TO: General Assembly

FROM: James H. Douglas, State Treasurer

RE: Inclusion of State Firefighters in Group C of the Vermont State Retirement System

DATE: January 15, 2001

Introduction

Section 28a of Act 150 enacted during the 2000 session directed the State Treasurer to report to the General Assembly the impact on the funds of the Vermont State Retirement System if firefighters currently employed by the State of Vermont have the option of being included in Group C of the System.

Background

There are currently 22 airport firefighters employed by the State Military Department. The firefighters belong to the Group F plan of the Vermont State Retirement System. The Group F plan is a contributory retirement plan that requires 30 years of service to reach the maximum benefit equal to one-half of the member's average highest three consecutive years of earnings. Mandatory contributions representing 3.35% of gross salary are withheld from each member's salary. Normal retirement is age 62 or 30 years of service, whichever comes first. Upon retirement, the member may elect between six payment options, four of which provide for a reduced benefit in order to provide a continued benefit to a designated beneficiary should the member predecease him or her.

Cost-of-living adjustments after retirement are equal to one-half of the Consumer Price Index for the prior June 30 with a minimum of 1% and a maximum of 5%. If a member becomes disabled while actively employed, the member receives a monthly benefit representing a minimum of 25% of his or her average final compensation or his or her accrued benefit with no early retirement reduction applied.

The benefit structure of the Group C plan is considerably more generous. The Group C plan requires 20 years of service to reach the maximum benefit equal to one-half of the member's average highest two consecutive years of earnings, which includes payment for all unused annual, compensatory time and personal leaves at retirement. The Group C plan mandates that members retire at no later than age 55, but allows members with 20 or more years of service to retire as early as age 50 with no early retirement reduction applied. An automatic 70% spousal survivorship option is built into the plan, thereby eliminating the necessity of the member receiving a reduced benefit to protect the income for a spouse. Cost-of-living adjustments after retirement are equal to the full amount of the Consumer Price Index for the prior June 30, with a minimum of 1% and a maximum of 5%. If a Group C member becomes disabled while actively employed, the member may apply for a disability benefit. If approved, in addition to the member's disability pension representing a minimum of 25% of his or her average final compensation or his or her accrued benefit with no early retirement reduction applied, the System would pay up to three concurrent benefits equal to 10% of the member's average final compensation on behalf of each dependent child, or dependent student up to the age of 23. Mandatory contributions representing 6.28% of gross salary are withheld from each Group C member.

Actuarial Review and Conclusions

The 22 firefighters currently employed by the State of Vermont were identified and their pertinent employment data was provided to the System's actuary. The actuary provided a cost analysis based on the assumption that the members would have the opportunity to be included in the Group C plan.

The actuary reported that if all of the targeted employees had been included in Group C, instead of Group F, in the valuation recently completed for the period ending June 30, 2000, the present value of future required contributions to the System would have been raised by $2.07 million. This cost reflects the liability for future Group C service only, and does not assume any increase in the value of previously accrued Group F service. If the additional liability were covered entirely by higher future State normal contributions, the normal cost percentage rate developed in the 2000 valuation report would have been 1.42% instead of 1.34%, and the projected State contribution to the System for the fiscal year ending on June 30, 2001, would have been increased by approximately $213,000. If the increase in costs were covered by increased contributions from the 22 affected individuals only, the resulting increase in their employee contributions would be substantial - approximately 22.05%.

The above costs assume that all of the 22 firefighters would elect to transfer into the Group C plan, and would accrue benefits at the Group C rate for all future service. The value of the previously accrued Group F service would not increase except that it would be applied toward the higher two-year average final compensation of the Group C plan. The actuary confirmed that, although the total liability would be less if fewer than the full 22 firefighters elected to transfer to the Group C plan, the additional liability per individual would increase, based on the potential for adverse selection.

The actuary also confirmed that the ability for members of defined benefit plans to select the level of benefits they desire is highly unusual and potentially problematic. In order to maintain low volatility of recommended funding levels over the life of a defined benefit plan, it is critical to be able to predict with some degree of stability the demographics of the members covered by the plans. If members were given the opportunity to elect between plans, the actuary would be unable to predict with any degree of accuracy what the future liabilities might be.

Although this study is targeted toward a population of 22 employees, if they were granted the ability to elect between retirement plans, a precedent would be set for other specialized groups to request the same consideration. The Treasurer’s Office is concerned about the proverbial “slippery slope,” and is adamantly opposed to providing an option, as opposed to a mandate, to enroll in the Group C plan.

<u>Funding the Additional Costs with Federal Funds</u>

There has been some discussion regarding the possibility of the employer, in this case, the Military Department, picking up the total cost of allowing the 22 firefighters to be included in the Group C plan. The rationale behind this discussion is to avoid any additional State liability, as the firefighters' compensation is paid with federal funds. Although this approach seems reasonable on the surface, there are several concerns it raises for the Treasurer’s Office.

The first concern is an administrative issue. Under the current funding mechanism, the State as a whole is considered the “employer.” All State contributions to the Vermont State Retirement System flow through the individual departments as a single percentage of salary for all employees, regardless of the plan to which they belong. The actuary calculates the recommended State contribution to the System as a total liability, without distinguishing among plans. It would be difficult and impractical to separate the annual liability for 22 employees out of a population of over 7,000 and provide a different employer rate for them.

The second concern is with setting a precedent that, again, may lead us down a “slippery slope.” There are numerous State agencies that receive federal funds. To allow employees of one State agency that receives federal funds to receive a higher retirement benefit will set a precedent that may be difficult to distinguish when other employees request the same consideration. For the reasons stated above, it would result in an impossible administrative burden for the System.

A third concern is fairness. All State employees should be treated equally in terms of benefits afforded to them, regardless of where the money comes from to pay for the benefits. Retirement benefits, through individual group plans, have been appropriately designed to recognize specific employment features. It would be unfair to provide a higher group plan to employees based on the availability of federal funds to pay for the additional liability.

Recommendations:

- If the State's firefighters are included in Group C membership, inclusion must be mandatory, not optional.
- Federal funds should not be used to pay the cost associated with this option.