MainePERS
PUBLIC EMPLOYEES RETIREMENT SYSTEM

9-11-19 Golub Center for Finance and Policy
Retirement Finance: Policies for a Better Path Forward

MainePERS Mission and Services

Our mission is to serve the public with sound retirement services to Maine governments.

We administer defined benefit plans for the State of Maine that are provided in lieu of Social Security.

We administer *optional* defined benefit plans for Maine Local Governments, and provide these employers with a set of supplemental defined contribution plans that we call MaineSTART.

Dilemma

What could possibly go wrong in an optional multiple-employer cost-sharing defined benefit retirement plan?

Short-term investment returns *DO* matter – you might not make it to long-term

May 2016

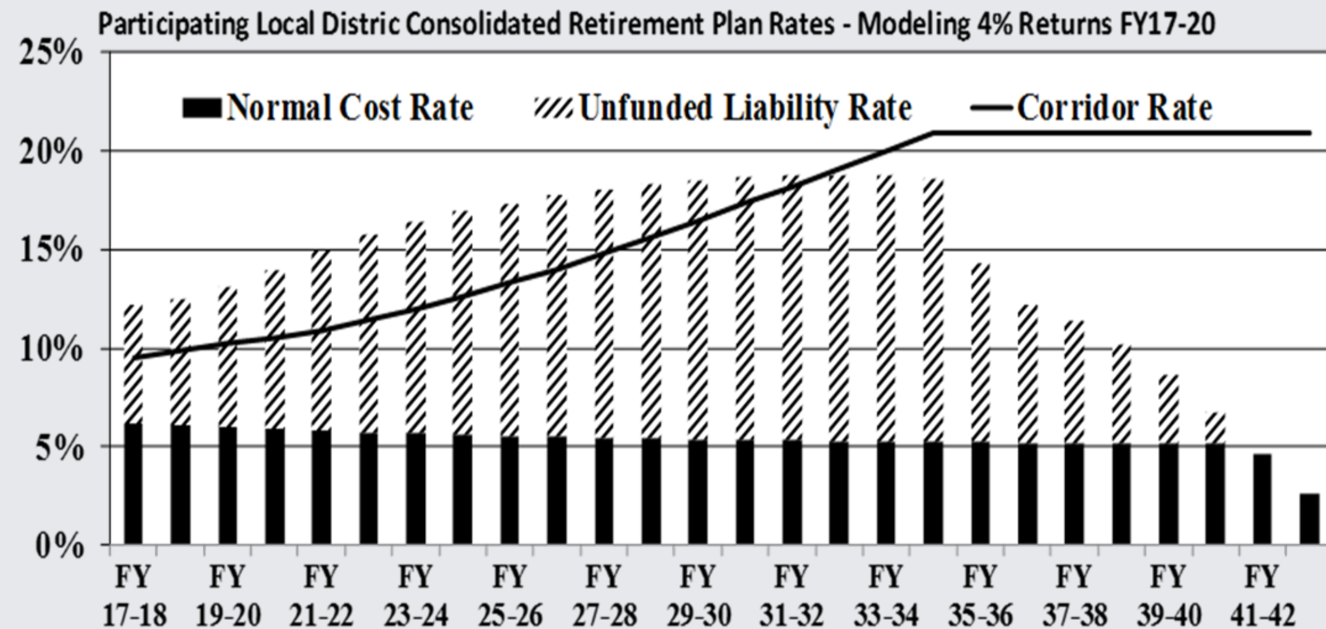
2 Years of low investment returns

- FY 2015 – 2%
- FY 2016 – 0.6%

Speculation

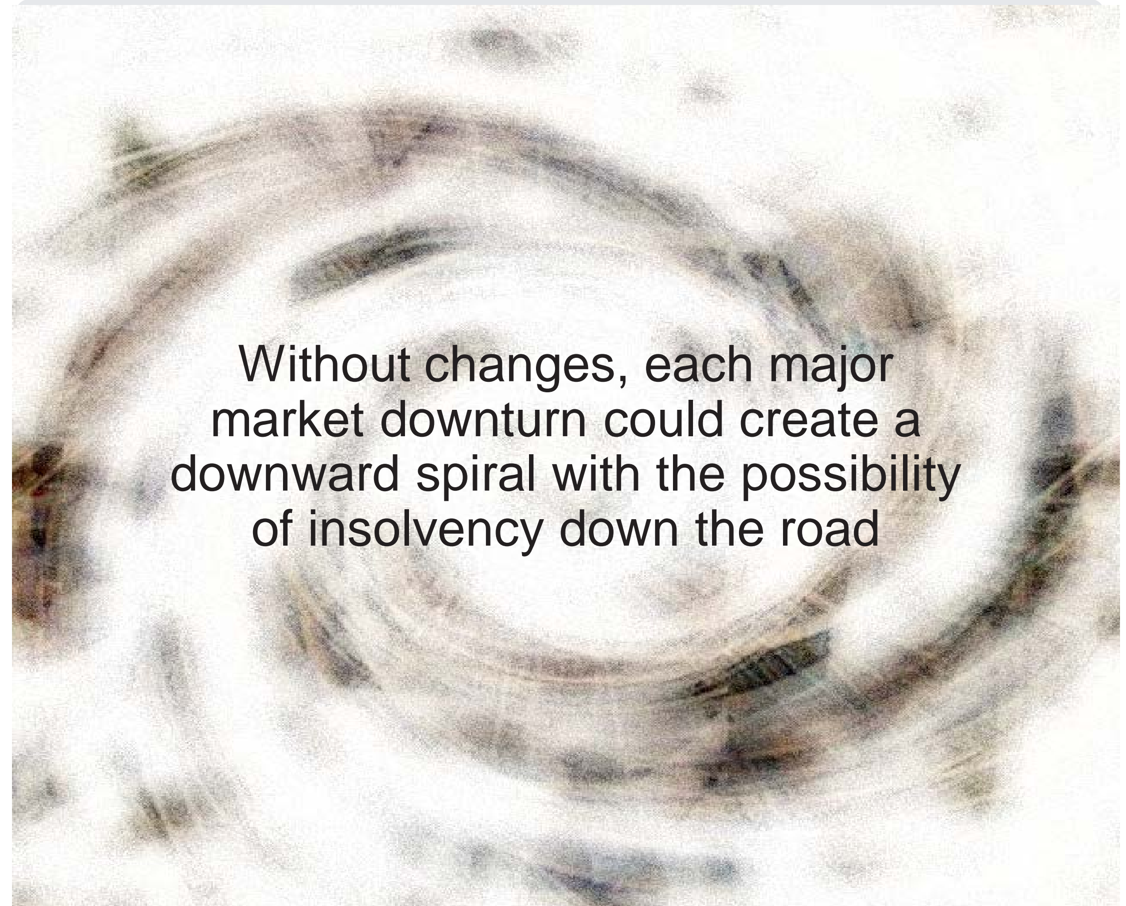
- Next 4 years – 4%
- Following 6 years – climbing up to 7% or 8%

Modeling this scenario showed employer contribution rates continuously increasing



What else mattered in this multiple-employer cost-sharing pension plan?

- Employers - Local governments with modest budgets and optional membership
- Discount Rate - 6.875% (now 6.75%)
- Funding – Struggling to recover
  - Dropped from 108% in 2008 to 87% in 2014 due to employer rate holiday through 2009 compounded by the Great Recession
  - Benefit cuts in 2014 temporarily restored funding to 90%
  - Funding continued to drop to 86% in 2016 as graduated employer rate increases did not yet fully cover the UAL payment
- Employer withdrawal liability - None



Besides panic, what could be done?

Traditional Approach	Known Downsides
• Freeze or reduce COLA	• Permanent loss of buying power
• Raise employer contribution rates for each market downturn	• If employers withdraw a "last employer standing" situation is created and plan failure is more likely
• Raise employee contribution rates in market downturns	• Cost to employees becomes greater than benefit value
• Reduce future benefits	• Employees only share in downside risk
• Restart cycle waiting for next significant downturn	• Can't invest out of underfunding

What did we actually do?

We set goals

- Pay each member their basic benefit throughout their life

Final average salary X years X multiplier

- Pay 100% of required annual contributions without rate uncertainty
  - Know ahead of time how market downturns will be handled

We broke the cycle

- Understand the cause of the risk each party to the pension faces

Members	Employers
Retirees	Taxpayers

- Redistribute the same risk in a different way that mitigates damage and makes the risks acceptable
- Assure that 100% of the required annual funding is paid

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New Risk Framework Adopted in 2018

Pay every member their basic retirement benefit throughout their life.

- Part 1 – Contribution Rates
  - Both employers and employees will share in market losses *and* gains through variable, not fixed, contribution rates
  - Rate maximums and minimums are established for both groups
- Part 2 – Benefits
  - Some discretionary benefit enhancements that no longer make sense and are weighing on plan costs were reduced
- Part 3 – COLA
  - When required contributions exceed rate caps for employers and employees, excess required contributions are collected by phasing into and reducing the COLA, allowing market recovery to phase back in and restore full COLA eligibility
- Part 4 – Withdrawal liability
  - Employers pay for their UAL upon withdrawal

How does the design mitigate risks?

Employers	Employees	Retirees	Funding
Rate certainty removes fear of continuous/endless increases which allows employers to budget for their range of required contributions. Employers are less likely to drop out.	Employees can have confidence their benefit will be there in retirement without further benefit reductions. Employees can share in the upside market risk through lower rates.	Benefit will grow throughout retirement with possible temporary reductions, but the COLA is unlikely to be frozen or permanently reduced absent extreme market losses.	Full contributions occur automatically as required contributions in excess of the employer and employee caps are phased into future COLAs and phased out as markets recover.

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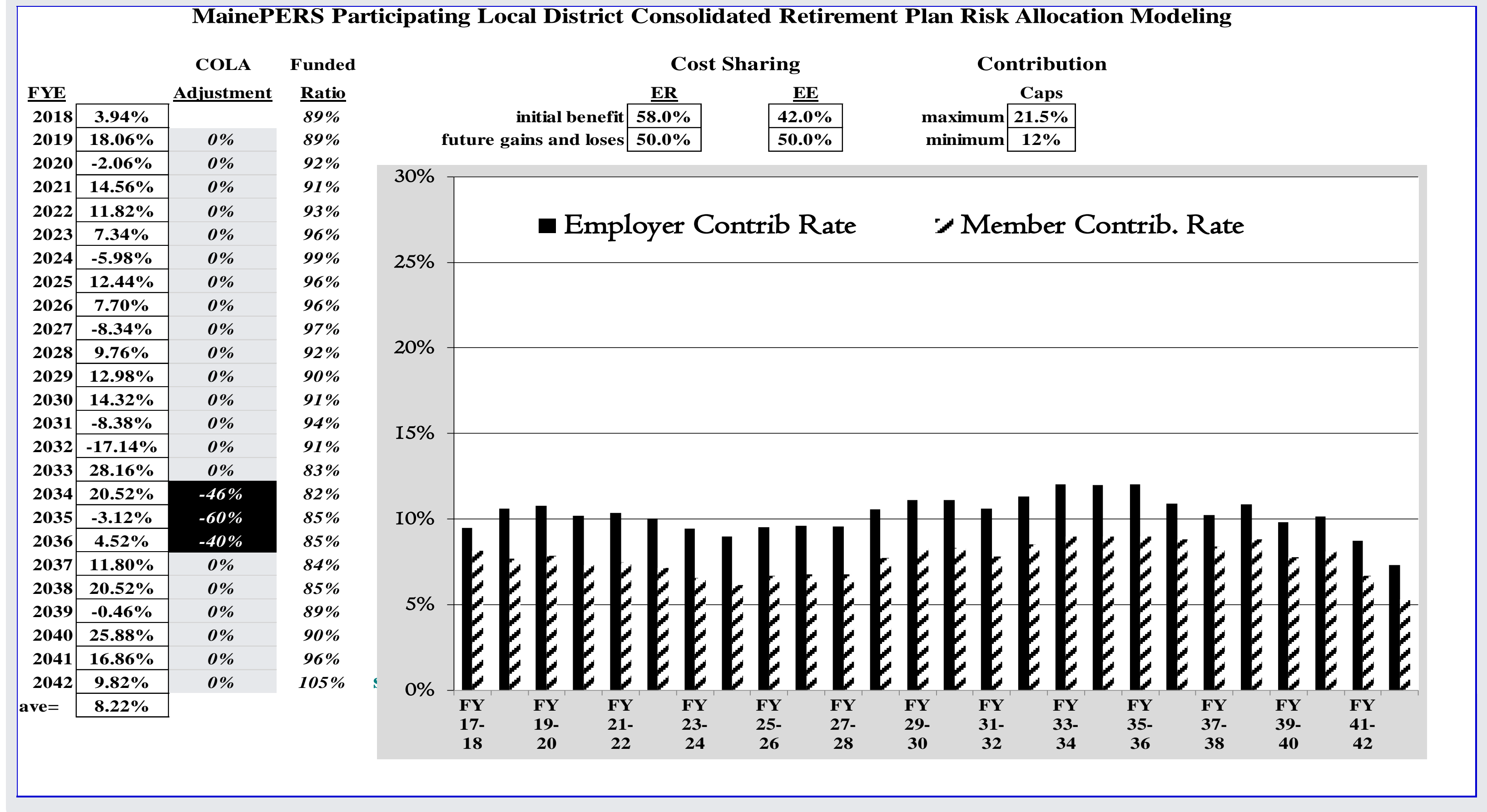
Modeling outcomes using historic returns

Extensive modeling showed that contribution rates can stay within the minimums and maximums using auto-trigger COLA reductions



MainePERS Participating Local District Consolidated Retirement Plan Risk Allocation Modeling

FYE		COLA Adjustment	Funded Ratio
2018	3.94%		89%
2019	18.06%	0%	89%
2020	-2.06%	0%	92%
2021	14.56%	0%	91%
2022	11.82%	0%	93%
2023	7.34%	0%	96%
2024	-5.98%	0%	99%
2025	12.44%	0%	96%
2026	7.70%	0%	96%
2027	-8.34%	0%	97%
2028	9.76%	0%	92%
2029	12.98%	0%	90%
2030	14.32%	0%	91%
2031	-8.38%	0%	94%
2032	-17.14%	0%	91%
2033	28.16%	0%	83%
2034	20.52%	-46%	82%
2035	-3.12%	-60%	85%
2036	4.52%	-40%	85%
2037	11.80%	0%	84%
2038	20.52%	0%	85%
2039	-0.46%	0%	89%
2040	25.88%	0%	90%
2041	16.86%	0%	96%
2042	9.82%	0%	105%
ave=	8.22%		

Cost Sharing	ER	EE
initial benefit	58.0%	42.0%
future gains and loses	50.0%	50.0%

Contribution Caps	
maximum	21.5%
minimum	12%

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How did we obtain buy-in to the changes?

- We worked as a team with our employers, members and retirees
- We educated each group first on the challenges pension plans are facing, then showed how the plan changes address each risk to keep the plan funded and there for them in retirement
- We listened to feedback and incorporated it whenever it made sense, never comprising our goal of paying every benefit throughout everyone's life
- We were sincere in our commitment to saving the benefit and gained trust that we were doing what is in stakeholders’ best interest

Samples from Outreach to Stakeholders

Retirement Plan Landscape
Longevity/Mortality

- Current census data shows people who reach age 65 will live on average to age 84
- Why is this a challenge for defined benefit plans?
  - Because the plan must pay all members for their additional years in retirement
  - If everyone on average lives two years longer, the plan must fund those additional years
  - This leads to increased contributions

Prepared by MainePERS as of 6/20/2018

Retirement Plan Landscape
Financial Market Challenges

- Financial market ups and downs create volatile contributions
- Funding levels are re-calculated every year – extreme losses can impact contributions immediately
- Long-term lower market returns also create funding challenges
  - Extended low interest rate environment

Prepared by MainePERS as of 6/20/2018

MainePERS Long-Term Fiscal Year Investment Returns Net of Fees

	Market Value (in millions)	1 Year	2 Year	3 Year	5 Year	10 Year	15 Year	20 Year	25 Year	30 Year
FY17	$13,385	12.5%	6.4%	4.9%	8.4%	4.9%	7.0%	6.3%	7.8%	7.9%
FY16	$12,283	0.6%	1.3%	6.2%	6.0%	5.2%	5.6%	6.6%	7.8%	7.9%
FY15	$12,610	2.0%	9.1%	9.8%	10.2%	5.9%	5.0%	7.4%	8.1%	8.7%
FY14	$12,732	16.7%	13.9%	9.3%	12.1%	6.9%	5.5%	8.1%	8.4%	9.5%
FY13	$11,264	11.1%	5.7%	11.0%	4.3%					
FY12	$10,470	0.6%	11.0%	11.0%	1.5%					
FY11	$10,739	22.4%	16.6%	3.4%	4.4%					
FY10	$8,934	11.1%	-5.0%	-4.4%	1.8%					
FY09	$8,291	-18.8%	-11.3%	-3.0%	1.9%					
FY08	$10,538	-3.2%	6.1%	6.5%	9.5%					
FY07	$11,031	16.2%	11.7%	11.8%	11.4%					
FY05	$9,558	7.5%	9.6%	11.9%	6.4%					
FY06	$9,559	7.5%	9.6%	11.9%	6.4%					
FY05	$8,921	11.8%	14.2%	11.1%	3.2%					
FY04	$8,021	16.6%	10.8%	4.3%	2.8%					

Remaining Changes Under Consideration
What Changed Next to Bring Us to Today?

Economics & Demographics

- *Economic* – The average S&P return from
  - 2001 to 2016 was 8.3%
  - Contribution rates increased
  - US funding went from 102% to 72%
  - Benefits like COLAs, multipliers going forward and others were reduced
- *Demographic* – Workforce Aged
  - Members were increasingly concerned about living longer and having enough money to do so and pay for increasing healthcare costs
  - Employers were increasingly concerned about filling positions

Economics & Demographics

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Lessons Learned

- Knowing how you are going to handle market fluctuations in advance can help you design a plan that protects benefits and funding
- Being realistic about what benefits the plan can and can't afford to provide is critical in creating a benefit that can be maintained without constant reductions and heartache
- Members and employers can understand and accept plan changes when they are fully explained and those changes are clearly in their best interest
- Remove the word "can't" and replace it with "how can we"
- Making plan changes is a lot of hard work but can be the very best thing you can do for your members
- Risk-sharing does not necessarily mean negative risk-shifting