonprofit organization  
22 providing services which are paid in excess of 50 percent by public money through a state, federal, or  
23 local government appropriation or grant].<sup>1</sup>

24 SECTION 4. [Pension Review Commission] [Commission on Retirement System Review and  
25 Standards].

26 (a) A [state pension review commission] is created within the [state fiscal agency] [depart-  
27 ment of administration] [other].

28 (b) The [commission] shall consist of [seven] members appointed by the Governor [by and

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<sup>1</sup>This option would provide for coverage of certain semipublic agencies such as nonprofit community mental health centers.

1 with the consent of the [*Senate*]]. One of the members shall be designated by the Governor as chair-  
2 person. At least [two] of the members shall be experienced in the fields of pensions, investments, ac-  
3 tual science, or pension law but must not be an active or retired member of any public employee re-  
4 tirement system. [One] member shall have experience in the field of [governmental finance]. [One  
5 member shall be an active member of a public employee retirement system in this state. One member  
6 shall be a retired member of a public employee retirement system in this state.]

7 (c) Members of the [*commission*] shall serve without compensation, but shall be entitled to rea-  
8 sonable and necessary expenses incurred in performance of their duties.

9 (d) Members shall serve a term of [five] years, except that the terms of the initial members shall  
10 be as follows: [three] shall be appointed for [three] years, [two] shall be appointed for [four]  
11 years, and [two] shall be appointed for [five] years. Members shall serve until their successors are  
12 appointed and qualified. A vacancy on the [*commission*] occurring other than by expiration of a term  
13 shall be filled in the same manner as the original appointment and for the unexpired portion of the term  
14 only.

15 (e) The [*commission*] shall meet at the call of the [*chairperson*] but not less than [six] times  
16 annually.

17 SECTION 5. *Powers and Duties of the [Commission]*<sup>2</sup>. In addition to the authority granted in  
18 other sections of this act, the [*commission*] shall have the following powers and duties:

19 (a) Gather, catalog, and maintain complete information on all public employee retirement plans  
20 in the state, based upon a review of audits, reports, and other data pertaining to these plans.

21 (b) Receive and comment upon all actuarial evaluations of pension systems maintained by units of  
22 local government conducted pursuant to Section 6 of this act.

23 (c) Conduct studies of income after retirement, disability and death benefits, and social security  
24 benefits; and other retirement needs of public employees. The [*commission*] shall formulate princi-  
25 ples and objectives related thereto and recommend new legislation, policies, or methods in the field of  
26 public employee retirement in the state.

27 (d) Maintain a continuing review of all state and local retirement plans and recommend changes  
28 and amendments in the plans, coordination of benefits of the plans, and appropriate financing methods  
29 to appropriate state or local authorities. The final decision as to such changes shall continue to rest  
30 with bodies currently charged with such decisions under state law and local ordinance.

31 (e) At the request of the [*board of trustees*] of an individual retirement system or on its own initi-  
32 ation, review proposed amendments to existing retirement plans and the establishment of new or revised  
33 retirement systems and other proposals concerning public employee retirement policy. The [*commis-*

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<sup>2</sup>The list of powers and duties is quite comprehensive; many states will wish to assign selected, rather than the total amalgam of respon-  
sibilities to the review, technical assistance, or regulatory body.

1     *sion*] shall prepare written evaluations of these proposals and transmit them to the [*appropriate*  
2     *authority or agency*].

3           (f) Cooperate with the various state and local pension boards on matters of mutual concern and  
4     provide technical assistance to local units of government in the assessment and revision of their retire-  
5     ment systems.

6           (g) Study the advantages and disadvantages of consolidating or integrating smaller local retirement  
7     systems into one or more statewide and state-administered systems and the steps necessary in such con-  
8     solidations.

9           (h) Study the relationship of public retirement and pension policy to other aspects of public per-  
10    sonnel policy and to the effective operation of government generally.

11          (i) Issue an annual report to the [*legislature*] and to the Governor citing its activities, findings,  
12    and recommendations. The report shall be made public. The [*commission*] may include proposed  
13    legislation to carry out its recommendations.

14          (j) Authority to appoint an [*executive director*] and other employees, engage consultants, and  
15    retain actuaries as needed, prescribe their duties, and fix their compensation within the amount ap-  
16    propriated for the [*commission*] and in accordance with [*cite state personnel act*].

17          (k) Authority to adopt reasonable rules of operation and procedure pursuant to [*insert citation*  
18    *to state administrative procedures act*].

19          (l) Subpoena witnesses, review books and records, hold public or private hearings, and take tes-  
20    timony. A witness summoned to a hearing shall have the right to be accompanied by counsel, who shall  
21    be permitted to advise the witness of his rights, subject to reasonable limitations to prevent obstruction  
22    of, or interference with, the orderly conduct of the hearing.

23           SECTION 6. *Actuarial Evaluations of Local Retirement Systems.*

24          (a) Beginning [January 1, 19—] and prior to [January 1] each [year] [three years] there-  
25    after, the [*chairman or secretary*] of the [*board of trustees*] of each local retirement system or oth-  
26    er person charged with the administration of such retirement systems shall file with the [*commission*]  
27    an actuarial evaluation of the system conducted by a [competent] [licensed] [meeting professional  
28    standards promulgated by the [*commission*]] [professionally qualified] actuary familiar with  
29    retirement systems and containing the following information and such other information as the local  
30    board deems pertinent or which the [*commission*] may require:<sup>3</sup>

31           (1) adequacy of employer and employee contribution rates in meeting levels of employee bene-  
32    fits provided in the system and changes, if any, needed in such rates to achieve or preserve a level of  
33    funding deemed adequate under actuarial standards adopted by the [*commission*] to enable payment

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<sup>3</sup>For a description of actuarial evaluations, see Municipal Finance Officers Association, *Public Employee Retirement Administration*, 1977, Chapter 9.



1 through the indefinite future of benefit amounts prescribed by the system being evaluated:

2 (2) valuation of present and prospective assets and liabilities of the system and the extent of un-  
3 funded accrued liabilities; and

4 (3) steps, if any, required to reduce unfunded liabilities to a level deemed adequate under ac-  
5 tuarial standards adopted by the [commission] or to otherwise strengthen the condition of the system.

6 (b) Upon receipt of such evaluation, the [commission] shall consider the sensitivity of the eval-  
7 uation to actuarial assumptions used and the appropriateness of those assumptions.

8 (c) Beginning [insert date] and thereafter, each [board of trustees] of a retirement system  
9 maintained by a unit of local government shall ensure the maintenance, in an accurate and accessible  
10 form, the following data required for the actuarial evaluation specified in subsection (a) above:

11 (1) for each active and inactive member of the system, a number or other means of identifica-  
12 tion, date of birth, sex, date of employment, period of credited service [split, if required between  
13 prior service and current service], and occupational classification;

14 (2) for each active member, in addition, current pay rate, cumulative contributions [together  
15 with accumulated interest, if credited], age at entry into system, and current rate of contribution;

16 (3) for each inactive member, in addition, final average salary or equivalent, and age at which  
17 deferred benefit is to begin; and

18 (4) for each retired member and other beneficiary, a number or other means of identification of  
19 birth, sex, beginning date of benefit, type of retirement (e.g. regular, disability, etc.), type and amount  
20 of monthly benefit, and type of survivor benefit.

## 21 SECTION 7. *Changes in Benefits.*

22 (a) No local government shall agree to a proposed change in retirement or associated benefits,  
23 through collective bargaining or otherwise, unless the [board of trustees] of the system, prior to  
24 adoption by the governing body, and prior to the last public hearing thereon, shall have issued a state-  
25 ment of the actuarial impact of the proposed change upon the retirement system. [The [admini-  
26 strator] of the [state retirement system] shall also issue a statement of the actuarial impact of any  
27 proposed change in the [state retirement system] on those units of local government participating  
28 in the state program.] These statements shall include, but not be limited to, an estimate of the cost of  
29 such change for each of the next [five] annual budgets of the jurisdiction and the expected method of fi-  
30 nancing such incremental costs through increased employer or employee contributions, or other means.

31 (b) Effective [insert date], any ordinance or amendment making an actuarially significant change  
32 to a retirement plan administered by a local unit of government shall not be considered until a written  
33 report on the proposed ordinance or amendment has been prepared by the [commission]. The report  
34 shall contain a comprehensive analysis of the effects of the ordinance or amendment including, but not  
35 limited to, an estimate of the cost of such change for each of the next [five] annual budgets of the

1 local unit of government and alternative methods of financing such incremental costs through increased  
2 employer or employee contributions, or other means. The [commission] shall make its report within  
3 [30] days after it receives the proposed ordinance or amendment. No such report shall be required  
4 where the local unit of government has adopted a procedure pursuant to subsection (a) of this section  
5 whereby a detailed estimate of the costs of proposed ordinances or amendments to local retirement  
6 plans is prepared by a qualified actuary and made public.

7 (c) A bill, or amendment to a bill, creating or modifying any state, local, or other public employee  
8 retirement system in the state shall not be considered by [either house of the legislature] until a written  
9 report on the bill or amendment has been prepared by the [commission]. The report shall contain a  
10 comprehensive analysis of the effects of the bill including, but not limited to, an estimate of the cost of  
11 such change for each of the next [five annual] budgets of the affected units of government and alterna-  
12 tive methods of financing such incremental costs through increased employer or employee contributions,  
13 or other means. The [commission] shall make this report within [30] days after it receives the bill  
14 or within [days] in the case of a further amendment.<sup>4</sup>

15 SECTION 8. *Separability*. [Insert separability clause.]

16 SECTION 9. *Effective Date*. [Insert effective date.]

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<sup>4</sup>An upward change in benefits mandated by the state legislature upon local retirement systems should provide cost reimbursement by the state. See ACIR, suggested legislation on *State Mandates*.







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The Advisory Commission on Intergovernmental Relations (ACIR) was created by the Congress in 1959 to monitor the operation of the American federal system and to recommend improvements. ACIR is a permanent national bipartisan body representing the executive and legislative branches of Federal, state, and local government and the public.

The Commission is composed of 26 members—nine representing the Federal government, 14 representing state and local government, and three representing the public. The President appoints 20—three private citizens and three Federal executive officials directly and four governors, three state legislators, four mayors, and three elected county officials from states nominated by the National Governors' Association, the National Conference of State Legislatures, the National League of Cities/U.S. Conference of Mayors, and the National Association of Counties. The three Senators are chosen by the President of the Senate and the three Congressmen by the Speaker of the House.

Each Commission member serves a two year term and may be reappointed.

As a continuing body, the Commission approaches its work by addressing itself to specific issues and problems, the resolution of which would produce improved cooperation among the levels of government and more effective functioning of the federal system. In addition to dealing with the all important functional and structural relationships among the various governments, the Commission has also extensively studied critical stresses currently being placed on traditional governmental taxing practices. One of the long range efforts of the Commission has been to seek ways to improve Federal, state, and local governmental taxing practices and policies to achieve equitable allocation of resources, increased efficiency in collection and administration, and reduced compliance burdens upon the taxpayers.

Studies undertaken by the Commission have dealt with subjects as diverse as transportation and as specific as state taxation of out-of-state depositories; as wide ranging as substate regionalism to the more specialized issue of local revenue diversification. In selecting items for the work program, the Commission considers the relative importance and urgency of the problem, its manageability from the point of view of finances and staff available to ACIR and the extent to which the Commission can make a fruitful contribution toward the solution of the problem.

After selecting specific intergovernmental issues for investigation, ACIR follows a multistep procedure that assures review and comment by representatives of all points of view, all affected levels of government, technical experts, and interested groups. The Commission then debates each issue and formulates its policy position. Commission findings and recommendations are published and draft bills and executive orders developed to assist in implementing ACIR policies.