BASIS STATEMENT FOR AMENDMENTS ADOPTION MAY 10, 2018/ STATEMENT OF COMMENTS:

The Participating Local District ("PLD") Advisory Committee and MainePERS staff proposed several substantive changes to Chapter 803 to enhance the PLD Consolidated Retirement Plan's ability to protect the basic retirement benefit and improve the long-term financial health of the Plan. The impetus for these changes was a decline in the Plan's funding level from 109% before the 2009 financial crisis to 86% as of the end of fiscal year 2016 following two-years of flat investment market performance.

The PLD Advisory Committee, established by 5 M.R.S. § 18802-A, is composed equally of members who represent PLD employers and employees. The Committee and staff worked for 18-months studying the Plan and various options for improvement before proposing these changes. As part of that process, the MainePERS Executive Director conducted 28 informational sessions around the State regarding the options under consideration during the fall of 2017. Notice of these sessions was provided by email to PLD employers, who were asked to share the information with their employees who are MainePERS members. Notice was provided to retiree's by mail. Information about the sessions also was posted on the MainePERS website. More than 500 employers, employees, and retirees attended these sessions. Feedback from these sessions was considered by the Committee and staff and incorporated into the final proposals.

The substantive proposals are as follows:

1. Withdrawal Liability. A withdrawing district would be required to make a withdrawal liability payment to avoid having that district's share of the Plan's liability imposed on remaining PLDs.

Requiring a withdrawal liability payment is an important provision now that the Plan is not fully funded. If, as under the current rule, PLDs can withdraw without paying their share of the Plan's UAL, rates will have to increase for the remaining PLDs and members to pick-up the shortfall. Rising rates may incentivize other PLDs to withdraw, potentially starting a cascade that would be disastrous to the Plan's ability to pay the basic retirement benefit. The proposed withdrawal liability payment will tend to negate that scenario while providing the withdrawing PLD with a measure of predictability and a fair liability payment that can be paid over time.

2. Unused Accrued Time. The ability to increase the retirement benefit by including unused sick or vacation leave would be eliminated except for members retiring with at least 20 years of creditable service.

Under the current rule, members may substantially increase their retirement benefit if they have unused accrued leave at the time of retirement. This add-on to the basic benefit was adopted in the mid-1970s and since has been pared back for the State/Teacher Retirement Plan, but not for the PLD Consolidated Plan. This abrupt increase at the end of a career exceeds the member's funding and thus burdens other members and PLDs. The proposal retains this add-on as a retention incentive for long-term employees, while otherwise eliminating it.

3. Risk Sharing. The risk of market increases and decreases would be shared among employers, employees, and retirees through variable contribution rates split 55% employer, 45% employee, with aggregate caps of 12.5% for employers and 9% for employees. If as a result of experience losses those caps would be exceeded, COLAs would be reduced for cost neutrality, but not below zero.

Market rate risk traditionally has been on the employer, with employee contribution rates fixed and employer rates adjusted annually to account for gains or losses. This framework has prevented employees from sharing in gains (and losses) and exposed employers to the prospect of unlimited future rate increases. Large market downturns or several years of flat markets may incentivize PLDs to withdraw from the plan because of rising contribution rates. Also, this type of pressure on contribution rates has led other plans around the country to freeze or eliminate COLAs to reduce plan funding pressures, which negatively impacts retirees.

The proposal would allow employees to share in gains (and losses), provide limits on how high rates could go to reduce risk and lessen withdrawal incentives, and lower the pressures that could lead to COLA freezes or eliminations.

4. Early Retirement. Members retiring before normal retirement age would have the amount of their benefit payments reduced to fully account for the actuarial cost of the additional benefit payments before normal retirement age. To reduce the impact on those career members nearing retirement, members with 20 or more years of service as of July 1, 2019, will continue to be eligible for the subsidized benefit payments available under the current rule.

Members who retire early receive a higher lifetime benefit than they otherwise would because they receive additional benefit payments in retirement. Under the current rule, these members have a benefit reduction factor of 2.125% or 6% per year of early retirement, depending on the date they entered the plan. However, the actual cost of these extra payments is approximately 6%-7% of the retiree's normal benefit for each additional year of early retirement. These additional costs are subsidized by all remaining active members and employers through higher contribution rates. This change would create equity between members retiring before and after normal retirement age.

5. COLA Cap and Waiting Period. The COLA cap would be lowered to 2.5% and the waiting period increased to two years.

The prospect of unlimited COLAs increases actuarial liabilities and puts pressure on plan funding. As noted above, in poor market conditions, this has led to COLA freezes and eliminations in other plans around the country. In order to alleviate this pressure, several years ago a 3% cap was placed on COLAs in the Plan, and there is a post-retirement waiting period of one year before COLA eligibility. Lowering the cap to 2.5% and lengthening the waiting period by one year will improve future Plan funding prospects with a low probability of a significant impact on retirees in light of the Consumer Price Index for Urban Consumers ("CPI-U") experience over the past 30 years (30-year average of 2.6%; 20-year average of 2.2%; and 10-year average of 1.7%). Should this change, COLA caps and waiting periods can be revisited through further rulemaking.

6. Retirees Returning to Work. When a retiree under the Plan returns to work in a position covered by the Plan, at the election of the employer, either: (1) contributions would be paid to the Plan for that position at the UAL contribution rate; or (2) the retiree would re-enter the plan, meaning benefit payments would stop and service credit would resume accruing. This change would not apply to retirees who already have returned to work in a covered position under an employment agreement until the agreement expires or July 1, 2021, whichever is earlier.

When a covered position is filled by a retiree, under the current rule the Plan loses the contributions that would be paid if the position were filled by an active member. The employer thus is not paying its full share of the Plan's UAL. If this practice were to become widespread, it could have a significant impact on plan funding.

The proposal corrects this problem. The UAL rate for FY2019 would be between 2% and 4.6%, depending on the particular plan covering the position. As the plan funding improves, the UAL rate would decrease. Once the Plan is fully-funded, the rate would be zero.

In addition to these substantive changes, the amendment also makes non-substantive language corrections and deletes historic references no longer needed.

Notice of this proposed amendment and public hearing was published in accordance with 5 M.R.S. § 8053 on March 21, 2018. Additionally, a mailer describing the proposed changes was sent to all PLD members and retirees on April 5, 2018; an email describing the proposed changes was sent to all PLD employers on April 10, 2018; and a second mailer was sent to all PLD members and retirees on April 20, 2018, advising them of the deadline for written comments.

A public hearing on the proposed amended rule was held on April 12, 2018, before the MainePERS Board of Trustees. Twenty members of the public attended the hearing. Comments were made at the hearing by five individuals, two labor organizations, and three PLD employers.

Written comments were received from 29 individuals, one labor organization, one human resources organization, and eight PLD employers (one of whom, the Maine Municipal Association, also represents other PLDs) by the comment deadline of April 27, 2018.[1] Some organizations submitted comments both at the public hearing and in writing.

Most of the comments received, 25, concerned the retirees returning to work provisions. Nine comments concerned the early retirement provisions. Five comments each were received regarding the unused leave and withdrawal liability provisions. Four comments were received regarding risk sharing and three were received regarding the COLA cap. Other comments criticized the System's communications, supported or opposed the changes in general, or addressed issues not in the proposed amendment. The comments are addressed by subject matter below.

1. <u>Retirees Returning to Work</u>.

Twenty-three commenters expressed opposition to this proposed change,[2] and two expressed support.[3]

Several of those opposed to the change emphasized the importance of retiree return to work on law enforcement recruitment. They pointed out the difficulty faced by many departments in recruiting qualified employees and expressed concern that the proposed change would cause an exodus of employees and difficulty filling positions.

Some commenters asserted that it would be unfair to change the rules on retire/rehire after they had made career, retirement, and financial decisions based on the existing rules. Some pointed out that this would be particularly unfair when retirees are not permitted to change their retirement elections, and that many were told when they

[1] Comments were received after the deadline from Marlene McMullen-Pelsor, Arthur Ledoux, Jennifer Lodge, Scott Walker, Tom Baran, and Craig H. Skelton. These comments were similar in content to comments submitted by the deadline.

[2] Shane Cote; Keith Ouellette, Caribou Police; Daniel Wells; Susan Bell; Shawn O'Leary; Ed Antz; Scott Adkins, Hancock County; Pamela Hile, Sagadahoc County; John Johnson; Martin Fournier; Anne Davis, City of Gardiner; Mark Holt; Paul Gaspar, Maine Association of Police; Greg Given; John Desjardins; Kate Dufour, Maine Municipal Association; Charles Rumsey; Dawn DiBlasi, Somerset County; Bill MacDonald, Town of Houlton; Don Brewer, Maine Local Government Human Resources Association; Gregory T. Zinser, York County; William Gagne; and Phillip L. Crowell, Jr.

[3] Ben Freedman, International Association of Firefighters, Local 740, Portland; and David Gagnon

retired that there were no restrictions on returning to work. One referred to the proposed change as punitive.

Some expressed concern about losing their jobs or not being rehired because they do not know what the UAL rate will be or whether their employer would be willing to pay it.

One PLD employer representative, whose PLD views "retire in place" as a benefit it offers its non-union employees, stated that it does not think this change should be made because the System does not know how widespread the practice is. A law enforcement labor organization asserted that further study should be done on the extent and effect of the practice before taking steps that will adversely impact law enforcement staffing.

One person said that the change would lead to the retirees becoming outside contractors doing the same work at greater cost to the PLDs and no benefit to the Plan. Another said that this would cause PLDs to offer retirement alternatives to the Plan. One commenter stated that the proposal will put PLDs at a disadvantage to non-PLDs in recruiting. Two commenters asserted that the proposal is based on the assumption that the position would be filled by a Plan member if not filled by a retiree, an assumption that one of the commenters thinks may not be true and the other thinks should be tested before a solution is adopted.

Many commenters asked that if this change were to be made, that it should apply only to future rehires. One PLD employer representative explained that it should not have an additional cost imposed for decisions it made in the past. Another said that it would require employment contracts to be rewritten. A third opined that applying the change to new hires would be sufficient to keep the practice from becoming widespread. One commenter suggested that it also not apply to those within five years of retirement who have planned on using this practice and have been promised and assured that they could do so.

One firefighter labor organization supported the proposed change. This organization said that unregulated retire/rehire has caused problems in other plans across the country, and we should not wait until there is a crisis here to address it. This commenter agreed with others that staffing problems exist, but stated that one of the best recruiting tools they have is a healthy pension. A second commenter supported the change, but questioned why it had not been done sooner and opined that restitution should be paid by those who had engaged in the practice.

After considering these comments, the Board decided not to adopt the retiree return to work changes at this time and instead direct the System to perform more outreach and solicit further public input before bringing this proposal or a modified proposal forward in later rulemaking. At least some of the comments opposing the proposed change were submitted in the context of not knowing what the UAL rate might be that would have to be paid. The FY2019 rates, at between 2% and 4.6%, are considerably less than the rates that would be required to be paid if the position were filled by a Plan member. These rates will decline as Plan funding improves, and any potential growth in the rates would be limited by the contribution caps discussed elsewhere in the rule. The modesty of these rates should mitigate the potential adverse consequences identified by the commenters, including recruitment impacts, retaining current rehired retirees, competitive impacts, and disincentives to Plan participation. Further outreach and public input informed by knowledge of these rates would be beneficial prior to rulemaking on this issue.

2. Early Retirement.

Ten individuals made comments opposing the proposed change to reduce the benefit for those retiring before normal retirement age to reflect the full cost of early retirement.[4] They indicate that it is unfair to apply this change to current members who have based plans and decisions on the existing rule, which at least some viewed as a promise or contract. One stated that when the law was changed in 2013 to introduce a 6% reduction factor for new members, he was assured that the reduction factor would not be increased for current members. Commenters noted that changing the reduction factor from 2.125% to 6-7% was a dramatic increase at one time and suggested a phase-in or lowering the threshold from 20 years to 10 or 15 for the exception. Individuals questioned whether the proposal is appropriate in light of the current well-funded status of the Plan.

The Board has considered these comments, and decided to adopt the early retirement reduction factor change as proposed. Without this change, every person retiring early with a lower reduction factor is imposing costs on the plan that will have to be paid by other members and PLDs. While it is the understandable that members who have expected a lower reduction factor would view this change as unfair, it would be unfair to impose the cost of the early retirement decision on others. The Board does not believe that it is appropriate to wait until the Plan is in a funding crisis to make this change.

3. Unused Accrued Time.

Five people objected to the proposed changes restricting the use of unused accrued leave time to enhance the retirement benefit.[5] They viewed the proposed changes as

[4] Daniel Wells, Ed Antz, Gretchen Gardner, Scott Evans, Kevin Hanscombe, Shawn Smith, Mike Lennox, Steve O'Leary, Blain Searle, and Forrest Dudley

[5] Jeff Harren, Kathy Jellison, Robert Stanton, Susan Bell, and Johanna Hanselman. Ms. Jellison is a member of the State/Teacher plan, so the change would not apply to her.

unfair to those who started covered service later in life and cannot or do not plan to stay long enough to fall under the 20-year exception. One commenter who is planning to retire in September with less than 20 years of service thought it unfair to make this change effective July 1, 2018, giving little notice to those on the verge of retirement. One commenter said that the ability to get service credit for up to 90 days of accrued sick leave was one of the reasons she joined MainePERS.

After considering these comments, the Board adopts the proposed change except that the effective date is changed to July 1, 2019, to avoid impacting those members on the verge of retirement. Members beginning MainePERS service later in life would have had other retirement savings opportunities during their pre-MainePERS work-life. Members also can increase their benefit without using accrued leave by working longer. For example, the 90 days of service credit now available for accrued leave equates to delaying retirement approximately four months.

4. Withdrawal Liability.

Four PLDs and one individual submitted comments opposing the proposed withdrawal liability provision. A labor organization supported the proposal.

Three of the PLDs made the comment: "In addition to imposing a potentially crippling economic burden on current employers who may need to withdraw from the Plan, it is likely that this could effectively discourage any new members in the future."[6] The individual commenter thought that this change was inconsistent with the concept of voluntary participation.[7]

Another PLD asserted that the withdraw liability payment provision is unnecessarily complex and does not provide enough cost certainty to the withdrawing PLD.[8] This PLD suggested that instead of having the withdrawing PLD pay the fluctuating UAL rate on its remaining active members, either the UAL rate should be fixed or the withdrawing PLD's portion of the UAL should be paid without any UAL rate applied to the remaining active member payroll going forward.

The labor organization opposed changes to the proposed rule that would make it easier for PLDs to withdraw and reduce employee benefits.[9]

The Board adopts the proposed change, modified to permit the withdrawing PLD and Executive Director to agree to the more predictable payment methodologies proposed by the PLD. Requiring a withdrawing PLD to pay its share of the Plan's UAL is fair

[6] Scott Adkins, Hancock County; Pamela Hile, Sagadahoc County; Dawn DiBlasi, Somerset County
[7] Daniel Wells
[8] Ken Ginder of Verrill Dana and Kevin Brooks, both on behalf of Maine Veterans Homes
[9] Ben Freedman, International Association of Firefighters, Local 740, Portland

and important to the Plan's sustainability. The ability to pay this share over time mitigates the economic burden and any disincentive to join the Plan. The modification provides greater flexibility without encouraging withdrawals. The Board also modifies the proposal by eliminating the processing fee for a withdrawn PLD that rejoins the Plan. This modification removes an unnecessary potential disincentive to rejoining.

5. Risk Sharing.

Three PLDs expressed concern and uncertainty about variable contribution rates, with employer aggregate rates capped at 12.5%. They are concerned about being able to forecast and budget for the potential fiscal impact.[10] One individual agreed generally with the concept of variable rates, but thought that the employee rate should be increased to 10% to help with plan funding and stabilize employer rates.[11]

The Board adopts the change as proposed with one modification. To avoid abrupt changes in contribution rates in moving to the risk sharing model, language is added to the amended rule's transition section to permit the new rate allocation to be smoothed in over an actuarially sound period of time. With the proposed change, as modified, PLD forecasting and budgeting will be no more difficult than previously and may be less difficult. Employer rates will continue to be set annually as they have been previously and the caps will limit any upside growth in rates. The FY2019 rates already have been communicated, and rates for FY2020 will be communicated later this calendar year. A fixed higher employee rate is not adopted because it is contrary to the concept of risk sharing and unlikely to be acceptable to many members.

6. COLA Cap and Waiting Period.

Four individuals took issue with lowering the COLA cap to 2.5%.[12] Some noted that although inflation has been low for many years, that has not always been the case, and inflation above 2.5% could return. Two of the individuals noted that the current provisions already protect against unreasonable increases, and changing the COLA provisions as proposed would burden those least able to make up for a loss of income.

The Board adopts the changes as proposed. If the inflation environment changes from what it has been in recent decades, the COLA provisions may be revisited in future rulemaking.

[10] Scott Adkins, Hancock County; Pamela Hile, Sagadahoc County; Dawn DiBlasi, Somerset County
[11] Leonard Blanchette
[12] Karen and Richard Mank, David Gagnon, and John Gill

7. Other Comments.

Several commenters criticized the timing and clarity of the communications sent by MainePERS to members, retirees, and PLDs regarding the changes.[13] The Board acknowledges that it would have been preferable for the mailers and PLD email to have been sent out earlier, and if the first mailer had stated up-front that the changes were only proposals and subject to Board consideration. It also would have been preferable to communicate the expected magnitude of the UAL rate proposed to be paid in the case of retirees who are retired. Nevertheless, with respect to the proposals adopted by the Board, sufficient notice was given to apprise interested parties of the proposals and permit them to comment on them.

One individual recommended that the use of overtime hours be limited in calculating retirement benefits.[14] Another individual recommended that there should be a refund to a retiree's estate if the retiree dies sooner than expected.[15] These recommendations are not part of the proposed amended rule, and the Board declines to adopt them without a recommendation from the PLD Advisory Committee.

One person expressed general support for the proposed changes.[16] Another expressed general opposition.[17]

In conclusion, the Board adopts the proposed amended rule with the following modifications: (1) The retire-rehire provision is not adopted at this time; (2) The effective date for the accrued leave provision is changed to July 1, 2019; (3) The withdrawal liability payment provision is modified to permit an agreement to pay the withdrawing PLD's portion of UAL without future variability, and the fee for rejoining after withdrawal is eliminated; and (4) The transition to the risk sharing model's contribution rates is to be smoothed-in. These modifications do not substantially change the amended rule as proposed.

At the Board's regular meeting held on May 10, 2018, Terry Hayes made the motion, seconded by Phil Brookhouse, to adopt the amended rule. The motion was unanimously approved by those Board members present.

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[13] Shawn O'Leary; Scott Adkins, Hancock County; Pamela Hile, Sagadahoc County; Dawn DiBlasi, Somerset County; Mark Holt; Cathy Moriarty; Lauren Carrier, Maine Turnpike Authority; Charles Rumsey; and Phillip L. Crowell, Jr.
[14] John Peverada
[15] Leonard Blanchette
[16] Karen Fussell
[17] Gregory T. Zinser, York County