Roads to Reform:

Changes to Public Sector Retirement Benefits Across States

States are grappling with the rising cost of public-sector employee pensions and retiree health care benefits. Many have taken steps to address them; in the first 10 months of this year, 19 states took action to reduce their pension liabilities, either through reducing benefits or increasing employee contributions, and more may do so in the remaining months and in 2011 legislative sessions. In 2009, 11 states made similar changes and eight did so in 2008. States as varied as New Hampshire and Kentucky, New Jersey and South Carolina have also made changes to how they structure and pay for retiree health benefits in an attempt to better manage their related long-term liabilities. All these states have acknowledged that the costs they face for these benefits have diverged from what they have been willing or able to pay and have started to take the steps to bring them back in line.

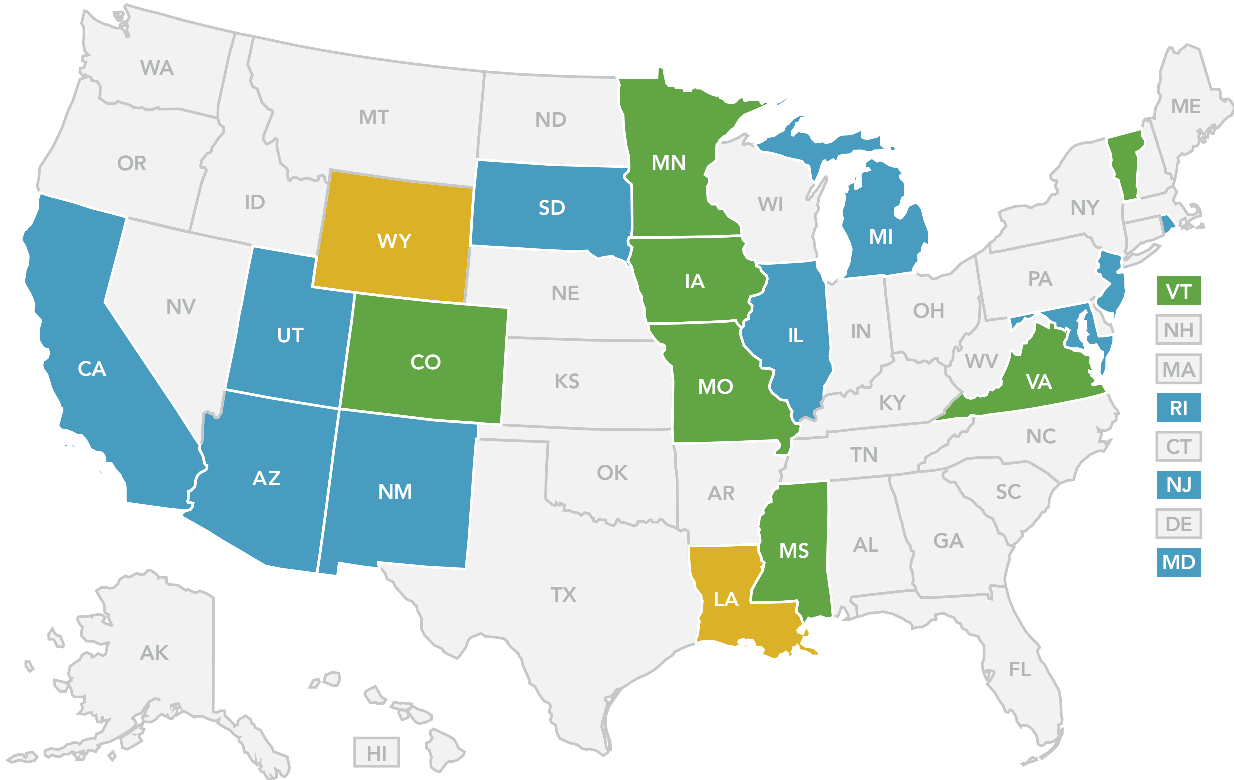
As the Pew Center on the States found in its February 2010 report, The Trillion Dollar Gap, states face a significant gap between the retirement promises they have made to employees and the money they have put aside to pay that bill. In fiscal year 2008 states and participating localities fell short by $452 billion for pension liabilities and $555 billion for retiree health care and other benefits—making the total shortfall more than $1 trillion. Pew found that in both good times and bad states ignored their retirement obligations—effectively kicking the can down the road.

It took years for states to get into their current pension predicament and it will take years for reforms and fiscal discipline to get them out. In January, newly elected governors and legislators from both parties will take office having promised to improve how their states will handle these bills coming due. These proposals range from drastic overhauls, such as switching from defined benefit to defined contribution plans, to more incremental changes such as increasing employee contribution rates, raising the retirement age and changing benefit calculations. In addition, many of the states that fell short on contributions to their retirement systems will need to show discipline in paying their annual bill as their budgets continue to recover.

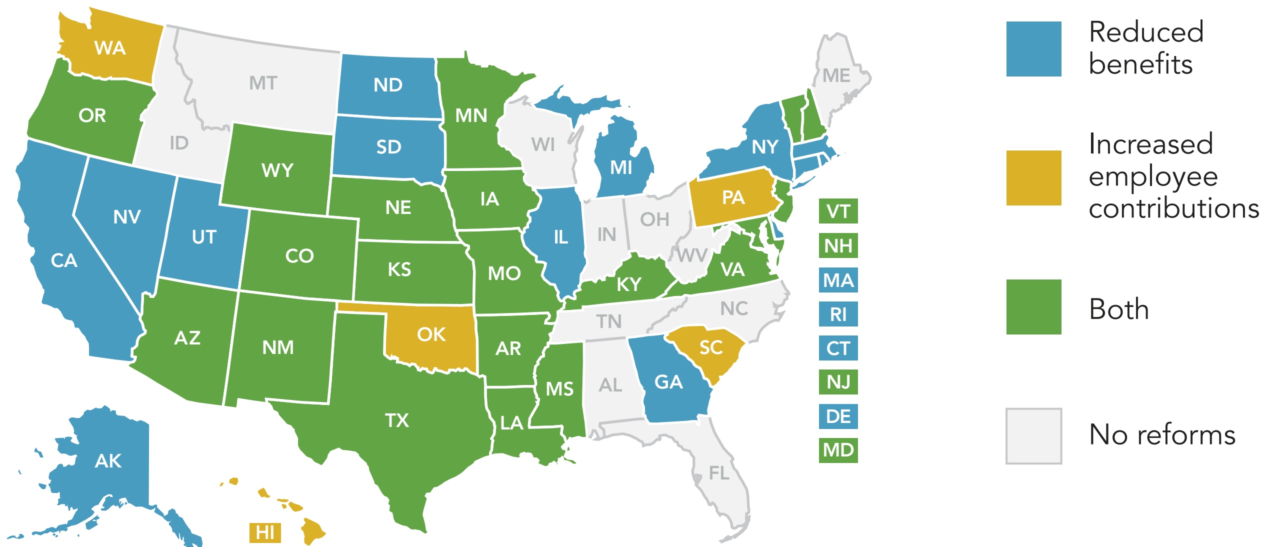
Learn more about the most recent changes enacted by states in the map that follows. You can also read more about this topic through The Trillion Dollar Gap report and related fact sheets, and reporting for Stateline.org, part of the Pew Center on the States.

State Pension Reforms

State pension reforms: 2010



State pension reforms: 2001 to 2010



The information presented here is based on the data collected by the National Conference of State Legislatures, which has tracked retirement reform legislation since 1999.

Key Developments in State Retirement Systems

Alabama, confronting projections that its public pension system will need an increase of as much as $1 billion a year by 2019, will consider reform proposals in 2011. In 2007, voters approved setting up irrevocable trusts to handle post-employment health benefits for public employees.

Alaska put all its new employees in a defined contribution plan in 2005. Bitterness lingers over the switch, made worse by the double-digit investment losses in individual portfolios in 2008. Lawmakers are asked by employees to consider repealing the change almost every year. In 2008, Alaska authorized the sale of up to $5 billion in pension obligation bonds by state and local governments to fund public pension liabilities.

Arizona has lengthened the average monthly compensation used in calculating a retiring employee's pension benefit, increased employee and employer contributions and created a voluntary, supplemental defined contribution plan.

Arkansas created a new defined benefit plan in 2005 in which employees contributed part of their salary for the first time. That improved cash flow, although the funding status of the public pension system fell from 90 percent in 2008 to 78 percent in 2009 because of the Wall Street financial collapse. Twice since 2001, Arkansas increased the multiplier used to calculate benefits.

California, with the largest public pension system in the U.S., enacted cost-cutting reforms in 2010 intended to roll back retirement benefit increases enacted in 1999. The changes include higher contributions for current employees, raising the retirement age for most employees from 55 to 60 and eliminating pension spiking, the practice of employees inflating their final salary to receive a larger pension check.

Colorado enacted some of the nation's most extensive public pension reforms in 2010, nearly all for newly hired workers. Lawmakers increased employer and employee contributions and raised the minimum retirement age from 55 to 60 for future employees. They also capped cost-of-living adjustments for current and future retirees at 2 percent, down from 3.5 percent, and froze them for a year. A group of retirees filed a lawsuit challenging the cost-of-living reduction, saying it violated U.S. and state constitutional protections against reducing benefits to existing pension plans. The Colorado case, which is similar to legal challenges filed by retirees in Minnesota and South Dakota, is being watched nationally because if the states prevail, other legislatures may

seek to trim or suspend cost-of-living adjustments.

Connecticut's largest bill is the $34 billion in unfunded public pensions and retiree health care, which is driving momentum to enact reforms. In 2007, the state sold $2 billion in pension obligation bonds to help close a $7 billion unfunded liability in the state teacher retirement system.

Delaware has not enacted significant reforms because of the relatively strong shape of its public pension system. The state increased benefits in 2000 and 2001 because the system was overfunded.

Florida has consistently funded its required pension plan contributions and has mandated that pension surpluses of less than 5 percent of total liabilities will be reserved to pay for unexpected losses in the system, a policy that has helped the state maintain a traditional defined benefit pension plan.

Georgia moved to a hybrid retirement system in 2008, offering new hires both a defined benefit plan that provides about half of the payout of the existing plan and a defined contribution plan with a mandatory 1 percent employee contribution and employer match. Employees may opt out of the 401(k)-style plan after 90 days.

Hawaii's public pension plan's funding level dropped between 2000 and 2006 largely because the state diverted employer contributions to help balance the state budget. Hawaii has passed some recent reforms. In 2010, the Legislature banned retirees from being rehired by the state or a county government unless they re-enroll in the state retirement system. In 2007, Hawaii restricted benefit enhancements or reductions in retirement age if there was an unfunded liability between 2008 and 2011. In 2006, Hawaii instituted a new plan that offered more generous benefits in exchange for increased employee contributions.

Idaho has not enacted significant public pension reform in recent years. In 2001, the state implemented a gain-sharing program in which excess investment earnings are channeled back to current employees and retirees in a defined contribution plan account.

Illinois took steps in 2010 to shore up the worst-funded public pension plan in the nation by raising the retirement age for new employees from 60 to 67, the highest of any state, and capping the salary on which public pensions are figured. To address ethical questions, Illinois ended double dipping, the practice of receiving a public pension and a second salary from a public entity. The state also put in place a number of protections to ensure

that pension trustees, employees and consultants are barred from benefitting from investment transactions. In 2009, Illinois authorized issuing almost $3.5 billion in pension obligation bonds to cover state pension contributions and is considering issuing additional debt to pay future bills.

Indiana has not enacted significant reforms despite funding only 70 percent of its total pension bill—well below the 80 percent benchmark preferred by pension system analysts. Most of the gap is due to underfunding of the state teacher retirement plan. In 2007, Indiana established a retirement medical benefit account to pay expenses after retirement, with annual contributions based on the age of the participant.

Iowa increased employee contribution rates and changed the way benefits are calculated, basing them on an employee's highest five earning years instead of the current three years.

Kansas lawmakers, facing a gap of $7.7 billion between assets and liabilities in their public pension system, will consider pension reform in 2011, four years after revamping the state's entire system. In 2007, lawmakers voted to increase employee contributions, change the formula for calculating final average salary and tighten age and service requirements.

Kentucky lawmakers approved a series of reforms in 2008 affecting new hires. Salaries are now calculated at the final five years of pay, not the highest five years of service. The legislature also implemented a graduated tier system for new employees that lowers retirement benefits. Kentucky teachers also began paying higher retiree health care contributions in 2010. Despite the reforms, the state still faces serious long-term pension troubles because of its past failure to make its full required payments each year.

Louisiana has increased employee contributions, cut cost-of-living adjustments and set the final average compensation for new employees at the highest five consecutive years.

Maine's public pension benefit payments will exceed $800 million a year by 2020, an unsustainable course that has prompted lawmakers to consider overhauling the system in 2011. One option is a defined contribution plan. Lawmakers also are considering a plan to shift state employees into Social Security; the state is one of six in which employees do not participate in the federal program.

Maryland shortchanged its public pension plan by trimming annual payments beginning in 2003. The Legislature will consider reforms in 2011. Maryland gave state employees and

teachers an option of increased pension benefits in 2006 if the employees agreed to higher contributions.

Massachusetts lawmakers in 2009 tightened loopholes that allowed some retirees to exploit the system and unfairly boost their public pensions. Among the loopholes closed was the so-called "one day, one year" provision that allowed elected officials to claim a year of service for working one day in a calendar year. The law also removed a provision that allowed elected officials to claim a termination allowance based on losing an election. It also struck provisions allowing some officials to establish pension credit for service in positions that have no compensation.

Michigan, which in 1997 became the first state to scrap its defined benefit plan for new employees, expanded the program in 2010 to include newly hired K-12 teachers. They now will be offered a combination defined benefit and defined contribution plan. Employees hired before 1997 are still in the defined benefit plan.

Minnesota approved higher contributions from workers and employers, reduced the rate of the cost-of-living adjustment and froze it in 2010 and 2011 for current and future retirees. A group of retirees filed a lawsuit challenging the cost-of-living reduction, saying it violated U.S. and state constitutional protections against reducing benefits to existing pension plans. The Minnesota case, which is similar to legal challenges filed by retirees in Colorado and South Dakota, is being watched nationally because if the states prevail, other legislatures may seek to trim or suspend cost-of-living adjustments.

Mississippi changed vesting and service requirements for newly hired employees and increased employee contributions to the state pension system in 2010.

Missouri joined Illinois in 2010 in pegging the standard retirement age for newly hired state workers at 67, the nation's highest. Another big change: New employees will be required to contribute to their pension plans for the first time. They will need to work twice as long until they are vested, enabling them to access their benefits. The plan is estimated to save the state $660 million over the next decade.

Montana lawmakers will consider proposals in 2011 to raise the retirement age from 60 to 65, boost employee and employer contributions, increase an employee's highest average compensation from three years to five years and phase in a lower multiplier formula to set benefits. The state twice increased employer contributions to the retirement system, in 2007 and 2009.

Nebraska instituted a cash balance plan in 2003 for new workers. Designed as an alternative to the defined contribution

plan that the state set up in the 1960s, the cash balance system requires employees and state agencies to chip in contributions that the state invests for the benefit of retirees. Like a defined contribution plan, employees receive a payout from their account upon retiring. The big difference is that Nebraska has cut dramatically the risk to employees by guaranteeing a 5 percent annual investment return.

Nevada ended a 15-year stalemate on pension reform in 2009 by increasing the retirement age from 60 to 62 for new hires and reducing the cost-of-living adjustment and the formula used to calculate final benefits. But state officials say more changes will be needed to keep up with growing costs.

New Hampshire set an example in 2010 on public employee retirement health care reform. Under the bipartisan plan approved by the Legislature, government workers would have the chance to make tax-free contributions from their paychecks to accounts managed by their unions. The employees' money would be pooled together and invested. And both the investment returns and the monthly distributions paid to retirees for health care expenses such as insurance premiums, doctor co-pays and prescription drugs would be tax-free. Unions still need to ratify the plan.

New Jersey increased public retirement benefits in 2001 and lowered the retirement age to 55 but then did not fully fund its annually required pension contribution. The federal Securities and Exchange Commission charged New Jersey in 2010 with fraud by claiming to municipal bond investors that it had the money to finance the benefit increases when it did not. The SEC, in settling the unprecedented case, said New Jersey officials were aware of the pension underfunding. Governor Chris Christie has made pension reform a priority, signing legislation in 2010 that reduced benefits for newly hired employees. Christie skipped the annually required pension payment but said he wants to repeal the 2001 benefit increase, raise the retirement age from 55 to 60 and increase employee health care contributions.

New Mexico moved in 2010 to prevent government workers from retiring with a monthly pension check and going back on the state payroll in another job 90 days later. They now must wait a year after retiring to return to a government job. Their pension checks would cease as long as they keep working. State officials also hiked current employee contributions to the pension fund in 2009, which unionized employees challenged in court, but those will end in June 2011. The 2009 reforms also included a new retirement plan for state and municipal employees with higher age and service requirements for benefits, and disincentives to retire before age 60.

New York lawmakers in 2009 raised the retirement age from 55 to 62 for new hires, increased the minimum number of years of service required to draw a pension from five years to 10 years and capped the amount of overtime used in calculating benefits. Teachers have a separate benefit structure.

North Carolina, with a public pension system funded above 90 percent, has not enacted major reforms but a commission is studying the future of the state retirement system. One of its recommendations: giving current and future employees a choice between a defined benefit plan and a defined contribution plan.

North Dakota, which is otherwise in the good financial condition, is facing projections showing that its public pension system may run out of money in 30 years. The 2011 Legislature will consider raising employee and employer contributions and proposals to create a 401(k)-style plan. In 2007, North Dakota created a new tier in its teachers' pension plan with changes in service and age requirements and a benefit calculation based on a five-year average of salary instead of three years.

Ohio lawmakers will consider pension reforms in 2011. Among them are increasing contributions, changing the benefit formula, reducing the cost-of-living adjustment and boosting the years of service required for retirement. The changes would affect new employees.

In 2004, Ohio reformed its pension governance systems by changing the membership of its pension boards, requiring an ethics policy and mandating continuing education for members.

Oklahoma increased retirement benefits in the 1980s and 1990s but state officials did not fully meet actuarially required pension contributions while the liability was building up. Pension reform will be a priority of lawmakers in the 2011 session. On the table is a change to a defined contribution, 401(k)-style plan for new hires. In 2007, the state increased employer contributions to its teachers plan and in 2004 hiked state agency contributions to its public employees' pension plan.

Oregon in 2003 shifted to a hybrid pension plan for new employees that provides less in benefits than employees hired before them receive. State officials also doubled employers' contribution rates beginning in 2011.

Pennsylvania was perhaps the most generous of the 11 states that boosted public pension benefits in 2001 when it increased benefits 25 percent for state employees and teachers, with ensuing cost-of-living adjustments for retirees. The state had been counting on strong investment returns to finance the benefit expansion but the 2008 Wall Street financial crisis dealt a serious blow—28 percent—to the pension fund. Because

state officials had spread out the cost of the benefit increases, Pennsylvania is expecting a big jump in employee contribution rates in the coming years. Lawmakers are weighing proposals to fix the spike in rates.

Rhode Island raised the age of retirement from 60 to 62 for new hires, provided a somewhat smaller benefit as a percent of final salary, reduced future annual benefit increases, and tightened eligibility for disability benefits in 2010. The minimum retirement age for current workers will depend on their length of service.

South Carolina in 2005 increased employer and employee contribution rates and set a 1 percent a year cost-of-living adjustment, one of the main cost drivers of the unfunded liability. In 2008, the cost-of-living adjustment was increased up to 2 percent each year if certain conditions were met, including that the plan funding ratio not drop that year as a result of the cost-of-living increase.

South Dakota, one of the last states to increase benefits before the Wall Street financial crisis in 2008, retreated in 2010 by removing the cost-of-living adjustment for retirees in the first year they leave state employment and reducing the percentage of the increase. A retiree challenged the state's action in court, alleging the state broke its contract. The South Dakota case, which is similar to legal challenges filed by retirees in Minnesota and Colorado, is being watched nationally because if the states prevail, other legislatures may seek to trim or suspend cost-of-living adjustments. South Dakota also increased benefits in 2002.

Tennessee has not enacted substantial public pension reform in recent years. In 2007, the state changed the age and service requirements for public safety officers.

Texas increased the age and service requirements for public employees, provided a smaller benefit as a percent of final salary and reduced the benefit available to those who take early retirement. The Legislature will consider increasing the state's share of the cost of the pension system in 2011.

Utah, facing a crisis in its pension fund after the 2008 Wall Street crash, replaced its traditional defined benefit plan in 2010 with one that offers newly hired employees a choice between a defined contribution plan or an arrangement that combines features of a defined benefit and defined contribution plan.

Vermont officials reached an agreement on a teacher pension plan in 2010 that bucked a trend away from defined benefit plans. The accord between the Legislature, the state treasurer and Vermont's largest public employee union will result in most teachers working additional years and making higher contributions to

the pension fund but receiving a larger pension check on retirement. The savings will help plug the state's budget gap.

Virginia is requiring new employees to pay into the state pension fund for the first time and trimmed the cost-of-living adjustment for future retirees. To balance the state budget, Governor Robert McDonnell deferred the state's public pension payment until 2013—with interest.

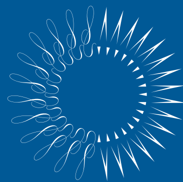
Washington has had a pattern of sweetening public pension benefits since 1998, allowing retirees to receive an additional benefit when investment returns exceed 10 percent a year for four years. The state tried to suspend the program because of its rising pension costs but a superior court judge upheld the program. If the ruling stands upon appeal, a state actuary says the pension program could require $150 million or more from the general fund. Washington reduced employee and employer contributions in 2001 because of strong investment performance. In 2004, the Legislature established a minimum monthly benefit of $1,000 for certain retirees and increased that minimum benefit by 3 percent annually. And in 2006, the state increased benefits for members who had been retired for 25 years or more.

West Virginia's teachers retirement plan was a defined contribution system between 1991 and 2005, when officials closed it to new members because members were experiencing such small investment growth that they said they would be poorly prepared for retirement. The teachers had a choice of moving to the defined benefit plan or staying in the defined contribution plan. In 2006, West Virginia made a $718 million contribution to their retirement plans to address unfunded liabilities. The contribution was needed because in 2005 voters rejected a plan to sell up to $5.5 billion in pension bonds.

Wisconsin, which has one of the best funded public pension systems in the country, replaced its standard cost-of-living increase with a dividend that is paid to retirees if investment returns are positive. The state issued $729 million in pension bonds in 2003 and at that time became the first state to issue bonds for non-pension benefits as well, about $600 million.

Wyoming has started asking current and future state workers to contribute to their retirement; before 2010 the state paid the cost. The state and employees also will contribute a higher percentage share of pension costs.

The Pew Center on the States is a division of The Pew Charitable Trusts that identifies and advances effective solutions to critical issues facing states. Pew is a nonprofit organization that applies a rigorous, analytical approach to improve public policy, inform the public and stimulate civic life.



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