PUBLIC PENSIONS

A LEGISLATOR'S GUIDE

THE NCSL WORKING GROUP ON PENSIONS
OF THE
FISCAL, OVERSIGHT AND INTERGOVERNMENTAL
AFFAIRS COMMITTEE

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The National Conference of State Legislatures serves the legislators and staffs of the nation's 50 states, its commonwealths, and territories. NCSL was created in January 1975 from the merger of three organizations that served or represented state legislatures. NCSL is a bipartisan organization with three objectives:

- To improve the quality and effectiveness of state legislatures,
- To foster interstate communication and cooperation,
- To ensure states a strong, cohesive voice in the federal system.

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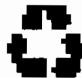

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PREFACE

This publication is a comprehensive revision of NCSL's 1985 publication, *Public Pensions: A Legislator's Guide*. The revision has been directed by a Pensions Working Group drawn from the Fiscal, Intergovernmental Affairs and Oversight Committee of NCSL, the successor to the Fiscal Affairs and Oversight and the Pensions Committees. Representative John Bragg of Tennessee has served as chair of the Pensions Working Group, and Representative Daniel Troy of Ohio has acted as chair in the absence of Representative Bragg. Representative Bragg also was the original chair of NCSL's former Task Force on Public Pensions, whose work on the issue in the early 1980s led to the original version of *Public Pensions*.

State retirement systems were in a state of crisis in the early 1980s when NCSL first organized its Task Force on Public Pensions. Since then, pensions management has been one of the great success stories of state government. Almost every state retirement system is soundly funded with provision made for the funding of existing accrued unfunded liabilities. Investment practices have been modernized to allow pensions funds to diversify investments away from traditional bonds. Employee benefits have been broadened and made more responsive to individual employee circumstances. The legislators who composed NCSL's Task Force and later its Committee on Pensions deserve credit for their contribution to this improvement, through the sound and restrained advice offered legislators in the first edition of this publication.

This update of a publication that has seen widespread use is intended primarily as an educational tool. It identifies major issues in legislative oversight of public pensions systems, and alerts legislators to controversial or difficult points. Its intent is not so much to specify one single approach to a very complicated area of public policy, but to remind experienced legislators and show new ones the issues that surround the most important topics related to public pensions. This report repeats the four fundamental principles of public pension policy as they were stated in the 1986 edition. It largely repeats the policy recommendations made by the NCSL Pensions Committee in 1986, with changes that seemed appropriate in light of the passage of time and of changing focuses of public policy.

The NCSL Working Group on Pensions hopes that this report is as serviceable for the next 10 years as the first version has been over the past 10 years.

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I. Principles of Pension Policy

This chapter discusses four basic principles of public pension policy to help legislators design appropriate pension plans:

1. Pensions should provide financial security in retirement.
2. Pension funding should be a contemporary obligation.
3. Pension investments should be governed by the Prudent Person Rule.
4. Pension benefits should be equitably allocated among beneficiaries.

These principles provide a general framework for choosing among numerous and often conflicting proposals for change. They do not, however, define an ideal pension plan in terms of benefits, vesting, contributions, investment policy, and so on. Since needs and attitudes vary from state to state, legislators should define and design a pension strategy to satisfy the particular needs of their state.

In doing so, legislators who adhere to the four principles will be able to construct a system that is equitable to both public employees and taxpayers. Consistently applying these principles will produce good pension policy and will help answer the following important questions:

- What purpose should pensions serve?
- Who should fund public pensions?
- What standards should govern investment of pension assets?
- How should pension benefits be allocated among beneficiaries?

One point is fundamental to the principles stated above. The laws governing state and local governmental pension plans generally provide a contractual right to plan participants guaranteeing that a pension, either current or future, will not be impaired or diminished. This guarantee is variously conferred by constitutions, statutes and judicial decisions. Whatever its source and scope in a particular state, legislators should be mindful that any revisions of pension occur within a framework of guarantees, and that they have only a limited power to affect past decisions. Likewise, they should be careful about binding future legislatures by their own decisions.

Pensions should provide financial security in retirement.

Pensions represent income that is deferred during a person's working life in order to provide income after retirement. State governments have, generally speaking, two goals in providing pensions: to provide retirement income and to retain and reward long-term employees. In general, state governments proportion retirement income to past earnings and length of service rather than to some specific measure of adequacy. They tend, however to provide pensions of some minimum amount for people who retired long ago. In states where employers and employees are not required to contribute to Social Security, they tend to make higher contributions to state retirement programs in order to fund somewhat higher state retirement system benefits.

The phrase *in retirement* means at the completion of a working career, not at the end of employment. The appropriate retirement age may vary according to occupation. In recent years, many retirement systems have lowered retirement ages and provided a variety of options to allow members more flexibility in retirement planning. These changes are popular with employees, but they can add to the long-term cost of financing benefits, and legislators should review actuarial estimates of the increased costs before deciding on such changes. For public safety and similar occupations that may demand a lower retirement age or that may place physical stress on older employees, the option of a "transition benefit" for those changing careers in mid-life may be worth considering. Pensions paid at the end of employment but before the normal retirement age should be actuarially reduced. If no reduction is made, then extra funding must be provided to ensure a financially sound system.

The term *financial security* should be viewed in terms of a floor of benefits; in terms of a commitment from the pension sponsor that the income will continue as promised; and in terms of career employment. Using length of service and final compensation as the principal factors in setting a retirement benefit is an expression of this principle.

Pension funding should be a contemporary obligation.

Pension funding should be the obligation of public employers, employees and people receiving the services provided by public employees at the time those services are provided. Unfortunately, the political setting in which benefits are determined works against this important principle. Most affected groups see the advantages in the process that allows public employees to seek benefits, politicians to grant them, and taxpayers to acquiesce, while deferring the problems of funding public pensions to a future generation of taxpayers. The cost of government employees' compensation should not be deferred in any way to future taxpayers.

The often-used phrase "pay as you go" in pension funding is misleading to employees, legislators and taxpayers alike. Such systems are actually "pay after you go" systems where all funding of pension costs comes after

the employee's service is completed and the pension is earned. "Pay as you go" funding --which is very rare in public plans--is antithetical to the proposition that pension funding is a contemporary obligation.

In addition, in defined benefit plans (the most common kind of state plan) the state maintains a responsibility--which some would call moral, some political and some legal--to fund the future retirement benefits it has promised.

Over the past 15 years, state governments have made great and often unheralded progress in securing the long-term interests of employees in their pensions. In 1992, state and local plans on average held assets equal to 85 percent of their accrued unfunded liabilities, up from an average of 51 percent in 1978, according to a measure commonly used by the systems themselves. Generally, public plans are committed to amortizing the remainder of the accrued unfunded liability over a period of 25 years or less. Pension professionals disagree on whether 100 percent funding is a necessary goal for public plans, as it is for private plans, since governments (unlike corporations) will not go out of business. There is no universally recognized criterion for establishing the appropriate level of reserve. State legislators, to their credit, have generally reacted to that uncertainty by putting more, not less, funding into pensions reserves over the past 15 years. One important private analyst of public pensions, Wilshire Associates of Santa Monica, California, has contended for some years that many state retirement funds are substantially overfunded as a result of unduly conservative actuarial assumptions and measurements of assets.1

Pension investments should be governed by the Prudent Person Rule.

Every state now uses the Prudent Person Rule or one of its variants such as the ERISA Prudent Investor Rule as the foundation of its pension investment practices. First stated in 1830, the Prudent Person Rule is well understood, has ample case history, and is flexible enough to adjust to modern investment strategies. The investment standard established by the following language of the Massachusetts Supreme Judicial Court has withstood the test of time:

> All that can be required of a trustee to invest, is, that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds considering the probable income as well as the probable safety of the capital to be invested.2

It is understandable that Congress chose nearly identical language to describe the standard of care for fiduciaries under the Employment Retirement Income Security Act of 1974 (ERISA), known as the "Prudent Investor Rule" which is stated as follows:

> The care, skill, prudence and diligence are to be measured in circumstances then prevailing according to how a prudent person in a like capacity and familiar with such matters would act in the conduct of an enterprise of like character and with like aim.

The ERISA standard also expressly includes the requirement clearly implied by the Massachusetts court that the fiduciary discharge his or her duties solely in the interest of the participants and beneficiaries.

These variants of the same principle establish a standard of care by which the actions of investment authorities are judged and require that standard to be applied to the factual situation as it was understood at the time, not through hindsight. It also requires knowledgeable, cautious investment, emphasizing "prudence, discretion and intelligence" while prohibiting speculation. In addition, it emphasizes the joint aims of protecting capital and maximizing investment income, requiring a balance of the two.

These rules provide an answer as to how pension capital should be invested. The Prudent Person Rule has survived the changing economic circumstances of the last 150 years, and the ERISA rule has been used for 20 years. They do not severely limit the form of the investment, and their language is clear and widely recognized. All 50 states now employ one of these rules in some form to define the fiduciary responsibility of public pension investment authorities.

Pension benefits should be equitably allocated among beneficiaries.

State and local governments are doing a good job in providing pension coverage for their employees. Nearly all full-time employees are covered, and in addition a growing number of governments provide health benefits to retired employees. Thus state and local governments have gone far toward meeting the call for equitable benefits that the original version of this *Legislator's Guide* called for.

Some issues of equity remain. Legislators should eliminate retirement provisions that unreasonably differentiate among groups of employees. They should also outlaw abuses, such as "spiking" in which a person manipulates compensation just before retirement in order to qualify for a higher benefit.

Vesting and portability require some attention as well. Lengthy vesting requirements are particularly onerous in times of increasing employee mobility. Portability of benefits between units of government within the same state should be facilitated. In addition, states should explore cooperative measures to allow interstate portability. Legislators should also consider laws to allow employees to purchase service credit at actuarial cost for public employment for which the employee is ineligible to receive a vested benefit under other laws.

II. Recommendations for Policy

This report is concerned primarily with improving the design, operation and soundness of state and local retirement systems. It includes a list of recommendations to help legislators improve their states' retirement systems by strengthening legislative management, providing more equitable benefits, and lessening the risk and uncertainty to the employee and taxpayer. These recommendations are a product of the authors' collective experience in state pension matters. They represent the ways the authors have attempted to manage their own systems.

The NCSL Pensions Working Group Recommendations

1. State legislatures bear ultimate responsibility to voters and beneficiaries for the financial security and well-being of state retirement systems. Therefore, state legislatures should approve all changes of benefits and funding of retirement systems, and should regularly review their management and investment policies.
2. State legislatures should establish permanent pension review bodies to analyze the problems of their retirement systems on an ongoing basis and to make recommendations for state legislative action.
3. State legislatures should require advance funding of pension benefits to ensure that pension costs are not shifted to future taxpayers.
4. State legislatures should require fiscal impact statements (fiscal notes) when establishing or amending pension plan benefit provisions.
5. The full, long-term costs of early retirement programs and incentives should be calculated before such a program is adopted in order to allow legislatures to provide for the costs.
6. Post-retirement adjustments should be independently funded and have a ceiling on the percentage of increase for a single year.
7. State and local pension plans should provide strict guidelines for disability coverage and should provide follow-up periodic screenings of disabled retirees.
8. Legislatures should use extreme care in developing health insurance provisions for retired employees, and preferably should provide for separate accounting and funding from retirement programs.
9. State legislatures should establish strict fiduciary standards and conflict of interest laws to govern the conduct of trustees as they manage the assets of the retirement system.
10. State legislatures should move toward requiring annual actuarial reports using uniform actuarial assumptions to evaluate the financial soundness of state and local retirement systems.
11. State and local retirement plans should provide for reciprocity of benefits for workers who shift jobs within the state and its political subdivisions and portability for those who shift jobs across state lines.

12. Pension plan participants should be fully informed of plan provisions including benefits, service and vesting requirements, assets and liabilities, investment performance and risk, actuarial assumptions and data, fiduciary requirements and selection of plan trustees.
13. State legislatures should support coordination of state and local retirement systems.
14. Legislators should encourage and support the efforts of state retirement system administrators to comply with the principles of pension system administration established by the Public Pension Coordinating Council.

In states where retirement systems do not meet all of these recommendations, the Pensions Working Group suggests legislative action to revise regulations to provide for adequate and soundly operated public pension plans. In addition, state legislatures should continue to study their public retirement systems and work to maintain the highest level of reporting, disclosure, fiduciary and funding standards.

Congress has considered broad federal controls over state and local pensions. Although the National Conference of State Legislatures has strenuously opposed these efforts to usurp state control, the working group subscribes to public employee protection principles expressed by proponents of federal legislation and urges state legislatures to implement the recommendations in this section. The best protection against federal interference in the management of state and local pensions is state compliance with sound pension principles.

Legislative control of public pension policy

State legislatures bear ultimate responsibility to the voters and beneficiaries for the financial security and well-being of state retirement systems. Therefore, state legislatures should approve all changes of benefits and funding *methods* of retirement systems, and should regularly review their policies. The state legislatures represent the members of the various employee plans and also the taxpayers who are ultimately responsible for funding a large percentage of the pension costs. Changes made in the system by legislation generally result from public hearings where both public employee and taxpayer concerns are fully heard. Therefore, it is more likely that any action will be well-reasoned and balanced.

In some states, boards of trustees or commissions are responsible for changes in the benefit structure and level of funding of public pension systems. Since these boards are usually composed of representatives of the several employee groups, they may have a vested interest in liberalized benefits and minimum increases in member contributions and may not present an unbiased or objective approach. The public interest in pension programs that are as fair to taxpayers as they are to beneficiaries requires a broader forum for policy development.

Legislative control of broad policy issues, as recommended here:

- Provides a maximum of public involvement through public hearings
- Provides a forum and means for balancing the interests of current public employees, retired employees and taxpayers
- Allows for balancing the long-term beneficial and fiscal concerns of all state pension programs
- Ensures that all decisions receive the maximum possible public scrutiny

Pension review commissions and committees

An important step toward responsible and effective supervision of public pension plans is the creation of a knowledgeable, respected and adequately staffed legislative body with responsibility to review all pension legislation and to recommend legislative changes. Such legislative commissions and committees are necessary because pension laws demand continuous supervision and attention. A single, ill-conceived provision in a single act could have significant fiscal consequences that are not fully apparent for many years. Worse still, such action might be irreversible since there are serious constitutional impediments in most states to legislation that would reduce an individual's prospective pension benefits.

Legislative commissions and committees can focus public attention and gain a public consensus on pension matters to a degree unattainable at a local level. To the extent that public exposure produces better results, the legislature is best able to raise the public visibility of pension issues.

Another reason for review bodies is the complexity of pension legislation. It rarely is possible to foresee the ultimate fiscal consequences of a piece of legislation upon first reading. It is important, therefore, that the reviewing body have staff and independent actuarial and economic assistance to make informed analyses and judgments about proposed changes in the pension system. The growing occurrence of legislative term limits and the trend toward greater turnover among legislators even without term limits make the establishment of such bodies essential if legislators are to have an independent source of information to help them place pensions issues in the widest possible context of public policy.

Because of their expertise and perspective on the total pension system, commissions or committees are in a good position to recommend reform measures that reflect consistent, sound principles of pension policy rather than isolated responses to pressures and crises.

Many states, including Arkansas, Louisiana, Massachusetts, Minnesota, Nebraska, North Carolina, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, West Virginia and Wisconsin, have permanent legislative bodies with responsibility for screening retirement bills and recommending changes. The authority of the bodies varies, but most groups review pension and retirement bills and prepare fiscal impact notes. Most also conduct comprehensive studies of the retirement systems and make recommendations.

States without formal oversight commissions have designated permanent and interim committees of the legislature to oversee pension fund performance. The existence of these commissions and committees has resulted in a core group of legislators and staff with special expertise in the complicated issues of pension funding and administration.

The appropriate membership of such review bodies is the subject of some debate. Some pension review commissions are composed entirely of legislators, but Massachusetts' commission includes non-legislators. In Tennessee, representatives of employee groups serve on the commission but do not vote. In still other states, employee representatives and others are voting members. The number of regular members assigned to a commission and committee ranges from six to 18, averaging approximately 10 members.

Critics of review commissions made up of legislators contend that it is easier for non-legislators to resist political pressure from powerful interest groups. They claim a non-legislative commission and committee can more easily bear the brunt of criticism about failure to liberalize benefits. A group of legislators who become experts in pension matters, however, can more effectively gain and keep the respect of the legislature as a whole than a group of advisers who are less familiar with the legislative process. In either case, continuity of policy and a full

appreciation of the complexity of pension system management are improved by infrequent turnover.

Advance funding

No justification exists for the practice of deferring pension costs to a future generation of taxpayers. Advance funding on a sound actuarial basis should always be required because otherwise benefit improvements can be promised without corresponding contribution increases. Without this discipline, future taxpayers face the potentially disastrous consequences of trying to pay later for benefits that have accrued over a long period of time without proper funding. By insisting on advance funding, legislatures bring to everyone's attention the real cost of any proposed benefit increase and make it less likely that employee groups will demand unreasonable benefit improvements.

Tennessee requires any bill that creates a financial liability on the state pension system to contain the manner of funding of the liability. The costs of any accrued liability must be actuarially determined for a period of not more than 20 years. Similar legislation exists in other states.

Because of the financial difficulties states and localities have experienced in recent years, investors and dealers in municipal securities now demand more information about the present and future obligation of states and cities, including the fiscal condition of their pension systems. In some cases, municipal bond issues have been given lower ratings because of poorly funded pension plans, thus making the issues more difficult and expensive to market. The practice of advance funding is almost certain to have a beneficial effect on the marketability of a state's securities.

In 1991, 55 percent of state retirement fund receipts were derived from investment income. If that figure diminishes, the difference has to be assumed by employer or employee contributions. Therefore, the earlier funds are appropriated, the greater the opportunity for investment return and the less likely the government will have to invest larger sums later to make up for lost investment income.

Favorable investment return and substantial contribution levels in the 1980s and 1990s have helped many state retirement systems accumulate assets that approach or exceed the system's total accrued liability. For most systems, these prudent practices have done away with the concern about growing unfunded accrued liabilities that federal, state and local government authorities expressed in the late 1970s and early 1980s.

Late in the 1980s, however, that very success coupled with new fiscal pressures on state governments led to revisions of pension systems' methods of funding in ways that reduced state contributions and thus relieved some of the pressure on state budgets. No two situations are exactly alike, and it certainly is reasonable to reduce

contributions when a system reaches full funding. But legislators and system administrators should not lose sight of the possibility of generally lower investment returns in the 1990s, or of the way that changes in actuarial assumptions can again shift costs to future generations by reducing present contributions.

The growing strength of public pension system reserves has been one of the great success stories of state government in the past 15 years. It would be a serious and enduring failure of judgment for legislators to undo the gains achieved in recent years through unrealistically optimistic changes in assumptions designed to increase benefits or to relieve what may turn out to be a temporary state fiscal crisis.

In order to protect retirement systems' long-term ability to meet pension payment obligations, legislators should ensure that actuarial assumptions are reasonable predictions of future events. Demographic assumptions such as mortality, turnover and disability rates should be checked against actual experience at least every five years. Economic projections such as future rates of inflation and salary increases should be checked against independent forecasts of inflation and productivity, and possibly compared with projections actuaries make for retirement systems in other states. Legislators should be especially wary of changes in actuarial assumptions that seem too favorable--that would, for example, substantially reduce required contributions to a pension system.

The reasons for being cautious are that relatively small changes in assumptions can greatly affect the strength of a pension fund over time. If investments earn less than it has been assumed they will, if salary increases outstrip assumptions, or if people live longer or turnover is less than predicted, an actuarial loss occurs, and it will have to be made up with higher contribution rates in the future. Opposite conditions produce actuarial gains that can reduce future contributions. Actuarial gains are preferable to actuarial losses. Actuarial losses transfer retirement system costs from the present to a future generation of taxpayers and may require tax increases. Gains, however, allow the compounding of investments to reduce future obligations.

This is simply a restatement of the basic principles that pension liabilities should be funded in the present, as they occur, with contributions that over time are a level or decreasing percentage of payroll. Pensions costs should not be passed to a future generation of taxpayers.

Fiscal notes on legislation

Because of the potentially large, long-term expense of pension benefit increases, the legislature should require actuarial cost estimates on all proposed pension changes. An independent actuary responsible only to the legislature should prepare the fiscal notes. Each note should clearly indicate the actuarial assumptions used, the method used to compute short-term and long-term costs, the potential annual cost rates, and the total additional liability created by the proposal. The actuary's assumptions should be clearly stated and should be reviewed

periodically. Legislatures have in some cases used an additional actuary for this periodic review of assumptions. Legislators are best-equipped to weigh proposed benefits for one group against those for another, to evaluate long-term designs for benefits packages, and to speak for the public interest, while actuaries are best qualified to measure the cost of plans in the short term and the long term.

The following example illustrates the need for detailed, thorough fiscal notes. Some years ago a state enacted legislation to provide an automatic cost-of-living increase limited to 3 percent annually. Projections at the time estimated the first year's cost to be $1.8 million and the total cost to be $21 million. In 1977, a detailed actuarial analysis was undertaken and the cost of funding the increases on an actuarially sound basis was $30 million annually by 1985. If the initially proposed legislation had included a thorough actuarial analysis including specification of actuarial assumptions used, the state might have been spared some of the resulting financial burden.

No projections can be infallible. Carefully prepared fiscal notes by an independent actuary, however, can help ensure that improvident special interest legislation will not be enacted and that the legislature can accurately account for the long-run fiscal impact of legislation that is enacted.

Finally, although fiscal notes are an essential requirement of sound legislative management, the actual cost of a provision should be considered secondary to sound plan design. The fact that a legislative proposal is not exorbitantly expensive is a weak argument for its adoption. Fairness and consistency with established principles of pension policy are most important.

Early retirement

Allowing full benefit payments at earlier ages has become a trend for state retirement systems in recent years. By doing so, state systems have moved in the opposite direction from the federal Social Security system. Federal law provides for a gradual increase in the age at which full benefits are available; by 2027, the normal retirement age for Social Security will have increased to 67 years. In contrast, in 1992, 12 of the 83 major state plans for public employees and teachers provided for full retirement benefits at age 55 with 25 years of service, up from seven in 1988. Seventy-five major state plans permit retirement with full benefits at age 62 with long service.

Early retirement incentive programs have accelerated the trend toward collecting benefits earlier in life. In 1992, NCSL described 17 state early retirement incentive programs in effect in 1991 and 1992, and there may have been more. Such programs relax some of the usual retirement criteria in order to allow employees an earlier retirement than would otherwise be possible, or they offer an improvement in benefits to induce retirement among people who are already eligible but who would otherwise postpone their retirement to order to become eligible for higher benefits. Such opportunities are usually available for a short time--three months or so--and their stated

purpose is usually the reduction of personnel costs, a reduction in the number of public employees, or, in times of fiscal stress, avoiding employee layoffs by getting people to retire.

Ideally, savings and workforce reductions occur simultaneously with the additional bonus of opening up opportunities for promotion for remaining employees. Savings occur in part because of a planned reduction in the total number of employees and in part because the program may presume that most of the people who take advantage of the offer will be among the more highly compensated long-term employees. Their replacements, if any, could presumably be paid less.

State experience over the past decade indicates that early retirement incentive plans can meet expectations, but only if the expectations are moderate and if the plans include controls on replacement hiring and funding to cover the growth in retirement system costs. According to one study of 24 retirement-incentive programs in effect from 1984 through 1988, controls on hiring are the critical issue:

> Many states felt that an early retirement incentive program was useful in meeting the initial stated goals of reducing work force, avoiding layoffs and providing payroll savings. At the same time, most states indicated disappointment in the long-term reduction of employees and costs. It appears that in some cases the costs were considerably more than the savings, with the costs of the incentives wiping out any financial gains. States which showed some cost savings were those whose enabling legislation either placed restrictions on the number of hires or included provisions for the cost of the program to be borne by the employer with cost savings certified prior to implementation of the retirement incentive program.3

A more recent study by the National Association of State Budget Officers reported similar findings.4

Issues other than measurable costs must also be taken into consideration in connection with early retirement incentives or regular plan provisions. A kind of cost that cannot readily be measured is the loss of skilled, experienced employees. *The New York Times* summarized this issue in 1991 in discussing a legislative plan intended to encourage New York state teachers to take early retirement:

> The plan will allow New York City's hardpressed school system--and others around the state--to save the jobs of many young teachers, many of them from minority groups. But concern has been expressed among principals, teachers and parents that schools will lose some of their most experienced teachers to save teachers with relatively little classroom experience.5

Early retirement contributes to pension problems in another way. The employee who retires at age 50 or 55 may go on to other employment and perhaps even qualify for another pension. A retiring state employee may, for example, obtain employment with a local government and ultimately qualify for two taxpayer-supported pensions.

Early retirement places a substantial burden on pension systems since the retired person is likely to collect benefits for a longer time. Early retirement is the most expensive feature of a pension plan unless there is a corresponding actuarial reduction in benefits. The Social Security system permits an individual who elects to retire at age 62 rather than age 65 to receive only 80 percent of the regular benefits. The actual costs of early retirement to a pension system are even more dramatic. The value of a pension beginning at age 55 is twice that of an equal pension beginning at age 65.

Regular early retirement programs and early retirement incentives are legitimate policy alternatives and have a role to play in good retirement policy. But it is essential to calculate their costs in advance of action. Legislation that authorizes an early retirement incentive program should require a cost-benefit analysis of the program, and include the present value of any additional pension system liability among the costs. The legislation should specify how any additional costs are to be financed, require financing over a relatively short term such as 10 years and should prohibit people who take advantage of the program from returning to work for the same employer.

Post-retirement increases

During the past few years many states have adopted some form of post-retirement pension or cost-of-living adjustment (COLA) for retired people. Fifty-nine of the 83 major state systems now provide for such adjustments. Originally, some states linked their increases to the Consumer Price Index (CPI). Most plans that are linked to the CPI cap increases at some percentage defined by law.

While post-retirement cost-of-living increases help ease the effects of inflation, states can find the costs of providing the benefits quite high if the increases are CPI-based and there is no ceiling or cap on the percentage of increase. Estimating the future cost effects of an open-ended cost-of-living adjustment is highly speculative. While perhaps not expected in today's world, automatic increases (especially higher percentage ones) may outstrip percentage boosts for active employees.

According to a recent study, the cost of providing an automatic annual adjustment is significantly greater than that of providing a level benefit. Several factors account for the unexpectedly high expense. Cost-of-living adjustments generally apply to active as well as retired employees. Often the cost-of-living adjustments are not funded in advance so there is the loss of investment earnings that regular contributions to the system produce. Also, the cost frequently is borne entirely by the employer. Consequently, with just a 2 percent annual cost-of-living adjustment, the state may pay a third more than with a level benefit.

A state planning to offer some form of cost-of-living adjustment should do so only if there is a cap on the amount of increase for a single year and a provision for actuarially sound funding of such benefits. In this alternative, regular legislative review of increase proposals could replace automatic adjustments.

Disability benefits

A strong argument exists that a disability program does not belong in a pension system at all. It is primarily an insurance system and should be kept separate from the regular pension program. Where pension programs include disability plans, however, the legislature should receive an annual report with sufficient data to permit a thorough evaluation of the effectiveness of disability programs under its jurisdiction.

Unless eligibility for disability retirement is controlled and monitored, recipients and employers can abuse it, which results in unnecessarily high costs to the state or local government. In some jurisdictions, all that is required to establish a claim for disability retirement is the claimant's testimony before a board. Often there is no medical expert on the board and no requirement for an independent medical evaluation. In more extreme cases, disability retirement has been used to get rid of undesirable employees or to reduce the work force.

Legislators should be aware of two different definitions of disability:

- The inability to perform the duties of the individual's current position
- The inability to perform the duties of any and all positions for which the individual is reasonably suited

The definition used can have a significant effect on the administration and management of a benefit program. Use of the second definition would make disability benefits less broadly available than use of the first definition. Use of the first definition can result in people legally holding jobs and simultaneously receiving disability benefits. This situation could raise questions of equity and the purpose of the program, when no illegality was at issue.

Once a person is placed on the disability rolls, it is unlikely that he or she will ever be removed. Most retirement plans lack adequate laws or procedures that require members to report earnings and submit periodic proof of continued disability. And the fiscal consequences for the state are enormous when young employees retire with disability. In addition, a substantial fraction of all disability claims are cardiac-related, and many of these employees recover sufficiently within six months or a year to be employed in appropriate occupations.

Proof is a significant factor in removing a person from the disability rolls. The individual must establish his or her disability in the first instance, but the system must prove that the individual has subsequently recovered from the disability. Disability evaluation boards should receive competent, independent medical evaluations of all cases and should reevaluate all awards periodically to determine whether the disabling condition has improved.

Emphasis should be placed on retraining disability claimants through vocational rehabilitation. It may be necessary, however, to make such training mandatory in certain instances since some studies have shown that disability recipients are not highly motivated to participate in retraining programs. In those cases where the disabled are subsequently employed, some adjustment should be made in the disability award.

Post-retirement health insurance

States have increasingly supplemented traditional retirement income benefits with health care coverage for former employees. In 1990, 54 percent of all state and local retirees received at least some employer-financed health benefits (not counting Medicare), and for about three-quarters of them the coverage was equivalent to what they had received as active employees, after any Medicare benefits are taken into consideration.6 In some states, the cost and funding of retiree health insurance coverage are integrated with retirement programs to a greater or lesser extent. The potentially vast expense and the difficulties of accurate actuarial evaluation of future health care costs probably make it advisable to keep cost and funding provisions entirely separate (this should not be an obstacle to commingling funds for investment management).

While the adoption of some sort of national health care could make any recommendations obsolete, the working group on pensions offers the following points as considerations legislators should keep in mind when reviewing proposals or programs for health insurance for retired state employees.

- The cost of health care benefits should be shared between the employer and the retiree and should be designed to provide greater funding for employees who have served longer terms with the employer. (A 1993 survey of 48 major state retiree health insurance plans reports that in 18, the state pays 90 percent or more of the insurance cost, and in 11 the state makes no contribution toward the cost of the insurance. A relatively small number of plans offer long-term employees more generous provisions than short-term employees).7

- Long-term liabilities for post-retirement health care plans should be advance-funded like pension benefits, and legislators should require annual actuarial reviews of future costs and necessary contribution rates.

- The state should retain in statute the rights to modify coverage, reduce benefits or increase retiree premiums, and should communicate its reservation clearly to all current and potential beneficiaries.

- Benefits should be coordinated with Medicare and can be extended to spouses and children if the health of the funding system allows. Benefits can be extended or improved depending on what decisions are made about cost-sharing between the employer and retirees and the long-term costs as revealed by actuarial reviews.

- Eligibility should occur only upon the commencement of retirement benefits, and should not exist between termination of employment and that time. A retiree should have the option to elect coverage only when he or she is first eligible, in order to guard against adverse selection later on. If a later election is permitted, the retiree should bear the full cost of coverage.

Investment guidelines

State legislatures should establish strict fiduciary standards and conflict of interest laws to govern the conduct of trustees as they manage the assets of the retirement system. Trustees should also be subject to the Codes of Ethics that regulate the behavior of state and local government employees. Strict penalties should be assessed for the violation of the fiduciary, conflict of interest or ethics rules.

As discussed above, under Principle 3, the Prudent Person Rule or its ERISA version should be the guiding principle and the basis for allowable pension fund investments. The Prudent Person Standard, originated-in 1830, has proved over time to be a reliable guide to prudent investments.

This 1830 standard served as the basis for the ERISA Prudent Person formulation. Statutory language setting forth this concept should be required for all pension trustees, regardless of who controls the fund assets. In addition, the legislature should set minimum experience qualifications for trustees and define what sorts of activities or situations represent a conflict of interest for them.

While states may choose to restrict the kinds of investments that may be made and their allowable proportion in a pension fund portfolio, these restrictions should be broad enough to allow sufficient investment flexibility.

The ultimate social goal of pension fund investments should be the timely payment of the plan's beneficiaries in their retirement. Any attempt to invest pension fund assets in ways designed primarily to perpetuate public services or to improve the business climate or tax base should be viewed with extreme suspicion.

Uniform actuarial reporting

Pension liabilities can be managed if problem areas are identified early and if sufficient information exists to make a rational legislative judgment. In many states, managers of pension plans do not report annually to the legislature about the condition and operations of the fund. When the managers do report, the plans are not always presented in a consistent format. Consequently, making meaningful comparisons between individual plans is difficult. To correct this problem, all plan managers should be required to use the same reporting forms and the same actuarial methods. State legislatures should recognize that the small size of some existing pension systems and the high cost of producing reports may make annual reports impractical. In these cases, periodic reports should still be required at least once every three years. Reporting should be in accord with the standards required by the Governmental Accounting Standards Board.

If informed regularly of the financial condition of a plan and of the nature and basis of its actuarial assumptions, the legislature can identify problems at an early stage and act in a timely fashion. Although differences in actuarial assumptions may vary justifiably, even small deviations should be scrutinized. Projected over 20 or 30 years, small differences in interest or salary assumptions or mortality rates can mean large amounts of money.

Reciprocity and portability

Reciprocity and portability relate to a public employee's ability to move pensions benefits when he or she changes jobs. Practices have to differ depending whether the job change is within a state (intrastate) or across state lines (interstate). The term reciprocity usually refers to intrastate job changes. Portability refers to interstate changes.

State legislators should seek practical methods for conferring reciprocity on those employees who change positions within a state and its political subdivisions. Proportional vesting for people who reach a mandatory retirement age is a common provision in pension plans. Minnesota's Combined Service Annuity allows employees to combine service in any state public plan to meet the minimum vesting requirement and thereby earn a proportional benefit in two or more public plans. Legislators should also consider laws to allow employees to purchase service credit for out-of-state public employment for which the employee is not eligible to receive a vested benefit already.

A reduction in the service requirement for vesting may help address the need to move pension credit from one system to another. In general, the shorter the vesting period, the less need for other provisions providing portability. Current vesting requirements are reported in table 1 in chapter III.

Reporting and disclosure

The public, active and retired members of the systems, and the legislature must be informed of the costs and benefits of public plans to ensure good policy decision making. Periodic financial audits, for example, keep the legislature apprised as to whether a plan is competently and appropriately administered and whether its obligations are fairly disclosed.

Participants should be fully informed of plan provisions including benefits, service and vesting requirements. This information should be provided through a summary plan description. Participants should also have access to information about assets and liabilities, investment performance and risk, actuarial assumptions and underlying data, fiduciary requirements and selection of plan trustees. These can be provided most readily in an annual report. Each active member of a pension plan should receive an annual statement that reports the person's accrued service credit, employee contributions and named beneficiary.

System coordination

The retirement systems within a state should be coordinated whenever possible to improve fairness to the different groups of employees in the state and to achieve economies of scale. Coordination helps the legislature establish and maintain a fair, understandable, uniform pension system. It eliminates many of the political pressures that exist when one group of public employees can point to an overgenerous special benefit applicable to another group of public employees.

Better administration is a significant advantage of coordination. Other advantages are employee protection features such as plan reporting and disclosure, reciprocity, and sound investment and funding policy. Legislatures should try to bring uniformity to the statutes that regulate state pension systems and to provide full reciprocity for employees who move from one governmental unit to another.

If it seems possible that economies of scale would result, legislatures should consider the consolidation of pensions systems. In particular, states with comparatively large numbers of small systems should examine the issue from the perspective of savings in administrative costs from consolidation. There are factors peculiar to each plan that should be considered before consolidation. Because of local factors, such as disparate benefit levels and unfunded liabilities, the state may be required to assume additional liability in combining state and local programs. In addition, combining various systems also may raise qualification issues under the Internal Revenue Code.

Consolidation has reduced the number of state and local retirement systems in recent years. According to the Bureau of the Census, the number fell from 2,564 in 1983 to 2,362 in 1991. Hawaii and Maine each have only one retirement system for all state and local employees. Alaska, Delaware, the District of Columbia, Idaho, Iowa, Mississippi, Nevada, New Hampshire, New Mexico, Oregon, Utah and Wisconsin each have five or fewer. What is practical for these states may not be practical in larger states, but states with very large numbers of systems for

individual local governments might do well to consider the administrative savings and other advantages of consolidation.

The Public Pension Principles Achievement Award

In 1993, the Public Pension Coordinating Council (PPCC), a consortium of national organizations concerned with public pension issues, granted its first achievement awards. The awards recognize and commend public employee retirement systems for meeting high professional standards of policy and administration. Compliance with 11 required principles and with at least five of nine exemplary principles is required for a reward. The 11 required principles are summarized below. Some of them restate recommendations of the NCSL Working Group on Pensions, and some go into more detail on investment, administrative and reporting issues than does this Legislators' Guide.

The Working Group on Pensions commends this important project, and recommends that state retirement systems make every effort to comply with the principles the project espouses. The principles include the following:

1. Perform a professional actuarial valuation at least every two years.
2. Fund promised benefits with contribution rates that are designed to stay level or decrease as a percentage of payroll over time, and maintain contribution rates that are at least 90 percent of the actuarially required rates.
3. Prepare annual financial statements in accordance with generally accepted accounting principles.
4. Audited financial statements annually in accordance with generally accepted auditing standards.
5. Receive an unqualified opinion by an independent auditor regarding the audited financial statements.
6. Adopt written investment objectives that specify the system's asset allocations, investment return, risk expectations and the role of all parties in the investment process.
7. Adopt written fiduciary standards requiring that fiduciaries act only in the interest of system members and according to the prudent person rule.
8. Obtain annual, professionally produced investment performance measurements.
9. Provide all new members with a clearly written summary plan description.
10. Provide all active members with an annual statement that at least shows accrued service credit, employee contributions and named beneficiary.
11. Publish an annual report that includes financial information, actuarial assumptions and investment performance in the past year.

III. DEFINED BENEFIT AND DEFINED CONTRIBUTION PENSION PLANS

Public retirement plans in the United States have traditionally been *defined benefit* plans. These provide employees who meet specified conditions with a life-long benefit whose amount is determined by the employee's length of service and salary level at retirement. Such plans imply a commitment to the employee's income security for life. In many cases, the commitment to income security is made more explicit through provisions for cost-of-living increases to protect the buying power of the pensions benefit from inflation. In 1990, 90 percent of state and local government employees participated in such defined benefit retirement plans.

The alternative form of employer-sponsored plan is called a *defined contribution* plan. Defined contribution plans do not guarantee any particular level of benefits. An account is established for each eligible employee. In public sector defined contribution plans, both the employer and the employee make contributions to the account which are invested and eventually determine the amount of benefits the employee receives. The employee is likely to control the way the account is invested. Since people will make different investment choices, employees with similar employment and salary records will have different retirement benefits. The design of such plans makes cost-of-living adjustments impracticable, and in any case the underlying assumption of such plans is that all employer contributions will have been made by the time an employee retires.

Defined benefit plans used to be as predominant in the private sector as they continue to be in the public sector. In 1975, 87 percent of the participants in private sector plans were covered by defined benefit plans. Employers have steadily replaced such plans with defined contribution plans since then; by 1987, only 68 percent of those covered by private sector plans were under defined benefit plans. The number of private-sector employees in defined contribution plans more than tripled from 1975 to 1987.

The growing presence of defined contribution plans in the private sector has increased interest in their adoption in state and local government. That interest was reflected in the enthusiasm with which the first edition of *State Pensions: A Legislator's Guide* advised state legislators to consider replacing their defined benefit plans with defined contribution plans. Defined contribution plans are still rare in the public sector, however, except as supplements to defined benefit plans. Three state-wide defined contribution plans--for teachers in West Virginia and for state and county employees in Nebraska--are described below. In addition to those, some states make defined contribution plans available to certain classes of employees. Some states permit some higher education employees to choose such plans, in some cases to supplement the state defined benefit plan.

STATEWIDE DEFINED CONTRIBUTION RETIREMENT PLANS

Three state-wide defined contribution retirement plans are the two Nebraska plans for state and county employees and the Teachers' Defined Contribution Retirement Plan that West Virginia created in 1991.

NEBRASKA. The Nebraska State Employees' Retirement System covers state employees except for judges, the state patrol and public education employees. Employees may elect to join the system if they are 20 years old and have completed 12 months of full-time employment. Membership is mandatory for employees over age 30 who have completed 24 months of service. Members contribute 3.6 percent of the first $24,000 of earnings and 4.8 percent of any additional earnings. The state contributes about one-and-one-half times the employee contribution.

Employees may choose among a guaranteed investment account, balanced conservative fund or growth fund for investment of their contributions; state contributions all are deposited in the guaranteed investment account. The State Retirement System provides each employee with quarterly statements of contributions and earnings.

Vesting occurs after five years of participation in the system. Employees may retire at age 65 or age 55 with five years of service. Members may not withdraw amounts from the employer's account before they are 55 years of age. Disability payments are available at any age under the same conditions so far as vesting goes. At retirement, the system allows for lump-sum withdrawals in any amount or purchase of one of a variety of annuities intended to meet various personal circumstances.

The Nebraska County Employees' Retirement System is structurally identical to the state employees' program, although contribution levels are different.

WEST VIRGINIA. The new Teachers' Defined Contribution Retirement Plan is mandatory for K-12 education employees hired since July 1991. It replaces an older defined benefits plan. Teachers may transfer from the old plan to the new one. Members contribute 4.5 percent of earnings and the state contributes 7.5 percent of earnings.

Members may choose among five investment options--money market, bond, equities, fixed annuity and insurance investment contract funds. Each member is assessed an annual $20 administrative charge. Financial administration of the plan was contracted out to a private firm.

Vesting of state contributions occurs by stages. Members are vested in 33 1/3 percent of the state contribution after 6 years of employment, in 66 2/3 percent after 9 years, and fully after 12 years.

Advocates of defined contribution retirement plans hope to use them to settle some of the issues that result from the use of defined benefit plans.

- Defined benefit plans are designed to benefit long-term employees and may produce no benefits at all for short-term employees. Benefits are not always portable (although reciprocity and portability provisions can address this issue) and lengthy vesting periods are disadvantageous for people who change jobs even once or twice.

- Employer costs in a defined contribution plan are readily predictable, do not require long-term actuarial calculations, and are paid at the time benefits are earned, preventing the possibility of a long-term accrued liability.

- Defined benefit plans require more administration than defined contribution plans to keep records and oversee fund investment; this is because defined contribution plans shift this responsibility to the employee.

- Defined benefit plans are not designed to distribute the results of favorable investment return directly to individual system members.

Advocates contend that defined contribution plans would solve each of those problems:

- Defined contribution plans are completely portable; the plan can readily be designed so that no pension credit is ever lost, no matter how short a period of employment is involved.

- In defined contribution plans, benefits are determined by the amounts contributed to each individual account. The only way to increase benefits is to increase contributions, and no unfunded liability can ever exist.

- With a defined contribution plan it is impossible to transfer funding obligations to a future generation of taxpayers; obligations occur and are met when paychecks are passed out.

- The system is simple and easy to understand. Investment management can readily be contracted out for administration.

- Individual members can tailor an investment package according to individual preferences.

Proponents of defined benefit plans contend that the problems with such plans are overstated and that replacing of them with defined contribution plans would undermine the basic purpose of public retirement systems to provide a secure and predictable level of income for former employees after retirement.

- Defined benefit plans are well suited for large employers, like state governments, that want to attract and retain employees for full careers. State plans have been addressing the problem of benefits for short-term requirements by reducing the length of time for vesting. In 1984 50 of the 85 major state systems required a vesting period of 8 years or more. Only 35 did so in 1992 (table 1). In addition, many states allow reciprocity among retirement systems within the state and provide for purchase of service credit for unvested out-of-state service.

- Any public-sector pension plan *can* be subject to revision for political reasons; that is irrelevant to the merits of defined benefit plans. If a defined contribution plan does not provide a sufficient level of benefits, there will be political pressure for increased public contributions or for its replacement with a defined benefit plan. For example, in 1967 the Tennessee Teachers' Retirement System was converted from a defined contribution to a defined benefit plan, resulting in an unfunded liability that took decades to finance.

- Defined benefit plans allow for definite retirement planning, but defined contribution plans make retirement planning speculative, and place a burden on employees that they may not be able to handle well. It is very difficult for an employee to reach a specific retirement income objective. The employee bears the entire inflation and investment risk and has no way of knowing in advance what rates of investment return, employer contributions and annuity costs will be in the future. The employee may lack the necessary information and experience to make prudent long-term investment decisions.

TABLE 1. STATE RETIREMENT SYSTEMS' VESTING REQUIREMENTS: 1992

Immediate Vesting	0 plans
Vesting after 3 years	3 plans
Vesting after 4 years	4 plans
Vesting after 5 years	36 plans
Vesting after 8 years	3 plans
Vesting after 10 years	32 plans
Other or variable	5 plans
Total	83 plans

Source: Wisconsin Retirement Research Commission

The question whether a public retirement plan should be a defined benefit or a defined contribution plan is a question of who should bear the risk of providing an employee with retirement income. The difference between these two kinds of plans expresses opposite ideas of an employer's obligation to employees. In the case of a defined benefit plan, the employer agrees to provide a specified level of retirement benefits. In the case of a defined contribution plan, the employer agrees to make a specified contribution to individually allocated investment accounts.

In terms of individual equity, the principle underlying a defined benefit plan is that of providing lifetime benefits proportionate to each member's terminal salary and length of service. In defined benefit plans, there is no necessary relationship between the amount contributed on a person's behalf and that person's eventual benefits. A defined contribution plan, on the other hand, defines individual equity in terms of contributions proportionate to a person's earnings, and accepts the necessarily unequal benefits that result from equal employer contributions. The employer who provides a defined benefit plan accepts the responsibility to provide a specified level of income to each vested employee for the employee's lifetime. The employer who provides a defined contribution plan encourages each employee to assume responsibility for his or her long-term welfare.

Hybrid or split plans are now under consideration in a few states, in an effort to give employees some of the benefits of both kinds of plan. In the state of Washington, a proposed split plan has these features: Guaranteed employer contributions would be made as a defined benefit and would be vested in an employee after 10 years of service, or five years for those over 55. Employee contributions would fund a defined contribution plan. Members would direct the investment of their own contributions, and the employee contributions plus earnings would be

available at any age as a lump sum or as the purchase of an annuity. Concerns have been raised about the long-term cost of the proposal and the degree of risk that employees would bear.

Colorado's Public Employees' Retirement Association has proposed a more complicated hybrid plan that incorporates more protection for an employee than the Washington plan. Rather than actually establish a new plan, members' potential benefits would be calculated on two bases--one the current defined-benefit plan, and the other a theoretical money-purchase plan. In the latter, the benefit would be calculated using the value of the member contributions, a 50 percent match from the employer, and interest earnings over the duration of the person's membership. Then a lifetime benefit is calculated on the basis of those assumptions, as well as the member's life expectancy and the member's preference for spousal and survivor benefits. If the retiring member elects a monthly benefit, he or she would receive whichever lifetime benefit would be more: the benefit calculated in the conventional fashion or the benefit produced by the new plan. COLAs would be paid on the benefit. One effect of this proposal would be to improve benefits for short-term employees. A second proposal would allow those who withdraw their contributions from the system before they are eligible for a benefit to receive 50 percent of the employer match as well as their own contribution, plus interest on both amounts. Again this is designed to improve the retirement outlook for short-term employees.

IV. Conclusion

The recommendations contained in this guide are not intended to solve all the problems of public pensions. They represent only the working group's consensus on fundamental guidelines for reform. Pension problems are too varied and complex to be solved simply or quickly. Neither is the solution to be found in comprehensive federal law. Pension systems are machines that must be tuned constantly, and their regulation is a continuing responsibility of the nation's legislatures. The purpose of the recommendations is to point the way, to illustrate some of the pitfalls, and to offer some suggestions. Improvements will come only as each state grapples with its own problems and develops its own unique solutions.

GLOSSARY

Actuarial reports—professionally prepared estimates of pension costs and funding trends.

Cost-of-living adjustment (COLA)—an increase in pension benefits after retirement that offsets the effects of inflation.

Defined benefit plan—a system providing a pension benefit determined by a formula based on age, service credit and final salary. Final salary is defined in various ways by different plans, but tends to be the average of annual salaries for the three, four or five years before a person retires.

Defined contribution plan—a system providing a pension benefit equal to the combined employer and employee contributions plus interest and minus administrative expenses.

Fiscal note—estimate prepared by an independent actuary regarding the cost of pension legislation and policy changes.

Legislative review commission—a legislative body with responsibility to review pension policy and administration.

Plan consolidation—merging pension systems by combining assets and developing a unified administrative system.

Portability—this term relates to a public employee's ability to move pension credit and years of vesting with him or her when changing jobs. Portability usually refers to job changes between states--interstate moves. State laws sometimes allow employees to purchase service credit for out-of-state service at actuarial cost when the employee is otherwise ineligible to receive a vested benefit for the service.

Prudence Rule / Prudent Person Rule / Prudent Expert Rule—a standard of fiduciary responsibility providing that a fiduciary must act with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. The rigor of this requirement leads to its sometimes being called the Prudent Expert Rule.

Reciprocity—this term relates to a public employee's ability to move pension credit with him or her when changing jobs. Reciprocity usually refers to job changes within a state (intrastate), in the course of which the person moves from one public sector employer to another under conditions that force the employee to change

pension plan membership. Reciprocity provisions allow such employees to move pension credit between systems.

Tier plan—a plan that provides one set of benefits for employees hired before a certain date and another set for those hired after a certain date.

Vesting requirements—requirements that employees work a specific length of time before receiving the right to a pension benefit.

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