



STATE OF NEW JERSEY

Benefits Review Task Force

The Report of the
Benefits Review Task Force
to
Acting Governor Richard J. Codey

December 1, 2005

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INTRODUCTION

REPORT OF THE BENEFITS REVIEW TASK FORCE

This report, dated November 21, 2005, contains the recommendations of the Benefits Review Task Force and is respectfully submitted to Acting Governor Richard J. Codey as required by law.

Executive Order No. 39 (the Executive Order) was signed by Acting Governor Codey on May 25, 2005, creating the Benefits Review Task Force (Task Force).

The Task Force consists of eight members, consisting of the six public members appointed by the Governor, the State Treasurer and the Commissioner of Labor and Workforce Development. In accordance with the Executive Order, the public members are individuals with knowledge or experience in the areas of employee benefits, pensions, management, finance or economics in the academic, corporate or government setting. Please see Appendix 1 for additional information regarding the Task Force Members. The Task Force was chaired by Philip D. Murphy, who was appointed to that post by the Governor, consistent with the Executive Order.

Section 2 of the Executive Order charges the Task Force with:

Examining the current laws, regulations, procedures and agreements governing the provision of employee benefits to State and local government workers; analyzing the current and future costs of the benefits; comparing the level of benefits provided to government employees in this State to the benefits provided to other workers; recommending changes to the laws, regulations, procedures and agreements designed to control the costs of such benefits to the State's taxpayers, while ensuring the State's public employees a fair and equitable benefit system.

EXECUTIVE SUMMARY

When we accepted Acting Governor Codey's May 2005 invitation to serve on the Task Force, we were fully aware of the political and economic consequences that our recommendations would have on the short and long-term health of the state. We commend Governor Codey for his decision to start a serious conversation about this growing problem.

To help us in our deliberations, we did not limit ourselves to our over 150 years of corporate and academic experiences with employee compensation. We received extensive input during five public meetings held across the State and we solicited input via email from our website. We heard from dozens of members of the public; two former State Treasurers; numerous advocacy groups representing key constituencies and stakeholders; and over a dozen scholars and national experts. Please see Appendix 9.

We were quickly reminded that public employee benefits are not simply a line item in the budget. They represent an important part of compensation. Benefits are an integral tool of State and Local governments to attract and retain a high quality workforce. We were also made cognizant of the increasing cost of providing these benefits; the annual challenge the State faces funding these benefits; and the need to protect the interests of all citizens.

Our recommendations attempt to identify feasible solutions that ensure that appropriate pension and health insurance benefits are available to career employees at an affordable cost. To arrive at these recommendations, our research and discussion was driven by a core set of values:

- State and local governments have a moral obligation to their employees to make the payments they promised to make.
- State and local governments also have a moral obligation to always act with fiscal integrity, openness, and honesty.
- The pension system was meant for career employees. Abuses by the politically well-connected are more than simply inappropriate; they erode the integrity of the system.
- The pension benefit structure must be able to attract and retain a high quality workforce. But that goal must be consistent with a benefit structure that is affordable.
- The collective bargaining process must be respected and input from public employees is essential as future changes are considered.
- Health care benefits are directly related to wages. Health care costs can, and must be, controlled through the collective bargaining process.

We also decided that :

- Some sacrifices on the part of all stakeholders is reasonable as a way to shore up the finances of the system, ensuring that benefits continue to be available over the longer term.
- While what is "fair" is not easy to define, a widely-distributed sacrifice that does not fall disproportionately on low and moderate-income retirees is to be preferred to other possibilities.

Our recommendations are broken into five themes.

First, government at all levels must meet its current and future commitments to fund the pension plans. They must also commit to using financially sound practices and be accountable to taxpayers. While workers continued to contribute, the State enjoyed a pension holiday for seven of the past nine years. Moreover, the State changed the accounting and valuation rules as it saw fit to justify both pension holidays and increased benefits. Such valuation gimmicks and pension holidays must end.

Second, the rules that allow the politically well-connected to game the system for their own benefit must be changed. The pension system exists to serve public employees who dedicate their careers to government and the eligibility rules must ensure that only they can participate. When non-deserving individuals are allowed to essentially freeload off the system, everyone loses. The bottom line is the system must be returned to those for whom it was designed.

Third, restoring integrity to the system is critical but ultimately the current structure of the benefit programs cannot be sustained over the long term (unless taxes are to be significantly increased or other spending significantly cut). The Task Force considered, but ultimately rejected, far ranging structural changes such as switching from a defined benefit plan to a defined contribution plan.

Instead the Task Force identified two major ways to modify the benefit structure. First, in recognition of increasing life expectancies, longer work, and a possible “brain drain” at the state and local level due to the upcoming retirement of baby boomers, raise the age at which one can retire with full benefits to sixty from fifty-five. Second, to make the pension reflect a longer time horizon of an employee’s salary, base the pension on the average of the five highest salaries (as opposed to the current three) or on the highest three years (for those individuals for whom it is now based on the highest single year).

As further elaborated in the recommendations section, members Paula Voos and William Rodgers felt additional information was needed before they could support these two recommendations.

Health care changes are the most difficult to address but in light of the rapid increase in costs, changes are necessary. Unlike pension changes, which are made through legislative action, changes in health care benefits are made through negotiations between the government and its employees. Our recommendations respect this process and are meant to serve as a framework for the next round of negotiations. The recommendations are meant to encourage significant change in the cost sharing and health care arrangements presently offered.

The Task Force did not recommend adopting a two-tiered system of benefits. Instead, the Task Force believes that active and retired employees must contribute a greater amount to their health care whether through co-pays, deductibles, or other means. The State should provide a fixed contribution to health care coverage and create greater options to ensure that every employee has access to coverage and is protected against a catastrophic incident.

Prescription drug costs are proportionally much higher in New Jersey than in other states. To narrow this gap, New Jersey should increase the use of generic drugs. The State should also use mail order for maintenance drugs and the State should hire its own pharmacy benefits manager.

Finally, the governance and process for reviewing and approving benefit enhancements is broken. Both political parties have used enhancements to obtain support and they continually pass with overwhelming bi-partisan support. The manner in which the Legislature switched to $n/55$ to calculate retirement income provides the best example of a political process in need of reform. Putting aside our policy beliefs about the decision’s wisdom, the fact is the only reason the State was able to “afford” the change

was because the legislation the legislation statutorily changed the valuation method used for pension fund assets. Furthermore, the benefit was applied retroactively. Not surprisingly, this change was done in an election year environment with support from both political parties.

Everyone will be focused on the dollar value of the recommendations we have made. The Task Force chose not to start this process with a set goal of achieving some pre-determined amount of savings. The Task Force did not view its job as changing benefits to meet a budget number. The Task Force does not believe that is the appropriate framework. Rather, the Task Force went through its deliberations and considered every possible option on its individual merits. That is the spirit of its recommendations.

That being said, we understand that this Task Force was created because of a growing concern about the affordability of these benefits over the long term. We were assigned the job of offering ideas and recommendations for the State's policy makers to consider as they approach a very difficult job; and we have done that.

Any of the changes we recommend reflect input that was received during our work and our experiences as professionals and consumers of government services. We have put forward our ideas, which now have to be considered by the Legislature and discussed with the stakeholders as part of the governmental process. In the past, the process for changing benefits has often failed to meet the highest standards of fiscal integrity. Future changes must be considered under a process that is more transparent, accountable and fiscally responsible or we risk making the same mistakes all over again.

In terms of timing, we did not choose our recommendations based simply on what could or could not be implemented quickly. We made our recommendations based on changes that we believed to be feasible. Some changes can be made quickly. Other changes will take more time. We leave this process to our elected officials with the caveat that reform of the system should start now and must be a top priority of the next Governor, Legislature and organized labor.

In our main report we have made more than thirty recommendations for changes to the pension and health benefit program. When feasible, we have listed the potential savings next to each recommendation below. We describe their benefits and costs in more detail in our report.

Specific Recommendations:

I. Government Must Meet Its Obligation

No More Pension Holidays — State and local government must meet their full obligation to make annual payments to the pension plans.

No More Actuarial and Valuation Gimmicks — State government must use consistent and generally accepted actuarial standards.

No more pension bonding.

The \$12.1 billion unfunded deficiency must be immediately addressed.

II. Put a Stop to the Abuses and “Gaming” of the System

End pension boosting and tacking.

- *Restrict end of career salary hikes.*
- *Require employees to designate a single job for pension purposes.*

- *Base pension on average of five highest salaries as opposed to current three highest salaries or highest three years where it is currently highest single year. (Annual savings range from \$45 million if implemented for employees who are not vested, to \$260 million if applied to all current employees.)*

No pension for professional service contractors and vendors.

Elected officials and appointees should participate in defined contribution plans instead of defined benefit plans.

No pensions for convicted officials.

Limit sick day payouts at all levels of government, not just the State.

III. Structural Reform of Pension Benefits

Maintain the current defined benefit plan with changes but do not move to a defined contribution plan for public employees.

No pension credits for jobs that pay less than \$5000 (current threshold is \$1500). (Combined annual savings to state and local governments \$3.7 million. This threshold should be periodically indexed for inflation.)

In order for pensions to reflect a slightly longer time horizon of a worker's salary history, base pension on the average of the highest five years of work, not three years; or the highest 3 years, instead of the single highest year.

In recognition that life expectancy is increasing, people are working longer and the State is expected to face a "brain drain" due to the upcoming retirement of the baby boomers, raise the age at which an employee (PERS and TPAF only) can retire without a reduction in benefits to sixty from fifty-five. (If enacted immediately and traditional retirement practices continue, annual savings could be as high as \$175 million. However, this figure does not account for employees choosing to leave public service prior to the recommendations implementation. If the number of retirements is large enough, the savings could be a more modest figure.)

Permanent moratorium on early retirement plans.

Extend moratorium on benefit enhancements put in place by Governor Codey.

IV. Structural Reform of Health Care Benefits

All current and retired employees should contribute to health care. (If State and local governments contributed 95% instead of the current 100% towards the base plan, annual savings would be \$350 million. Again, these savings are only illustrative and any changes to health care cost sharing would have to be done through negotiations.)

Merge Traditional and NJ PLUS health care plans into a new Preferred Provider Organization (PPO) option. (Combined annual savings \$104 million for State and local governments.)

Increase use of generic drugs to reduce prescription drug costs.

Obtain State's own Pharmacy Benefits Manager (Estimated annual savings \$27-\$45 million.)

Immediately apply health care benefits changes negotiated by State in last contract to local employers and employees. (\$23 million annual savings for local governments.)

Provide greater health care options for local negotiations.

V. Strengthen Process for Reviewing Benefit Enhancements

Members of the Pension Health Benefits Review Commission should have no conflicts of interests.

Require every benefit bill to:

- *identify a revenue source;*
- *certify its costs and revenues have been developed in accordance with generally accepted actuarial principles; and*
- *estimate the benefits and costs to impacted constituencies.*

Collectively bargained agreements should be independently analyzed and a report made public prior to adoption.

THE HISTORY OF PENSION AND HEALTHCARE BENEFITS

Pensions:

“A History of Sound Financial Principles”

Early in the history of New Jersey’s State-administered retirement systems, the State Legislature recognized the need to place these systems’ plans on a sound financial footing by requiring the application of generally accepted actuarial principles to pre-fund public employee pensions. The consistent application of sound funding principles over the years allowed New Jersey’s plans to grow into one of the largest and well-funded pension plans in the country. Since the early 1990’s, this growth and stability has attracted administrations to use the Pension Fund Systems as a tool to balance the State budget. The funds were used to offset tax reductions and some were to maintain or expand current programs. These choices, along with pension benefit enhancements that generated increased liabilities, and the downturn in market conditions, have led to the increased pension costs being experienced by State and local public employers today.

First Steps

The Teacher’s Retirement Fund was established in 1896 as a statewide contributory annuity plan for teachers (L. 1896, c. 32). Because no provision was made for funding the liability for these pensions, the plan experienced financial difficulties to the extent of near collapse by 1919. To address the large unfunded pension liabilities of this plan, the Legislature established the Teachers’ Pension and Annuity Fund (TPAF) with the enactment of L. 1919, c. 80, which continues to be the State-wide retirement program for teachers in New Jersey. This legislation was the State’s first effort to use sound actuarial principles.

A significant aspect of the law that created the TPAF was that the Legislature, for the first time, recognized as policy that public funds should be used to fund State and local public employee pensions, and that public retirement systems should be “established on a scientific (actuarial) basis” to “protect the future well-being” of their members (L. 1919, c. 80, Preamble). These same sound funding policies were subsequently reflected in laws enacted by the State legislature establishing several other defined benefit pension plans for other classes of public employees in this State, including the following:

Public Employees’ Retirement System (PERS): L. 1954, c. 84

Police and Firemen’s Retirement System (PFRS): L. 1944, c. 255

State Police Retirement System (SPRS): L. 1965, c. 89

Judicial Retirement System (JRS): L. 1973, c. 140

Consolidated Police and Firemen’s Pension Fund (CPFPPF): L. 1952, c. 266

Prison Officers Pension Fund (POPF): L. 1941, c. 220

Laws providing for the PERS, PFRS and CPFPPF allowed local governments to move from their unfunded pensions to State-administered plans that allowed centralized administration of these benefits and funding on an actuarial reserve basis. (Please see Appendix 5 for a glossary of terms and acronyms used in this report.) Today, the process of consolidating public retirement benefits in a State-administered plan is virtually complete, with the exception of the Employees Retirement System of Jersey City and a small number of special funds for lifeguards in a few beachfront cities that are still open to new members.¹

¹ *The New Jersey Pension System*, by Tom Bryan, *Pensions in the Public Sector*, edited by Olivia S. Mitchell and Edwin Husted, University of Pennsylvania Press, 2001.

Adherence to sound pension funding principles, in accordance with the Governmental Accounting Standards Board (“GASB”), has allowed New Jersey’s plans to become one of top ten retirement systems in the nation in terms of market assets, the size of which can be seen in Table 1. By the year 2000, the market value of the plans assets had exceeded \$85.8 billion and the GASB funded ratio (Valuation Assets divided by Accrued Liability) peaked at 111.4%:

Table 1: Pension’s Funded Levels (in millions)

Valuation Date	Valuation Assets	Accrued Liability	Unfunded Liability	GASB Funded Ratio	Market Value of Assets
6/30/1995	42,288.6	45,173.3	2,884.7	93.6%	40,581.0
6/30/1996	49,888.0	48,653.8	(1,234.2)	102.5%	50,399.6
6/30/1997	53,324.7	52,063.0	(1,261.7)	102.4%	55,216.2
6/30/1998	60,042.6	56,936.3	(3,106.3)	105.5%	68,973.1
6/30/1999	67,570.5	61,732.7	(5,837.8)	109.5%	78,855.8
6/30/2000	74,047.7	66,465.6	(7,582.1)	111.4%	85,863.1
6/30/2001	83,440.8	76,427.3	(7,013.5)	109.2%	74,905.3
6/30/2002	83,426.3	82,240.3	(1,186.0)	101.4%	65,813.9
6/30/2003	82,527.9	88,265.3	5,737.4	93.5%	64,227.5
6/30/2004	82,750.5	94,864.5	12,114.0	87.2%	69,699.3

Experts have advised that the declines might not be significant, yet the Task Force is concerned with the long-term health of the funds for the reasons that follow.

Sound Pension Principles Not Prioritized

Beginning in the early 1990’s, a number of pension changes were implemented to offset tax reductions and to maintain or expand current programs that are important to the State’s citizens. Hindsight has shown that these existing pension changes led to an erosion in the health of the plans.

The Pension Revaluation Act (PRA), L. 1992, c. 41, changed the methodology by which plan assets were measured. Instead of continuing to use book value, a shift was made to using actual market value (Market Value of Assets or MVA).

The higher MVA, as well as an increase in the projected rate of return from 7 percent to 8.75 percent, resulted in a \$733.4 million and \$785.7 million reduction in State and local employer pension contributions for Fiscal Years (FY) 1992 and 1993, respectively.

PRA also allowed the use of what is known as market-related value (determined through a “5-year averaging” of plan assets, called the Actuarial Value of Assets or AVA). The plans could have stayed actuarially sound with AVA, however, the Legislature several times subsequently switched from the conservative AVA to the higher MVA, with the sole intention of reducing employer contributions to the funds.

More Major Pension Changes

Pension funding policy was revised again with the enactment of the Pension Reform Act, L. 1994, c. 62. This major piece of legislation revised the actuarial funding methodology for the State plans from the conservative entry age normal (EAN) method to the projected unit credit (PUC) method. Although still

an actuarially accepted method of pension funding, the shift to PUC reduced State and local employer pension contributions by \$547.4 million and \$946.8 million for FY 1994 and FY 1995, respectively. Those amounts represented a majority of the contribution due those years. Only eight states use PUC.

A third significant change in pension funding policy was instituted with the enactment of the Pension Security Plan (PSP), L. 1997, c. 115. PSP allowed the issuance of \$2.75 billion in pension obligation bonds to finance the plans' outstanding unfunded pension liabilities that had emerged due to the previous pension changes. Additionally, PSP allowed the use of surplus pension assets to offset employers' annual normal contributions to the pension system. The PSP funding policy change resulted in either complete or partial reductions in the State's and local employers' otherwise required normal contributions to the plan for FY 1997 through FY 2003, as shown in Table 2.

Table 2: Employer Pension Contributions (in millions)

PENSION FUND	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Public Employees' Retirement System										
State	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 24.5
Local	\$ 57.0	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 42.4	\$ 121.8
Teachers' Pension and Annuity Fund	\$ 54.0	\$ -	\$ 258.8	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 94.9
Police and Firemen's Retirement System										
State	\$ 15.1	\$ 53.7	\$ 25.3	\$ 61.7	\$ -	\$ -	\$ -	\$ 22.2	\$ 49.3	\$ 73.5
Local	\$ 235.0	\$ 233.5	\$ 266.8	\$ 213.0	\$ 225.7	\$ 0.2	\$ 0.4	\$ 53.4	\$ 132.7	\$ 261.0
State Police Retirement System	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 0.2	\$ 12.9
Judicial Retirement System	\$ 9.6	\$ 13.5	\$ -	\$ -	\$ -	\$ -	\$ 8.5	\$ 3.4	\$ 6.2	\$ 8.0
Consolidated Police & Firemen's Pension Fd	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 0.5	\$ 2.7	\$ 2.0	\$ 7.0	\$ 6.4
Prison Officers' Pension Fund	\$ 2.8	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
TOTAL	\$ 373.5	\$ 300.6	\$ 551.0	\$ 274.7	\$ 225.7	\$ 0.7	\$ 11.5	\$ 80.9	\$ 237.9	\$ 603.1

A fourth significant change in pension funding policy was L. 2003, c. 108. That law enabled local employers to "phase-in" as of FY 2004 their total contributions due in increments of 20 percent a year. They will reach 100 percent in 2008 for the PFRS and in 2009 for the PERS. The phase-in further increases the unfunded accrued liability by a portion of the current \$12.1 billion. At this time, employee contributions that had been decreased from 5% since 1997 to as low as 3% annually were returned to 5%, except for PFRS contributions that had remained at their 8.5%. The State is also doing a "phase-in," but its contributions are coming in part from the Benefit Enhancement Fund (BEF) of L. 2001, c.133. BEF was to have been used to pre-fund the recent "n/55" pension enhancement.

These past actions describe the complex nature of short term needs and long term impacts, and the impact that pension liabilities have on the overall State budget. Had these actions not been taken, it is likely that either programs would have been reduced, tax cuts would not have occurred and/or taxes would have been increased potentially at both the State and local level.

While the trend to seek budgetary relief through changes in pension funding policy aimed at decreasing employer contributions to the plans has contributed to today's high State and local employer pension costs, the problem was exacerbated by the enactment of legislation that provided pension benefit enhancements. These enhancements increased pension liabilities considerably. The most costly was provided by L. 2001, c. 133 (known as n/55), which increased PERS and TPAF pensions by 9.09 percent, while increasing pension liabilities by over \$4.2 billion, a portion of which represents the cost of providing the n/55 benefit to retirees, to past service for current employees, and to the cost for future service for current employees. L. 1999, c. 428, which provided enhanced pensions benefits including "20 and out" and "50

percent surviving spouse pensions” similar to the State Police for members of the PFRS, increased pension liabilities by over \$500 million. Numerous other pieces of legislation were enacted that provided pension enhancements to prosecutors, workers compensation judges and others. Cumulatively, since 1999, these enhancements increased State and local pension liabilities by over \$6.8 billion (Please see Appendix 7). Because of a constitutional State mandate, State-pay issues, the annual additional pension costs arising from the increased local employer pension liabilities attributable to these enhancements are, or will be, State obligations.

Market Downturn Impacts Pension Funds

The downturn in market conditions compounded the impact of legislative changes to funding policy and benefit enhancements. For FY 2001 through FY 2003, pension fund assets experienced either negative investment returns, or rates of returns that did not meet actuarial expectations of 8.75 percent:

Table 4: Actual Rates of Return on Pension Fund Assets

FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
16.1%	11.9%	-10.4%	-9.0%	3.3%	14.1%	8.7%

In summary, the combination of enhancements, reduced contributions and lower rates of return have resulted in a \$12.1 billion unfunded accrued liability that must be addressed.

Health Care:

“A History of Rising Costs”

The State’s benefits package includes providing health benefit coverage to State employees, including dependents, and those who retire with 25 or more years of service (L. 1972, c. 75).

In 1987, the Legislature expanded the State’s obligation to provide the post retirement healthcare (PRM) benefit to local employees who retire from school districts (L. 1987, c. 385), giving them the same benefit provided to state employees in 1972. However, when in 1997 the State negotiated changes for State retirees requiring cost sharing, the teachers’ plan was unchanged. The Legislature again increased the State’s PRM obligation in FY 1997 to include locally employed police and firemen retiring from locations that did not provide post-retirement medical benefits (L. 1997, c. 330).

Efforts to deal with the State’s increasing employee health benefit costs resulted in the enactment of L. 2002, c.11, which allowed the State to completely deplete reserves accumulated in the Post Retirement Medical (PRM) Fund in FY 2002 and FY 2003 (\$338.9 million and \$110.4 million, respectively). Continued budgetary constraints made the Legislature decide to curtail funding into the PRM account, as required by L. 2002, c.11, for FY 2004, FY 2005 and FY 2006 by \$67.1 million, \$69.6 million and \$72.5 million, respectively.

Since 2001, the costs of providing health benefits to State employees and retirees through the State Health Benefits Program (SHBP) have continued to rise, for reasons that experts advise range from an aging population to high technology medical procedures. In spite of the State’s efforts to reign in these costs through initiatives such as premium sharing and limiting participation in the SHBP’s Traditional Indemnity Plan for State employees, these costs continue to increase (See Table 5.)

New Healthcare Reporting Requirements

The State's fiscal obligation to provide employees with health benefit coverage after retirement will be more visible with new financial reporting requirements (Government Accounting Standards Board Statements Nos. 43 and 45) which will require the State to include the PRM liability for the first time in its financial statements beginning in FY 2008. The PRM liability has initially been estimated to exceed \$20 billion.

Table 5: State SHBP Costs (in millions)

	Actual				Projected				
	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Health Benefits - Active	\$ 701.3	\$ 837.2	\$ 912.8	\$ 990.9	\$ 1,089.9	\$ 1,249.8	\$ 1,421.7	\$ 1,618.1	\$ 1,842.3
Health Benefits - Retired	\$ 50.8	\$ 429.3	\$ 741.3	\$ 911.2	\$ 1,015.2	\$ 1,254.0	\$ 1,533.6	\$ 1,875.8	\$ 2,294.5
Total Health Benefit Costs	\$ 752.1	\$ 1,266.5	\$ 1,654.1	\$1,902.1	\$ 2,105.1	\$ 2,503.8	\$ 2,955.3	\$ 3,493.8	\$ 4,136.8
% of Change from Prior FY		68.4%	30.6%	15.0%	10.7%	18.9%	18.0%	18.2%	18.4%

Note: PRM payments in FY 2002 and FY 2003 (\$338.9 million and \$110.4 million, respectively) are not shown in Table 5, making the percentage increases in FY 2003 and FY 2004 very large. PRM is not shown because Table 5 reflects contributions made out of annual appropriations.

For FY 2005, the State's cost of providing all of the various benefits to employees and retirees exceeded \$2.72 billion. In the table above, the figure of \$1,902.1 million represents SHBP costs. (It should be noted that local employers' cost is \$1.724 billion.) The \$2.72 billion comprised more than 8.1 percent of the total State budget for that fiscal year. If the State does nothing, based on current trends, these costs are projected to exceed \$6.94 billion by FY 2010 and comprise over 21.3 percent of the State's annual budget. (Note: These figures do not include items such as salary, FICA, vacation days, fringe, etc., totaling approximately \$5.2 billion annually, that are not in the Task Force charge.)

RECOMMENDATIONS¹ AND CONSEQUENCES, FINANCIAL AND OTHERWISE

I. *The State (and by extension local government) must meet its financial obligation by fulfilling its duty to fund the pension system.*

From the 1990's to the present, public employers at all levels of government have not fully adhered to their financial commitments to their employees. Before anything can be asked of employees in terms of a changed benefit structure, the State must first meet its existing obligations. Accordingly, the Task Force's initial recommendations are focused on meeting this commitment.

1. **Use consistent and generally accepted actuarial standards to determine pension fund asset values, obligations and annual contributions.**

The retirement system actuaries use consistent and reliable standards for determining pension fund values and contribution requirements. Methodologies for determining pension fund values and contribution requirements should not again be changed in order to mask the true cost of benefit enhancements.

Any modifications to assumptions or actuarial methodology at the direction of the State that change asset values, obligations or annual contributions, should require public disclosure prior to adoption including a financial impact analysis.

2. **Immediately reduce the Defined Benefits Plans' \$12.1 Billion deficiency.**

We estimate that \$12.1 billion is required to eliminate the current fund deficiency across all systems, including \$8.6 billion for the State, and \$3.5 billion for local government employers.

The \$12.1 billion is an estimate upon which actuaries rely to ensure full funding in future years. It contrasts with the widely-reported \$25 billion deficiency, which is based solely on current market values. It is expected that the difference between the two numbers will be made up over time by the market, sound finances and full contributions. Accordingly, resolving the \$12.1 billion deficiency is the priority.

We reluctantly acknowledge that such a large reduction in the liability might be achieved through the sale of a publicly-owned asset. While we are generally opposed to a one-time asset sale to generate revenue, we feel compelled to put aside our reservations and make the recommendation. By reducing the current \$12.1 billion deficit as the result of a state contribution from the sale of a state asset, the annual pension payments will be significantly reduced for both the state and local employers.

This reduction in the current unfunded deficiency might also be achieved over time through normal cyclical increases in revenues and/or savings generated by other recommendations contained in this report. We do not support the sale of bonds for this purpose. If the Governor and the Legislature sells a publicly-owned asset to reduce the liability, it should be done only in conjunction with other reforms as recommended in this report in a "Global Settlement."

¹ All recommendations require legislative action, except as indicated. All figures are based on information provided by the New Jersey Department of the Treasury, except as indicated.

In other words, a one-time sale of a publicly-owned asset cannot be the only step taken to reduce the liability.

The following chart illustrates future projected savings based upon various scenarios involving additional contributions in FY 2006.

Employer contributions would be reduced with a “one-time” payment, as follows:

Annual State Contributions to Pension Funds

	If “one-time” \$8.6 billion payment is not made	If “one-time” \$8.6 billion payment is made	If ½ of “one-time” or \$4.3 billion payment is made
FY '06	\$1.5 Billion	\$944.5 Million (for a savings of \$555.55 million)	\$1.22 Billion (for a savings of \$280.0 million)
FY '07	\$1.8 Billion	\$1.1 Billion (for a savings of \$700.00 million)	\$1.45 Billion (for a savings of \$350.0 million)

Figures reflect State obligations for the PERS, TPAF, PFRS, SPRS and JRS.

Annual Local Employers Contributions to Pension Funds

	If “one-time” \$3.5 billion payment is not made	If “one-time” \$3.5 billion payment is made	If ½ of “one-time” or \$1.75 billion payment is made
FY '06	\$740.0 Million	\$558.0 Million (for a savings of \$182.0 million)	\$649.0 Million (for a savings of \$91.0 million)
FY '07	\$835.0 Million	\$591.0 Million (for a savings of \$244.0 million)	\$713.0 Million (for a savings of \$122.0 million)

Figures reflect Local employer obligations for the PERS and PFRS.

3. Make annual full, actuarially sound pension payments.

The State and local employers participating in the retirement systems must be required, by explicit legislation, to make the full employer contribution each year as determined by the plan actuaries. The full contribution includes: a) annual payments of the actuarially determined normal pension contribution (defined as costs associated with service accrual between the past year and the current year); and, b) payments of a portion of any unfunded accrued liability (the difference between assets and liabilities amortized over a 30-year period, as authorized by law).

A full annual employer contribution was the practice of State government for the entire existence of the pension systems prior to the enactment of the 1997 Pension Security Plan. Much of the reason for the erosion in the pension systems’ fiscal health is attributable to the enactment of that law (L. 1997, c. 115). From FY 1997 to FY 2003, employers did not have to make contributions to the pension funds. The lack of contributions was compounded by another provision of Chapter 115, P.L. 1997, which allowed the use of surplus pension assets to replace the annual payments that should have been made by employers, as determined by

generally accepted actuarial principles. A subsequent law, L. 2003, c. 108, has led to the resumption of contributions (on a phased-in approach) with FY 2004's \$27.5 million, FY 2005's \$62.8 million, and FY 2006's \$220.2 million. However, this phased-in approach has also used surplus pension assets.

Offsetting normal employer contributions with surplus pension assets is not a prudent practice. Although State and local employers received holidays from most pension payments for seven years as a result of 1997 legislation, once the surplus assets were depleted the plans quickly returned to under-funded status, and employer pension bills became much higher than they otherwise would have been (a result of not only the deferral in funding but also the downturn in the market and the various benefit enhancements previously discussed).

4. Practice good fiscal stewardship, and do not use unsound techniques.

The State's operating budget shortfalls should not be closed through Pension Obligation Bonds or other unsound funding techniques. They create the illusion of healthy, well-funded plans, enabling State and local employers to avoid payments. Unsound funding techniques should not be part of the state's future fiscal practices. Avoiding them is a sound practice, and has the added benefit of focusing the State on the cost of any proposed benefits enhancements.

II. Prevent Abuses or "gaming" of the pension systems.

The state pension system primarily exists to provide retirement security to public employees who dedicate their careers to public employment. It was never intended to be a means for a handful of politically connected individuals to enhance their own retirement benefits at public expense. This "gaming" goes to the very integrity of the pension system. It hurts everyone from the taxpayers who must pay the pensions to public employees who see their retirement system weakened by pension payments inconsistent with the legitimate goals of a state pension system. The Task Force notes the extensive documentation of these abuses in a recent media series and the call for reform made in the 1998 State Commission of Investigation Report on Pension and Benefit Abuses.

1. End pension boosting, padding, tacking and other systemic abuses.

"Boosting" (or "padding") the retirement benefit occurs when an employee obtains a salary that is much higher in their final year(s) of service in order to increase their pension benefit. This can occur when someone who works on a part-time basis for much of their career moves to a full-time position for the necessary period of time to increase their benefit, or when a public employee obtains a high-paying position at the end of their career to achieve similar results.

"Tacking" occurs when a public employee accepts multiple positions at the same time in order to increase the salary base that will be used for retirement purposes.

In these situations, the funding generated by employer and employee contributions over the course of an employee's career is insufficient to cover the value of their retirement benefit. Insufficient contributions result in an underfunding and puts further pressure on the entire pension system.

These abuses were highlighted in a recent series by the Gannett newspapers. For example, a vendor was paid \$145,000 by virtue of three positions as attorney to three school boards. Though he admitted to the press that subordinates at his firm do some of the work, his pension would be over \$70,000 if he retired today.

To eliminate these practices, the Task Force recommends the following:

- A. No pension for contractors/vendors. Since the principal purpose of any public retirement plan is to provide adequate retirement benefits, such coverage should only be extended to “true” public employees.

a) Professional services vendors, such as municipal attorneys, tax assessors, etc., who are retained under public contracts approved by an appointing agency should not be eligible for a pension. In our opinion, these employees simply do not meet the original purpose of the public retirement plan and should not be eligible to participate in any pension plan.

In addition to preserving the integrity of the pension funds for those who had dedicated their lives to public service, this change will also serve as a disincentive to “tacking”.

- B. No defined benefit pensions for elected or appointed individuals. Instead of the defined benefit plan that is currently offered, elected officials and political appointees should be eligible for a defined contribution plan similar to the Alternate Benefits Plan (available to higher education employees). A prohibition on participation in the Defined Benefits Plan would not apply to those who have previously vested with a defined benefit pension account and who meet the annual income requirements.

A defined contribution plan is a more portable benefit and more appropriate for individuals such as appointees or elected officials who may only remain in public employment for a short period.

In addition by moving elected and appointed officials from the defined benefit system to a defined contribution plan, the opportunity for political games with individual pensions would be greatly reduced, if not eliminated.

- C. No tacking of several jobs. There is currently no prohibition against employees enrolling in the retirement system through multiple jobs and aggregating the salaries for the purpose of increasing their retirement calculation. This practice cannot be continued.

Employees must be required to designate a single job on which their pension will be calculated, and contributions will be derived solely from this job.

As reported in the Asbury Park Press, State records show that salaries annually attributable to “tackers” are estimated to total \$238 million. By requiring “tackers” to choose only one position upon which to base their pensions, and assuming one position results in a decrease to their aggregate pensionable salaries by 50 percent, annual savings are estimated to be as follows:

	Annual Savings (PERS)
State	\$2.7 Million
Local	\$4.5 Million
Total	\$7.2 Million

- D. No pensions for convicted officials. The Task Force believes that public monies should not be used to provide retirement benefits to individuals at any level, whether elected, appointed or hired, who have been convicted of violating the public trust.

Currently, the forfeiture of pension benefits for convicted employees is not automatic under existing statute. N.J.S.A. 43:1-3 requires the Boards of Trustees of the State retirement systems to consider and balance several factors (length of the public service, the gravity of the misconduct, whether the misconduct was isolated or ongoing, relationship of misconduct to the employee's public duties, and other sanctions already imposed) when determining whether forfeiture or partial forfeiture of an employee's pension is appropriate.

Of the 50 cases in FY 2005 considered for possible pension benefit forfeiture, 34 cases resulted from criminal activity and 4 were total forfeiture.

- E. End pension boosting by restricting end of career salary hikes. The ability to dramatically increase salaries, particularly at the end of a career, must be restricted. Restrictions are a matter of fairness to all employers and taxpayers who ultimately pay the cost for the pension system deficits caused by boosting. While long-term employees should be fairly compensated for their expertise and experience, excessive increases should not be permitted to have an adverse impact on the retirement systems.

As an example of boosting, a recent PERS employee with 24 years of service earned less than \$10,000 a year, until being paid \$141,000 in the last year of employment. At 25 years of service, without the boost, his retirement benefit would have been approximately \$3,600 annually. With the boost, his retirement is based upon his prosecutor's one year's highest salary and his pension benefit is over \$70,000 annually, representing an unfunded liability for the government of over \$500,000.

To limit boosting at the end of a career that results either for an individual or in collective bargaining, the following actions should occur:

- 1) The Division of Pensions and Benefits will examine at least 5 years of salary history for all members filing for retirement.
 - 2) If in any one year a member's salary is increased by more than the average plan experience, then the increase will be reviewed. That average is currently actuarially based at 5.95% for PFRS and 5.45% for all others, and is adjusted periodically based on system experience. The formal "Review" will be done by the Division of Pensions and Benefits.
 - 3) During the "Review," the employer is required to provide documentation justifying the salary increase(s). The employer must also verify whether these increases were given on an individual basis or to other employees as well. Acceptable salary increases include: legitimate promotions, negotiated contracts, and part-time to full-time employment.
 - 4) In any case, the higher pension that results shall be permitted only if the employer pays any unfunded liability (amount over 5.95% for PFRS in the example above) that results from the higher salary. If the unfunded liability is not paid, the amount of the pension that the retiree receives will be based upon the lower salary.
- F. End sick day manipulation. The State's cap on sick day payouts of \$15,000 must be implemented at all government levels. This applies to the lifetime amount of unused sick days. Use of sick day payouts is only a pension issue for local employers that allow sick days to

be included in the final average salary for pension benefit calculation, but is also a costly retirement benefit that is appropriately in this section of the report. As documented in the 1998 State Commission of Investigation Report on Pension and Benefit Abuses, the 11 highest payouts in one year totaled approximately \$1 million, with an average per person payout of nearly \$100,000.

III. *Implement Strategic Pension Reform.*

Public employee pension benefits are an integral part of the State's efforts to attract and retain a high quality workforce. The Task Force also recognizes and supports the policy goal and societal benefit of providing a secure retirement for its citizens. However, those goals must be consistent with a benefit structure that is affordable to the State and fair to the taxpayers who pay the pensions and the employees who contribute to their pensions. Consistent with the Task Force's efforts to require a fair and equitable degree of sacrifice from everyone, the following recommendations are made:

1. **Proposals and philosophies analyzed and considered.**

- A. Maintain Defined Benefit Plans for Employees Instead of Switching to a Defined Contribution Plan. Defined Contribution (DC) Plans have a number of attributes that limit their applicability to most state and local public employees, although they are suitable for well-paid higher education professionals and elected or appointed officials. DC plans place considerably more investment risk on the individual. Hence, they are best for employees who can bear that risk because they have other assets and who are knowledgeable about investment alternatives. DC plans are also more suited to a mobile workforce because they are portable across employers and they tend to promote such mobility. In contrast, Defined Benefit (DB) Plans minimize risk to individuals; professionals make investment decisions that spread risk and maximize returns. DB Plans also can be structured to ensure an adequate level of retirement income; they are particularly appropriate for moderate income employees (who might not have a sufficient income to retire under a DC plan). Furthermore, DB Plans tend to promote workforce stability, which is desirable in many public sector jobs. While the Task Force considered the options of placing all new employees into a DC plan, or even transferring all employees to a DC plan, for all the above reasons, the Task Force recommends against moving from a defined benefit to a defined contribution strategy for public employees in the state of New Jersey. There is simply insufficient current evidence to support such a shift or a justification for such a transition.
- B. Adhere to "n/55" retirement calculation. The Task Force spent considerable time debating the wisdom of the Legislature's decision to adopt the current "years of service" over 55 (n/55) instead of the former "years of service" over 60 (n/60) formula. In our opinion, this change by the Legislature in 2001 is the poster child for why the current system is a failure. Regardless of whether the decision was warranted on any public policy basis, the process by which it was undertaken and the manner in which it was justified and implemented was indefensible.

It was done in the most political of environments, pushed forward in anticipation of an election. In addition, the benefit was provided retroactively substantially increasing the costs to taxpayers. And the pension funds valuation was statutorily manipulated to give the appearance that the benefit was funded.

Despite our strong condemnation, legally there is little that can be done to reverse the change due to state and federal laws regarding retiree and vested employee rights. As a result, this over \$4 billion enhancement can only minimally be reduced. While we would never have made the change to n/55 in the first place, we have made other recommendations to preserve and strengthen the pension funds that are more defensible and appropriate.

- C. Anti-“two-tier” philosophy. The Task Force did not recommend creating intergenerational differences within plans. While not always possible to use two-tier due to the difficulty to implement, the animosity that would result would be detrimental to the workforce and State.
- D. Provide for part timers. While there was consideration given to requiring full time employment for participation in the retirement system, the Task Force determined that a more equitable approach would be to increase the minimum salary requirement to \$5,000 annually.

2. Make a series of adjustments to the Defined Benefit Plans systems.

The Task Force attempted to frame its recommendations within the context of maintaining systems that attract and retain skilled workers. Yet we know how difficult this is and determining the appropriate level and structure of benefits for public sector workers is not a simple process. There are differences between the public and private sectors that complicate a pure comparison between the two. The Task Force spent a great deal of time comparing and debating public versus private sector compensation structures. At the end, we agreed to disagree. Some members of the Task Force felt strongly that historical research finds, on average, that public sectors workers earn less than their private sector counterparts and that benefits have become a crucial tool for attracting and retaining people to public sector careers. Others disagreed that public sector employees earn less.

The Task Force attempted to ensure that every stakeholder contributed toward solving the problem, without unduly burdening any particular group. For reasons explained below, we rejected a massive structural change such as a move to a defined contribution plan. Instead, we made more targeted strategic reforms designed to maintain the current systems with modifications. Even with this effort, Professors Voos and Rodgers still were concerned that some of the changes disproportionately fell on employees, especially low/moderate income employees, particularly if recommendations (a) and (b) below were enacted in concert. They called for more factual research and discussion with stakeholders before legislative decisions were made.

Please see Appendix 4 regarding some areas of additional research not possible with the Task Force's timeframe.

With that summary of our deliberations on this point, we make the following recommendations.

- A. Calculate pensions based on five highest years (where currently it is three) and three highest years (where currently it is one year).

Under current law, the annual pension for individuals in the PERS and TPAF system is calculated based on the average of the highest three years of salary.

For veterans, prosecutors and individuals in the PFRS, SPRS and JRS systems, the annual pension is calculated based on the average of the highest single year of salary.

The Task Force found that basing the annual pension on the highest three years and especially the highest year of salary is inconsistent with national trends among state plans, encourages “boosting” and other manipulation at the end of a public employee’s career by requiring a minimal time commitment, and results in a pension that does not reflect a replacement level of the salary a worker received throughout their time in government. In addition, this change is simply one of the most broadly-distributed ways to achieve savings from employees.

Accordingly, the Task Force recommends increasing the number of base years used to calculate the pension from the average of the highest three years to the average of the highest five years salary (for PERS and TPAF) and from the high one year salary to the average of the highest three years salary (for veterans, prosecutors and individuals in the PFRS, SPRS and JRS).

Please refer to Appendix 3 “Final Average Salary Revisions” for examples of the change in the annual retirement benefit based upon various scenarios. The projected impact varies based upon each individual’s salary history (for salary distributions, please see Appendix 6), which may include promotions, cost-of-living adjustments, etc. In the examples in Appendix 3, the benefit reductions related to this recommendation ranged from 2.64% to 5.97% of the annual retirement benefit."

Savings from Final Average Salary Revisions

	Annual Savings (All Systems)
State	\$148.0 Million
Local	\$112.9 Million
Total	\$260.9 Million

B. Increase the “unreduced benefit” retirement age from 55 to 60.

Current eligibility for retirement is as follows:

PERS and TPAF employees may, prior to age 60:

- terminate their public employment with 10 or more years but less than 25 years of service and vest their benefits until they reach the age of 60;

OR

- retire and receive their pension less 3% for each year before age 55 if they have at least 25 years of service.

Different rules apply for disability retirement.

In light of increased life expectancy, the Task Force recommends that the “unreduced benefits” retirement age for PERS and TPAF members be raised to age 60. It notes that according to Hewitt Associates, “2004-05 Report of Salaried Employee Benefits at 640 Major US Employers With Defined Benefit Plans,” 91% of such large private employers utilize age 65 for normal retirement eligibility. We are told that thirteen states have established a retirement age for a full retirement benefit that is greater than age 55, although additional states’ formulas may have the same result. The thirteen states are: Arizona;

Iowa; Kansas; Kentucky; Maine; Massachusetts; Minnesota; Nebraska; New Hampshire; Oregon; Washington; Wisconsin; and Wyoming, according to the “2005 State Employee Benefits Survey,” done by Workplace Economics. Nonetheless, the majority of the Task Force believes New Jersey should increase the retirement age.

The current average retirement age in the PERS system is over 63 years and TPAF is over 61. So the average public employee would not be affected by this change, and those who would be affected would have the opportunity to change the age at which they retire — they would not necessarily suffer any reduction in benefits.

Based upon a 3% reduction in retirement benefits prior to age 60, a PERS or TPAF member’s benefit would be reduced as follows:

Retirement at age 60 or above...	100% of benefit with no reduction
...at age 59	97% of benefit
...at age 58	94% of benefit
...at age 57	91% of benefit
...at age 56	88% of benefit
...at age 55	85% of benefit
...at age 54	82% of benefit
...and so forth.	

For additional examples, please refer to Appendix 3.

The Task Force recommends the implementation of this modification be phased in over a period of three years. A phase-in is a matter of fairness to employees on the verge of retirement. In year one, the reduction per year between ages 55 and 60 would be 1%, in year two, the reduction per year would be 2%, and finally in year three, the reduction per year for each year of age less than age 60 would remain at 3%.

Total Annual Savings from Retirements Prior to Age 60

	Year 1	Year 2	Year 3
State	\$44.7 Million	\$89.4 Million	\$134.1 Million
Local	\$13.6 Million	\$27.2 Million	\$41.0 Million
Total	\$58.3 Million	\$116.6 Million	\$175.1 Million

Professors Voos and Rodgers urge the legislature to consider a series of issues before adopting this recommendation. One set of issues is fiscal — if these incentives lead to sharply reduced retirement, public employers may suffer increased costs of compensating an older, more highly-paid workforce; it is especially important to hear from School Boards and municipalities about this matter given the role of the property tax in supporting local compensation costs. A different set of fiscal issues involves the pension system itself; gradually phasing-in a changed retirement age

has the potential to lead to a rash of retirements as individuals attempt to retire before the changes go into effect, potentially burdening the pension system with increased costs in the short-run. A second set of issues is distributional. The legislature should garner testimony regarding which employees are likely to retire early despite this reduction; whether those retirees tend to be low/moderate income, with physically-demanding or stressful jobs that would lead them to retire despite these changed incentives, leading to a disproportionate impact on low/moderate income retirees.

- C. No pension year credits for jobs paying less than \$5,000 (as opposed to current threshold of \$1,500) and periodically index this for inflation.

The pension system is meant for individuals who are career employees of the state or local governments. The \$1,500 threshold has enabled many individuals who do not meet this criteria to earn years of credit in the pension system that they do not deserve. It has facilitated pension abuses, such as “boosting,” that occur when members participate at a minimal level for many years and obtain a high-paying position only as they near retirement, or when members who have had a full career take a low paying job prior to retirement in order to extend years of service that are used to calculate the pension. Simply put, this means people who shouldn’t be earning credit in the pension system are and that hurts everyone. The Task Force is not naïve enough to think that increasing the threshold to \$5,000 will eliminate this problem but it will be a meaningful improvement.

The PERS annual salary for enrollment was established as \$500 in 1955 and was increased to \$1,500 in 1986. It has not been changed since. The TPAF has a minimum annual salary requirement of only \$500, which was established at the fund’s inception in the mid-1950s.

As recommended here, to disallow participation for those making under \$5,000 would affect 8,500 people, most of whom are employees of local employers.

Savings to State and Local Employers

	Annual Savings
State	\$.2 Million
Local	\$3.5 Million
Total	\$3.7 Million

- D. Change vesting from 10 years to five (5) years. Lower the vesting requirements from 10 years to five (5) years. The vesting requirement reflects the years of service credit in the retirement system necessary for the employee to be entitled to future retirement benefits.

The recommendation to allow vesting at five years is particularly relevant should the employee resign, instead of retire at the normal retirement age; the retirement benefit is not payable until the former employee reaches the normal retirement age.

The rationale follows commonly accepted private sector practice as required under the Employee Retirement Income Security Act of 1974. Similarly, a minority of states still require 10 years of service for a public employee to vest their earned benefits; many states now allow employees to vest with five (5) years of service credit (or less). While the Task Force considered that if vesting were to remain at 10 years it would prevent more pension liabilities, it considers the cost of lowering the requirement to five (5) years to be minimal.

Cost to State and Locals with Vesting Change

	Annual Cost
State	\$0.0026 Million
Local	\$1.783 Million
Total	\$1.809 Million

E. End retirement system loans. Employees should no longer be permitted to take loans against their pension fund contributions. The pension loan practice is outdated, not only in that employees are charged an insufficient rate of interest (4% instead of an interest rate equal to the State’s anticipated rate of return, which is currently 8.25%), but also because other resources are available for whatever need the loan is addressing. Most states do not have such programs, which also are not commonly available to private sector employees. Approximately \$11 million is lost annually from the retirement systems for each percentage point difference between the plan’s assumed current rate of return (8.25%) and the current loan interest rate (4%).

No Loans to Employees

	Annual Savings
State	\$18.75 Million
Local	\$28.0 Million
Total	\$46.75 Million

3. Declare a moratorium on traditional Early Retirement Incentive (ERI) Programs.

The moratorium would apply to both the State and local level.

Generally, New Jersey’s public employee ERI programs have provided limited, short-term savings in exchange for large, long-term retirement system liabilities. Any future programs aimed at reducing the workforce should be limited to severance packages that have no impact on New Jersey’s public employee retirement systems.

Savings produced by an early retirement program are very much dependent upon not refilling the vacated positions. Experience with the prior ERI programs has shown that refilling of the vacated positions is more than likely, and refilling tends to erode the initial estimate of the savings an ERI program can produce.

Along with the cost of providing enhanced benefits, an ERI program also generates additional costs to the pension system as a result of members retiring sooner than actuarially anticipated. The population targeted by an ERI program would generally retire under normal circumstances within 3 to 5 years of the program’s inception date. The additional pension costs will remain long after the population who participated in the program would have retired under normal situations. As a result, long-term savings become questionable.

In light of the relatively low unemployment rates and the anticipated dramatic increase in retirements as the “baby boom” generation reaches retirement age in the next few years, the advisability of ERI programs is questionable. Instead, programs to encourage older employees to continue to work may be necessary.

These are the remaining costs for previous ERI programs:

	FY 06 Additional Payment to the Pension Funds for Past ERIs
State	\$35.5 Million
Local	\$25.5 Million
Total	\$60.9 Million

	Future obligations for ERIs enacted since 1991
State	\$585.3 Million
Local	\$182.1 Million
Total	\$765.5 Million

The short term budget savings for the first year of the ERI in Fiscal Year 2003 was \$64.6 million.

4. **Offer life-long survivors benefit.** For survivors who meet the rules regarding age difference and relationship to those who die while employed by the State, provide a pension equal to 50% of the pension amount (consistent with current rules on age difference and relationship) that had been earned up to that point by the employee provided that the employee had completed a proscribed period of service (e.g. 10 , 12, 14 years). If the individual had not met the service requirement but was vested and married, the spouse would have the choice of collecting a deferred pension benefit at the earliest age the individual could have collected, or receiving a return of contributions. All other cases would receive a return of contributions.

New Costs to Governments Annually

State	\$15.65 Million
Local	\$ 7.64 Million
Total	\$23.29 Million

Please see Appendix 2 regarding additional pension reform ideas.

IV. *Implement strategic health care reforms.*

The cost of health care, even more than the pension obligation, represents the fastest growing liability to the public employers. The state's fiscal obligation to provide employees with health benefit coverage after retirement will be more visible with new financial reporting requirements (Government Accounting Standards Board statements nos. 43 and 45) which will require the state to include the post retirement medical (PRM) liability for the first time in its financial statements beginning in FY 2008. The PRM liability has initially been estimated to exceed \$20 billion. The State should re-examine its current pre-funding obligations under existing law.

As a general proposition, the provision of affordable health care is critical to keeping citizens, especially senior citizens, out of poverty and to maintaining the overall welfare of the citizenry. As a fundamental policy goal, the Task Force supports the efforts by the State to ensure affordable access to health

care for its employees. However, the State must undertake efforts to manage the double digit increases in costs and encourage smarter health care utilization by consumers and lower costs for the State. As an overriding philosophy, the Task Force believes that participants, both active and future retired, should be contributing towards the cost of their health care.

The Task Force recognizes that health care benefits are inextricably linked to wages and rightly must be negotiated in tandem. However, the Task Force is concerned that while wages are known and increases prescribed, healthcare costs are unknown, not prescribed, and annual increases often far exceed the rate of wage increases. The Task Force applauds the recent bi-lateral negotiations in 2003 and 2004 that produced a limited closure of the Traditional plan as well as other increases in health care contributions. Both parties in good faith demonstrated that savings in this area are achievable. In light of the impact of on-going annual double-digit health care cost increases, these efforts must continue in future negotiations and the Task Force offers the following thoughts.

1. All employees and retirees in SHBP should contribute for health care benefits.

Currently, the State pays the following percentage of costs (exclusive of co-pays) for active State employees for each plan:

- 75% for Traditional; closed to new employees and some bargaining units.
- 95% for HMOs
- 100% for NJ PLUS.

The Task Force believes that all active and retired employees should share in the cost of health care. The current cost sharing method should also be revised so that the employee selects a plan based on personal need and cost. The State would contribute a fixed dollar amount toward each employee's choice, based upon an established percentage of one of the plans. The employee's cost would be higher or lower depending on the plan they select.

For example: if the State or local employer's contribution for employee health care coverage was 95% or 90% of the cost of a base plan (the NJ PLUS plan was used for purposes of developing the estimate) savings in FY 2007 would be as follows:

Annual Savings

	If Employer Contributes 95% of Base SHBP Plan
State	\$130.3 Million
Local	\$218.0 Million
Total	\$348.3 Million

	If Employer Contributes 90% of Base SHBP Plan
State	\$206.0 Million
Local	\$283.2 Million
Total	\$489.2 Million

In order to make universal cost sharing work and to ensure health care access for everyone, the healthcare plan options must be overhauled to include the following choices for participants.:

- A. Develop a safety-net base plan. A base plan or safety net plan must be established that is priced at or near the base state contribution. It should have little or no employee contribution to ensure that every employee will have health care coverage and be protected against catastrophic expenses.
- B. Accelerate the effort to end the Traditional Plan and create a Preferred Provider Organization (PPO). The Traditional Plan's trend toward closure should be brought to a conclusion as soon as possible. This is a plan that is no longer competitive in the marketplace and no longer suitable for the needs of the workforce.

New Jersey must establish a Preferred Provider Organization (PPO) plan. As suggested by a variety of sources at the Task Force public meetings, including representatives of workers, business groups and consultants, a PPO should be offered that allows direct access to doctors without referrals. PPO products provide better discounts for in-network usage, while still allowing participants to access out-of-network providers (although at a higher cost to encourage in-network utilization). The SHBP would therefore receive better provider discounts than the Traditional Plan provides, and unlike the current Point of Service (POS) product, coverage could be available on a nation-wide basis, not just in a few states. Among state and local governments and their employees, the overwhelming trend is towards PPO's as a replacement for POS. New Jersey is in the minority of States that do not offer this option to its employees.

To be cost-effective, the PPO option should replace the existing NJ PLUS and Traditional plans. The plan design should encourage in-network utilization so all parties would receive maximum benefit from available discounts. Creating such a PPO should produce savings of approximately 2% from the current expenditure for the Traditional Plan and NJ PLUS. Savings of an additional approximately 2% would be available if employee out-of-pocket costs for providers not in the PPO network were structured to encourage greater in-network utilization. Savings of 1% should occur from reduced administrative fees due to the elimination of the referral process.

**Annual Savings if Traditional and NJ PLUS Plans
Replaced with More Cost-Effective PPO**

State	\$40 Million
Local	\$64 Million
Total	\$104 Million

2. Reduce Prescription Drug Costs.

Prescription drug costs in the SHBP have doubled in the last 5 years (2001-2005) and are projected to be over \$900 million in plan year 2006. Since cost trends indicate continued double digit annual growth, prescription drug expenses, which currently comprise more than 20% of the total SHBP expenditure, will continue to be a significant cost driver in the years ahead. In order to better manage this expense, the Task Force recommends the following:

- A. Contract directly with a Pharmacy Benefit Manager (PBM). While the State currently has indirect access to PBMs through its medical contracts, the State should contract directly with a PBM through a competitive bid process to provide prescription drug coverage for all employees and retirees.

The transfer to a PBM will establish a master contract with greater volume, ensure the State receives the best deal available, eliminate the current subcontracting arrangements that exist with many of the SHBP health plans, streamline administration and rate-setting processes, standardize coverage and provide greater transparency and audit capabilities.

The State's health care consultant has estimated the potential savings to be approximately 3% to 5% of Rx costs — or \$27 million to \$45 million from directly contracting with a PBM.

- B. Encourage greater Generic drug utilization. There must be greater financial incentives to encourage use of generics. Best Practices in this regard must be explored. New Jersey is one of the lowest “generic fill” states in the nation. Savings opportunities are sometimes lost through the selection of expensive brand name drugs when equally effective, lower-cost generics are available. The most effective way for plan sponsors to encourage generic utilization is to create cost sharing models that compel users to consider alternatives to brand name drugs. To be effective, co-pay differentials between generic and brand should be at least \$15-\$20. Member and physician educational outreach programs are also employed in an effort to increase generic drug use. There are many innovative programs designed to encourage generic drug utilization, including formulary strategies and offering coupons to members waiving co-pays if they use a generic.

- C. Require mandatory mail-order for maintenance prescriptions.

Require mandatory mail order for maintenance drugs for up to 90-day supplies. Mail order pharmacies are very successful at substituting generic alternatives because they take the time to reach out to physicians to discuss alternative therapies.

- 3. Immediately apply health care benefits changes negotiated by State in the last contract to local employers and employees.**

Historically, changes resulting from the State's collective bargaining agreements' have been applied administratively by the State Health Benefits Program (SHBP) to local employers. However, the changes from the 2003 collective bargaining agreements were never applied to the local level. Application of these changes (by the SHBP) would be consistent with historical practice, and would allow local government employers to achieve health care savings that have benefited the State.

The following are the changes instituted at the State level as the result of collective bargaining and implemented in 2003.

- Increases in managed care office visit co-pays from \$5 to \$10.
- Increases in prescription drug co-pays from \$1 for generic and \$5 for brand for a 30 day supply at a pharmacy to \$3 for generic and \$10 for brand, and for mail order drugs from \$1 for generic and \$5 for brand for a 90 day supply to \$5 for generic and \$15 for brand.
- Elimination of multiple SHBP coverage options (See B.5 in Other Sections/ Appendices). An employee may only be covered as an employee or as a dependent but not both.

Local Savings Annually

State	\$0
Local	\$23.0 Million
Total	\$23.0 Million

4. Provide greater health care options for local negotiations.

The State must provide greater options to local employers for cost savings in their employee negotiations. At present, local employers that participate in the SHBP are required to pay the full cost of employee coverage. Premium sharing is currently only allowed for the cost of dependent coverage, and, only if all employees at that locations are treated the same. The State is not bound by the same restrictions in its negotiations. As requested by the League of Municipalities, The Association of County Colleges, and the New Jersey School Boards Association, and other organizations, local employers should be given the flexibility to negotiate terms and conditions of coverage under the State Health Benefits Program. This would include premium sharing arrangements for both employees and dependents on a bargaining unit level, as well as the ability to negotiate what plans are to be included for offering to their bargaining units.

Expected expenditures for local employers in FY 2006 are \$1.04 Billion. If local employers are allowed to negotiate, and reach an agreement to pay 95% (currently local employers pay 100%), the savings would be \$52 million annually.

Please see Appendix 2 regarding additional healthcare reform ideas.

V. *Revamp Governance Process for Benefit Enhancements.*

The current process for reviewing benefits is haphazard at best and excessively influenced by political instead of fiscal motivations. The non-stop requests (and too often action) for legislative action have eroded the state's fiscal health and created a benefit structure that the State cannot currently afford. At the time this Task Force was organized, there were 466 pension and health-related bills introduced in the legislature. We studied voting history for passed legislation and found that, on average, since the year 2000, benefit bills have passed with an average plurality of 89%. Clearly both parties share responsibility for this rush to grant political favors. The benefit enhancement process far too frequently happens in the complete absence of an informed debate on the actual costs of the change, yet alone how it will be paid for over the long term. And far too often, the taxpayer's interests are absent.

Our recommendations focus on bringing independence, integrity and informed debate to the benefit enhancement review process, specifically the overwhelmingly political process of benefit change via legislative enactment.

1. **Moratorium on benefits enhancement.**

A moratorium on benefits enhancement legislation, in keeping with Acting Governor Richard J. Codey's pledge not to sign any benefit legislation that does not provide for a source of funding, should continue.

Benefits enhancements enacted since 1999 will cost State and local employers well over \$6.8 billion. See Appendix 7. Also see Appendix 8 regarding the value of employee member contributions.

2. **The Pension and Health Benefits Review Commission must be strengthened and the public must be provided with more information about the impact of proposed changes.**

A. The Pension and Health Benefits Review Commission (PHBRC) and its members' conflicts of interest rules must be strengthened.

The Task Force considered and ultimately rejected providing greater independent control over the process by which benefits are changed. However, this respect for existing legal restrictions should not be interpreted as contentment with the status quo because the status quo fails the public.

The Task Force believes that through greater transparency and timely information about the impact of proposed changes, the public and the media will be able to serve as a more effective watchdog over the politicization of benefits. The PHBRC must be strengthened to become this independent voice.

The membership of the PHBRC must be overhauled to prevent anyone with a conflict of interest from serving. By conflict of interest, we mean not just those who have a pecuniary interest in the pension or health benefits plans, including the possibility of an effect on their financial well-being in the form of any gained benefit or a detriment, but also members of the government. Members of a government that has negotiated benefits or stands to gain politically from the enactment of benefits pose at least the appearance of a conflict that could preclude an honest airing of the pros and cons of a proposal.

Appointments to the PHBRC should be given to the Governor, the Senate President, the Speaker and each of the minority leaders. Strict criteria should be enacted to require appointments to have an extensive background and experience with employee compensation (whether from the business, legal, academic or labor side). Also overall limits on the number of members from each political party, as well as limits on how many members can come from a single background. Our goal is a diversified group with a high level of experience, knowledge and independence.

B. Any proposed benefits legislation, starting with the recommendations in this report, must include the following elements that will be part of the PHBRC analysis:

- 1) a fiscal note in the body of the bill showing the cost of the proposed law;
- 2) a fiscal note in the body of the bill showing revenue sources to cover the costs;
- 3) a certification that the costs and revenues have been developed in accordance with generally accepted actuarial principles;
- 4) a legislative determination in the body of the bill showing the likely affected constituency;
- 5) the estimated distributional impacts on employees across different income levels and years of service.

C. Collective Bargaining Agreements between the State and its employees should be reviewed by the PHBRC prior to final agreement. PHBRC should present the complete terms and their analysis of revenues and costs supporting all State government negotiated agreements, legislation and SHBC unilateral actions in a public meeting subject to the Open Public Meetings Act, prior to adoption of the agreement. The analysis should contain the estimated distributional impacts as noted in the preceding paragraph.

D. The PHBRC should periodically assess the benefits programs. PHBRC will be required, no less than once every three years, to have completed an assessment of the all benefits programs offered to state workers and participants in state plans to evaluate the relative competitiveness of these benefits in relation to major New Jersey employers, and to states surrounding New Jersey.

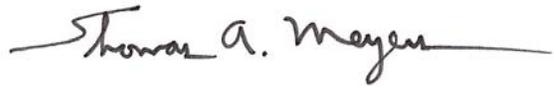
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Philip D. Murphy, Chair



David Alai



Thomas A. Meyers



Richard D. Quinn



William M. Rodgers, III



Paula B. Voos

APPENDIX 1

MEMBERS OF THE BENEFITS REVIEW TASK FORCE

Philip D. Murphy, Chairman

Mr. Murphy is involved actively as a board member in a range of national and local organizations, including: The National Association for the Advancement of Colored People, The Center for American Progress, 180 Turning Lives Around, Local Initiatives Support Corporation and the U.S. Soccer Foundation. Mr. Murphy is a retired Goldman Sachs executive who worked at the firm for over 20 years in the U.S., Europe and Asia and served on its firmwide Management Committee as head of its private client and asset management businesses. He lives in Monmouth County with his wife and their four children.

David Alai

Mr. Alai is Vice President of Corporate Human Resources for Sharp Electronics Corporation (SEC) where in addition to managing the corporate HR and other administrative functions he played a critical role in introducing a pension plan as part of a collective bargaining agreement. As a member of SEC's Retirement Plans Committee, Alai was also responsible for overseeing investment decisions and administrative functions of the plans, as well as ensuring compliance with appropriate government regulations and agencies. In the mid-1980's, he was instrumental in designing and launching SEC's 401(k) plan. Alai is active in community relations; he is on the Board of Directors for the Commerce and Industry Association of New Jersey (CIANJ) and represents Sharp on the Mahwah Chamber of Commerce.

Thomas A. Meyers, CPA, CFA, CPCU

Mr. Meyers is Senior Vice President & Chief Financial Officer, NJM Insurance Group. With more than 21 years of service at NJM, Meyers has extensive experience in the areas of accounting, insurance, finance and management. He serves as an Administrative Committee member on NJM's Employee Savings Fund Plan and Retirement Plan. He previously worked for Ernst & Whinney.

Richard D. Quinn

Mr. Quinn is Managing Director-Human Resources, Public Service Enterprise Group (PSEG), where he is responsible for compensation and benefit strategies for the company's 18,000 employees and retirees. Quinn has more than 43 years of experience in employee benefit plan design, administration, strategic planning, consulting and in compensation planning and over 25 years experience in labor negotiations. In 2002, he served on the NJ Governor's BEST Commission where he prepared an evaluation of the compensation and employee benefit practices of the state. He is affiliated with numerous professional organizations including the U.S. Chamber of Commerce Employee Benefits Committee and the Health Care, Employee Benefits and Executive Compensation Councils of the Conference Board.

William M. Rodgers III

Dr. Rodgers is Professor and chief economist at the Heldrich Center. He is also a senior research affiliate of the National Poverty Center, University of Michigan. Prior coming to Rutgers, he served as chief economist at the U.S. Department of Labor from 2000-2001, appointed to that position by Alexis Herman,

U.S. Secretary of Labor. He was also the Frances L. and Edwin L. Professor Cummings of Economics at the College of William and Mary and served on Virginia Governor Mark Warner's Advisory Board of Economists.

His research examines issues in labor economics and the economics of social problems. In recent years, he has focused his research on the impact of the 1990s economic expansion and now the current job loss recovery on the earnings and employment of Americans. He has written and edited numerous journal articles, books and reports on economic and labor issues. Recently, he and co-author Richard Freeman (Harvard University) published a series of articles titled, "Jobless Recovery: Whatever Happened to the Great American Jobs Machine?"

His policy work includes testifying before the Joint Economic Committee, U.S. Congress, and the NJ Senate Labor Committee. Rodgers holds a variety of board positions, ranging from the National Urban League Institute for Opportunity and Equality Advisory Board, the Congressional Black Caucus Foundation's Council of Academic Advisors, the Economic Policy Institute's Research Advisory Board, the Center for American Progress' Academic Advisory Board and the board of the University of Kentucky Center for Poverty Research. Rodgers' expertise is frequently called upon by journalists for articles in The New York Times, U.S.A. Today, Business Week, and other publications. He has been a guest on CNBC and CNNfn and many radio talk shows.

Paula B. Voos

Dr. Voos currently chairs the Labor Studies and Employment Relations Department at Rutgers University and is the Past President of the Labor and Employment Relations Association. An economist by training, she received her Ph.D. from Harvard University in 1981. Professor Voos has published numerous research articles on collective bargaining, economic policy, and public sector workers; she edited the volume, Contemporary Collective Bargaining (IRRA 1994) and co-edited the book, Unions and Economic Competitiveness with Larry Mishel (M.E. Sharpe, 1992). In 1993-94, she served as a Presidential appointee to the federal Commission on the Future of Worker Management Relations. She has also served on Wisconsin state commissions involving that state's minimum wages and collective bargaining process for state employees. She lives in North Brunswick, New Jersey with her family.

Ex-officio members

State Treasurer John E. McCormac serves on the Task Force. Also serving until his October 17, 2005 appointment by Governor Codey as Executive Director of the Casino Reinvestment Development Authority (CRDA), was Labor and Workforce Development Commissioner Thomas D. Carver. At that point, Governor Codey appointed A. J. Sabath as Labor and Workforce Development Commissioner, and appointed him as a member of the Task Force.

Eric B. Shuffler

Mr. Shuffler serves as Counselor to Acting Governor Richard J. Codey overseeing policy and strategic planning and is the Governor's principal speechwriter. He previously served as Chief of Staff to the NJ Department of Transportation and also worked for 10 years in Washington, D.C. He currently serves as Chairman of New Jersey Family Advocate Management, Inc, on the Board of The Stem Cell Institute of New Jersey and is a Member of the New Jersey Israel Commission.

APPENDIX 2

OTHER IDEAS TO CONSIDER

In addition to the Task Force recommendations above, it is our opinion that there are other ideas worth further study if comprehensive reform in an omnibus benefits bill is undertaken. These ideas follow.

A. *Implement Strategic Reform for Pensions*

1. **Standardize life insurance fees and payouts.** The current Group Life benefit from PERS of 1.5 times salary for an employee who dies is paid by the employer. That 1.5 should be the standard for other plans (TPAF basic benefit is equal to 2 times salary, and PFRS is 3.5 times salary). The program should not be restrictive about enrolling at higher levels of coverage at employee expense. Such an increased-coverage option will address changes in life, such as providing for the needs of any children. Furthermore, the insurance program should be separate from the pension plans.

Savings would be generated by standardizing basic coverage at the PERS level of 1.5. Cost neutral based upon employee paying for extra coverage.

2. **Amend dual pension and salary.** Revisit legislation that provided parameters for simultaneously receiving a public pension and a full public salary. For example, under N.J.S.A. 43:16A-3.1, which applies to police and fire members, a person retiring and taking a new position must continue as PFRS member if not out of the system more than six months; the result has been that members wait six months to get a new job at a high salary. There have been instances of a Police Chief retiring and being subsequently appointed Safety Director, or a school superintendent retiring and subsequently being appointed to the same job pursuant to N.J.S.A. 18A:66-53.2(b).
3. **Revise pension “pop up” increases.** Pensions currently revert to the higher amount for a retiree whose beneficiary dies first.

The Task Force recommends a limit that the “pop up” occur only in instances when the beneficiary dies within five (5) years of retirement, for the purpose of matching the private sector.

Also, have fewer than the eight (8) current retirement joint and survivor payment options for PERS and TPAF. Determining which of the eight are necessary would result in lower administrative expenses and less confusion by simplifying choices for employees.

- Maximum Allowance (Single Life Annuity established prior to 2001)
 - Option 1 – Single life annuity with return of reserve option
 - Option 2 – 100% joint and survivor annuity
 - Option 3 – 50% joint and survivor annuity
 - Option 4 – Other percentage joint and survivor annuity or annuity certain
- Additional Forms of Annuities (established by Chapter 120, P.L. 2001)
 - Option A – 100% pop-up joint and survivor annuity
 - Option B – 75% pop-up joint and survivor annuity

Option C – 50% pop-up joint and survivor annuity

Option D – 25% pop-up joint and survivor annuity

There is no cost savings to be had, since the pop-up program is actuarially determined to be cost neutral. However, as a relatively new program, the State may come to find that a large number of retirees' dependents have died within 5 years, in which case there may be costs that are not currently anticipated.

4. **COLA.** We recommend consideration of discontinuing the provision of a cost of living adjustment (COLA) for those employees who may have worked and vested in the State plan but who do not retire permanently as a State employee (the so-called “vested” termination).
5. **Disability pension should be changed to disability insurance.** All disability retirement benefits in the defined benefit pension systems should be changed to a privately insured Long Term Disability (LTD) insurance program. We would like to have had additional testimony, including from affected members, to describe the advantages of this recommendation; however, the program design should save money and provide greater flexibility for employees. It would be similar to the current disability plan for the Alternate Benefits Program. The program would guarantee a certain level salary replacement for all disabled employees and provide employees with the opportunity to purchase additional coverage for even greater benefits.

Currently, the problem is that there is no middle ground between being temporarily disabled and retirement. Economic circumstances force employees to retire because they do not have the sick time available to use while recuperating. As a result, if an employee's condition improves, it is very difficult to return them to work.

The receipt of a disability pension in the current plan is not contingent upon a member's eligibility for Social Security disability benefits and this eligibility practice should continue under the proposed change. Employer paid medical coverage would continue to be provided during the receipt of an LTD benefit, but only if an employer elects to provide post-retirement medical benefits, as is the case under current law.

A Request for Proposal should be developed with input from Treasury consultants and others familiar with the concerns of those who are disabled, including representatives from the Departments of Labor and Personnel, and should include: an oversight or appeals process when employees or employers disagree with the insurer on the ability to return to employment or on issues related to physical examinations; the accrual of pension service credit while on long term disability; retraining for return to employment; and, ensuring the coordination of temporary disability benefits with the LTD benefits.

The following are savings estimates net the cost of the current disability retirement plan (pending vendor responses):

State Savings for Switching to LTD

	Annual Savings
State	\$28.2 Million
Local	\$53.5 Million
Total	\$81.7 Million

B. *Implement Strategic Reform for Healthcare*

- 1. For “buy backs,” the employee should pay for health care.** The cost of purchasing pension service credit does not include the cost of post retirement medical benefits. These purchases (also known as “buy backs”) are often made in order to reach 25 years of service and qualify for employer paid health benefits after retirement.

For example, a 45 year old seeking to purchase pension service credit would pay an additional \$3000 for each year if post retirement medical coverage was added to the purchase. If buying 5 years back, the cost is \$15,000. With an average of 9,000 buy backs annually, if every person bought one year at \$3000, employers would save \$27 Million per year.

There should be considered a mechanism for refunds for those who purchase the credit and pay for the healthcare, and then do not reach 25 years of service, or who ultimately work more than 25 years of service and wouldn't have had to purchase it.

- 2. End dual healthcare within SHBP.**

Require spouses and domestic partners who are both in SHBP to be on the same policy. This is currently required for state employees and compliance should be verified, and apply to all employees in SHBP.

Seven million dollars is the amount employers would save on fees paid to the plan administrator (i.e., Horizon, Aetna, etc.) in total for all policies eligible to be merged into another policy.

- 3. Implement strategies that allow the State and local employers to reduce the cost of providing healthcare coverage to their employees, when other coverage is available.**

SHBP eligibility and participation rules should be revised and structured to not encourage employees to enroll spouses and dependents where other employer based coverage is available. In some instances, the lack of employee cost sharing and the high level of benefits available encourage anti-selection and results in claims importation. Strategies should be considered that include best practices.

Possible strategies include:

Strategy A) Provide a percentage of cost sharing for the employee, and a higher percentage of cost sharing for enrolled dependents (cost sharing by such means would require a statutory change);

Strategy B) Incorporate a surcharge if the spouse of a State employee with other employer coverage available is enrolled in the SHBP.

Strategy C) Provide cash incentives to not enroll in the SHBP when other employer coverage is available, as is currently used by some municipalities.

For example under Strategy C, possible savings for local employers is \$33 Million, based on \$1000 incentive given to each employee (10% would be expected to accept it). State savings would be \$27 Million.

The opposite of an incentive is a “spousal surcharge” if the employee wishes to cover their spouse. Then the cost to the employee for family coverage will go up depending on the size of the surcharge.

4. Allow better access to information.

There should be easier online access to documents, public evaluations of boards' decisions, and local employer data on fees charged by brokers. Local employers should be encouraged to make broker's fees data available under the Open Public Records Act. There is no cost to government, because citizens would purchase at their expense any documents they wish under the Open Public Records Act.

APPENDIX 3

FINAL AVERAGE SALARY REVISIONS

The following are examples of various retirement scenarios including the benefits provided under the current plan formulae as well as a projected impact of modifications as recommended by the Task Force, including a change in final average salary as well as application of the early retirement discount. For purposes of illustration, we have used actual salary examples but have assumed all participants are retiring at age fifty-five with twenty-five years service.

1) This example describes the pension benefits of a Teacher's Pension and Annuity Fund (TPAF) member. This particular member had moved from a teaching to an administrative position, i.e. Principal, and base salary for the final three years, under the current plan, was \$123,493, \$119,129 and \$114,999 resulting in a Final Average Salary (FAS) of \$119,207. With twenty five years service (25/55), this would provide an annual benefit of approximately \$54,184. If we changed the basis of FAS to five years and added in the two prior years of salary, \$111,586 and \$108,540, the FAS would be \$115,549 **and the resulting annual benefit would be \$52,522, as compared to the original \$54,184, for a reduction of 3.06%.**

If the Task Force recommendation to implement early retirement discounts for retirements prior to age 60, and to change the basis for FAS as described above, as opposed to age 55 as is the current practice, and if the individual elects to take advantage of early retirement, the annual benefit would be further reduced by 3% for each year below age 60 to \$44,643. If this same individual elected to retire at an age between 55 and 60, their pension would be as follows:

Age 56	\$46,219 per year
Age 57	\$47,795 per year
Age 58	\$49,370 per year
Age 59	\$50,946 per year

2) This next case describes a middle income TPAF member, i.e. retiring as a Teacher, with final three year salary of \$72,980, \$69,960 and \$69,150 resulting in an FAS of \$70,696. At twenty five years service, this would provide an annual benefit of \$32,134. If we modified the formula to high five years, and added two prior years at \$67,635 and \$64,320, the FAS would be reduced to \$68,829 **and the resulting annual benefit would be \$31,286, as compared to the original \$32,134, a reduction of 2.64%.** Should this individual elect to take early retirement at age 55, the annual benefit would be further reduced to \$26,585. If this same individual elected to retire at an age between 55 and 60, their pension would be as follows:

Age 56	\$27,522 per year
Age 57	\$28,461 per year
Age 58	\$29,399 per year
Age 59	\$30,337 per year

3) The next example describes a Public Employees Retirement System (PERS) member retiring from a position as a cottage training supervisor with three year salaries of \$46,202,

\$44,608 and \$44,221 resulting in a final average salary of \$45,010. At twenty five years of service, this would deliver an annual benefit of \$20,459. Again, if we modified the FAS to five years and added two years of salary at \$42,500 and \$40,950, the FAS would be reduced to \$43,696 **and the resulting annual benefit would be \$19,862, as compared to the original \$20,459, a reduction of 2.92%**. With early retirement at age 55, this annual pension would be reduced to \$16,883. If this same individual elected to retire at an age between 55 and 60, their pension would be as follows:

Age 56	\$17,479 per year
Age 57	\$18,074 per year
Age 58	\$18,670 per year
Age 59	\$19,266 per year

4) A professional level PERS case was developed with final salaries of \$73,071, \$70,232 and \$68,175 resulting in an FAS of \$70,492. At twenty-five years service, this would provide an annual benefit of \$32,041. If we added in two prior years of salary, \$68,552 and \$63,184, the FAS would be reduced to \$68,043 **and the resulting annual benefit would be \$30,928, as compared to the original \$32,041, a reduction of 3.47%**. Again, with early retirement at age 55, this annual pension would be reduced to \$26,289. If this same individual elected to retire at an age between 55 and 60, their pension would be as follows:

Age 56	\$27,216 per year
Age 57	\$28,144 per year
Age 58	\$29,072 per year
Age 59	\$30,000 per year

5) The final PERS case we examined was for an employee whose final three years earnings were \$34,062, \$33,185 and \$32,328 resulting in a FAS of \$33,192 which would provide an annual benefit of \$15,087. If the pension is based on a high five average and we add in two prior years' salary, \$29,324 and \$27,254, the FAS is reduced to \$31,231 **and the resulting annual benefit would be \$14,195, as compared to the original \$15,087, a reduction of 5.91%**. If the early retirement discount of 3% for each year prior to age 60 is applied, the benefit would be further reduced to \$12,066. If this same individual elected to retire at an age between 55 and 60, their pension would be as follows:

Age 56	\$12,491 per year
Age 57	\$12,917 per year
Age 58	\$13,343 per year
Age 59	\$13,769 per year

6) Finally, we examined one case within the Police and Firemen's Retirement System which currently bases benefits on the final year's salary. We examined the actual case of a police sergeant retiring at twenty five years service with a salary of \$111,566, which under the current formula would deliver an annual benefit of \$72,518 We then examined the effects of a three year average, at \$111,566, \$105,689 and \$97,482, which would produce an FAS of \$104,912. At the current twenty five year benefit level of 65%, **this would provide a resulting annual benefit of \$68,192, as compared to the original of \$72,518, a reduction of 5.97%**.

APPENDIX 4

ITEMS WHICH NEED MORE WORK AND SOME UNASKED FOR OPINIONS

More Work Needed

Six months may seem like a long time, even though each member of the Task Force has substantial professional and other commitments. It turns out there is always more work to do, some of it profound and worthy of standalone attention in its own right. Two of the most important are:

- We recommend a study on New Jersey retirees, present and future. While an important element of such a study will be to compare retirees from public sector careers versus their peers in the private sector, a study, in our judgment, is urgently needed to assess the absolute condition of retirees in the State. We heard from a number of parties and are convinced that poverty or potential poverty among retirees in the future in this State is a real risk — we strongly encourage a full study of the question. An aspect of such a study should include the question of a CPI index feature in public sector employees retirement plans, its importance and its presence in public sector plans and not in private sector plans.
- We debated often the question of whether a New Jersey public employee earns more or less than his private sector counterpart. We saw evidence on both sides and acknowledged all too often that a benefit comparison, excepting wages, was insufficient. A rigorous, New Jersey-focused study inclusive of wage and benefit comparisons between public and private sector workers would, in our judgment, be very valuable to state policy makers. Such a study would most likely include an actuarially-derived benefit index comparison across sectors. Holding constant for items such as education and level of responsibility would be critical factors, among others, for which to control.

Unasked For Opinions

- The principal area which touched our mandate most closely was the asset, or investment, side of the pension debate. Our mandate focused on liabilities and management of those liabilities into the future in a fair and affordable manner for beneficiaries, employers and taxpayers.

The means by which pension assets are invested is, while outside of our purview, nonetheless, a critically important topic. Based upon what we heard and on the collective experience of our Task Force (and accepting that we did not study the matter deeply) it is our sense that the diversification of assets currently underway is sensible. We base that opinion not only on what seems right for beneficiaries in an absolute sense but also on our understanding of the relative comparison to similar institutions.

- We heard from several sources — CWA being a good example — who have done a significant amount of work regarding the State's budget challenges. It seems to us that sessions between the new Administration and organizations, such as CWA, on this topic are sensible.

- We were honored to be asked to examine what is a major budget item for the State and the lifeblood for many of its employees. Ours is not the only category, in our judgment, which merits independent examination of this nature. Candidates include:
 - The manner by which state budgets are set and the feasibility of possible practices such as zero-based budgeting, “pay-as-you-go” requirements and multi-year budgeting;
 - Education, including how it is funded and the quality of the outputs, with particular emphasis on the achievement gap dilemma;
 - The feasibility of streamlining the layers and adjacencies of state, county and municipal governments; and
 - Tax policy, including value received for dollars spent, where the burden is/should be concentrated and relevant state adjacencies.

APPENDIX 5

GLOSSARY

Acronyms and Terms Relating to the NJ State-Administered Retirement Systems and the Division of Pensions and Benefits

- ABP — Alternate Benefit Program** — Program established by several pieces of legislation between 1965 and 1968 for full-time faculty members of public institutions of higher education. Later expanded to include certain administrative and professional titles. Chapter 385, P.L. 1993 increased the number of investment carriers to six. The investment carriers underwriting annuities are as follows: ING Aetna Financial Services, The Travelers Insurance Company (represented by CitiStreet), Lincoln Financial Group, Metropolitan Life Insurance Co., Teachers' Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF) and Variable Annuity Life Insurance Co. (VALIC). The ABP is a "defined contribution" plan as distinguished from "defined benefits" payable by the other State retirement systems. Immediate vesting after the first year's participation offers the mobility of pension credit among the private and public institutions of higher education in the United States and Canada. Group life insurance and long-term disability insurance are underwritten by the Prudential Insurance Company of America, Inc. Employees contribute 5% of salary; the employer contribution is 8%. Statutes can be found in the New Jersey Statutes Annotated, Title 18A, Chapter 66. Rules governing the operation and administration of this program may be found in Title 17, Chapter 7 of the New Jersey Administrative Code.
- ACTS — Additional Contributions Tax-Sheltered Program** — Established in 1996. ACTS is a tax-sheltered, supplemental, retirement program pursuant to Section 403(b) of the federal Internal Revenue Code offered to employees of institutions of higher education, the Commission on Higher Education, the Department of Education, and Higher Education Student Assistance Authority. Eligible employees are able to obtain tax-deferred annuities with a variety of investment carriers through a salary reduction agreement. The annuities are available from the same investment carriers who service the Alternate Benefit Program. Statutes can be found in the New Jersey Statutes Annotated, Title 52, Chapter 18A, section 113.
- AD — Accidental Disability Retirement** — A form of job-related disability retirement benefit available under the defined benefit programs. (Some of the eligibility restrictions detailed in the N.J.S.A. are no longer enforceable under the federal Older Worker's Benefit Protection Act.)
- Commuter Tax\$ave** — A benefit program for State employees, authorized by Chapter 162, P.L. 2001 and available under Section 132(f) of the federal Internal Revenue Code, allows eligible State employees to use before-tax dollars to pay for qualified commuter expenses. Under the program, eligible employees may execute salary reduction agreements to have up to \$100 per month (\$1,200 per year) deducted from salary to pay for mass transit commutation costs and \$195 per month (\$2,340 per year) to pay for parking at work or at park and ride sites. The program was implemented in February 2004. Statutes can be found in New Jersey Statutes Annotated 52:14-17.33a. Rules governing Commuter Tax\$ave can be found in Title 17, Chapter 1, Subchapter 14 of the New Jersey Administrative Code.

CPF — Central Pension Fund — Consists of the administration of a series of noncontributory pension acts. No reserves are established for the payment of retirement benefits. These benefits are administered by the Division in accordance with the governing statute and the rules and regulations of the State House Commission. (Participation is de minimus.)

CPFRS — Consolidated Police and Firemen’s Pension Fund — Defined benefit plan (closed to new entrants since 1955) established by Chapter 358, P.L. 1952, to place locally administered police and firemen pension funds on an actuarial reserve basis. The membership consists of police and firemen appointed prior to July 1, 1944. Statutes can be found in the New Jersey Statutes Annotated, Title 43, Chapter 16. Rules governing the operation and administration of this fund may be found in Title 17, Chapter 6 of the New Jersey Administrative Code.

FAC, FAS, FS, HYF — Final Average Compensation, Final Average Salary, Final Salary, Highest Fiscal Years — A collection of terms used in the various NJ administered defined benefit program pertaining to the base salaries/compensation utilized in the various benefit calculations, specified by the N.J.S.A. governing the various systems. The compensation used in the calculation may be based upon the average salary of the last 3 years, the highest fiscal years (July 1/June 30) the final 12 months (or highest 12-month period) or simply the last reported salary (less common) depending upon the requirement of the governing statute.

FSA — Flexible Spending Account — See Section 125.

GASB — Government Accounting Standards Board — Reporting requirements applicable to public employee benefit plans (similar to FASB in the private sector):

- GASB 25, “Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contributions Plans” Employer contributions are recognized when payable to the funds. Benefits and refunds are recognized when payable in accordance with the terms of the funds.
- GASB 26, “Financial Reporting for Post-employment Healthcare Plans Administered by Defined Benefit Pension Plans.”
- GASB 27, “Accounting for Pensions by State and Local Governmental Employers”
- GASB 32, "Accounting and Financial Reporting for Internal Revenue Code Section 457(b) Deferred Compensation Plans"
- GASB 34, “Basic Financial Statements-and Management’s Discussion and Analysis-for State and Local Governments”
- GASB 43, “Financial Reporting for Post-employment Benefit Plans Other than Pension Plans”
- GASB 45, “Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions”

GLI — Group Life Insurance — Group Life Insurance is available under each of the retirement system statutes and is currently underwritten by the Prudential Insurance Company of America, Inc. Coverage is linked to retirement system participation and the available benefit is linked to active or retired employee status.

- IRC — Internal Revenue Code** — (See Sections 125, 457, 415, 401(a), 403(b), 132(f) elsewhere in this document for additional information on plans administered through the Division of Pensions and Benefits.)
- JRS — Judicial Retirement System** — Established by Chapter 140, P.L. 1973 after the repeal of the laws providing pension benefits to members of the State judiciary and their eligible survivors. All members of the State judiciary are required to enroll. This system is maintained on an actuarial reserve basis. Statutes can be found in the New Jersey Statutes Annotated, Title 43, Chapter 6A. Rules governing the operation and administration of the system may be found in Title 17, Chapter 10 of the New Jersey Administrative Code.
- LTC — State Employees Long Term Care Insurance Plan** — The State Employees Long Term Care Insurance Plan is a voluntary participant-pay-all benefit available to State employees, retirees, and family members. This includes employees and retirees of State colleges and universities. The Prudential Insurance Company administers the insurance plan under contract with the State. The initial offering of the benefit was effective July 1, 2003. Statutes can be found in New Jersey Statutes Annotated 52:14-15.9a and 34:11-4.4b(10). (not group coverage)
- N.J.A.C. — New Jersey Administrative Code** — Rules governing the operation and administration of the various NJ state-administered retirement systems and programs may be found in Title 17, Sub-Chapters 1 through 14 of the New Jersey Administrative Code. Generally, the rules are promulgated by the various boards and commissions, with the exception of Sub-Chapter 1 (General Administration).
- N.J.S.A. — New Jersey Statutes Annotated** — Details the underlying legislative authority for all the retirement systems and programs administered by the Division of Pensions and Benefits. May sometimes be limited by various federal requirements (Internal Revenue Code, ADEA, Older Worker's Benefit Protection Act, etc.)
- NJSEDCP — New Jersey State Employees Deferred Compensation Plan** — Established by Chapter 39, P.L. 1978 and is available to any State employee who is a member of a State-administered retirement system. This plan is a voluntary pre-tax investment program that provides retirement income separate from and in addition to the basic pension benefit. Statutes can be found in the New Jersey Statutes Annotated, Title 52, Chapter 18A. See Section 457 (b).
- OD — Ordinary Disability Retirement** — A form of disability retirement for members of various defined benefit program. (Some of the eligibility restrictions detailed in the N.J.S.A. are no longer enforceable under the federal Older Worker's Benefit Protection Act.)
- PERS — Public Employees' Retirement System** — Established by Chapter 84, P.L. 1954, after the repeal of the law creating the former State Employees' Retirement System. The retirement benefits of this defined benefits system are coordinated, but not integrated with, Social Security. This system is maintained on an actuarial reserve basis. The employee contribution rate is 5%. Under the terms of Chapter 71, P.L. 1966, most public employees in New Jersey not required to become members of another contributory retirement program are required to enroll. Statutes can be found in the New Jersey Statutes Annotated, Title 43, Chapter 15A. Rules governing the operation and administration of the fund may be found in Title 17, Chapter 2 of the New Jersey Administrative Code
- PFRS — Police and Firemen's Retirement System** — Defined benefit plan established by Chapter 255, P.L. 1944. All municipal police and fire personnel appointed after June 1944 are required to become members of this system. Certain State and county employees are also covered. Employer

obligations are paid by the local employers and the State. This system is maintained on an actuarial reserve basis. The employee contribution rate is 8.5%. Statutes can be found in the New Jersey Statutes Annotated, Title 43, Chapter 16A. Rules governing the operation and administration of the system may be found in Title 17, Chapter 4 of the New Jersey Administrative Code.

POP — Premium Option Plan — One of the flexible benefits plans offered by the State to its employees under Section 125 (See section 125). Allows employees who contribute to the cost of their medical or dental coverage to make premium-payments from payroll on a pre-tax basis.

POPF — Prison Officers' Pension Fund — Established under Chapter 220, P.L. 1941. It was closed to new employees as of January 1960. New employees are enrolled in the Police and Firemen's Retirement System. This system is not maintained on an actuarial reserve basis. Statutes can be found in the New Jersey Statutes Annotated, Title 43, Chapter 7.

Pop-up — Pop-up Survivor Option — An additional form of Joint and Survivor option offered to members of the PERS and TPAF through legislation (L.2001, Chapter 120) . While not common in the private sector, the pop-up survivor option is common in public sector plans. As with all survivor options offered under these systems, the factors are determined on an actuarial equivalent basis, rendering them cost-neutral against the maximum allowance.

PRM — Post-Retirement Medical — Refers to employer-sponsored health insurance coverage after the retirement of retirement system members, or the cost of such coverage (i.e. PRM expenditures).

SACT — Supplemental Annuity Collective Trust — Trust established by Chapter 123, P.L. 1963. The Division of Pensions and Benefits administers two SACT plans. SACT Regular is open to all NJ public employees and all employee contributions are post-tax. SACT Tax-Sheltered is available to public school employees. Also see Section 403(b). Members make voluntary additional contributions through their pension funds to purchase variable retirement annuities in order to supplement the benefits provided by their basic system. Statutes can be found in the New Jersey Statutes Annotated, Title 52, Chapter 18A. Rules governing the operation and administration of the trust may be found in Title 17, Chapter 8 of the New Jersey Administrative Code.

Section 125 — Internal Revenue Code (IRC) Section — Also called Flexible Benefit Plan or Cafeteria Plan. Protects an employee from constructive receipt of the cash he or she has as a choice of benefits under a cafeteria plan. Employee contributions to a Section 125 plan may be made with pre-tax dollars. Cafeteria Plans offer participants a choice between cash and one or more qualified, or tax-favored, benefits. It requires plans to pass a concentration test which states that benefits actually provided to key employees is limited to no more than 25% of the aggregate benefits provided to all employees of the plan. For example, Tax\$ave Plan for NJ State employees, which consists of Premium Option Plan, Unreimbursed Medical Expense Flexible Spending Account Plan, and Dependent Care Spending Account Plan. Other public employers may offer similar plans.

Section 132 — Internal Revenue Code (IRC) Section — The section permits an employer to exclude from an employee's gross income (subject to a monthly maximum) employer-provided parking, transit passes, and employer-provided vanpool benefits. For example, Commuter Tax\$ave Plan for New Jersey State employees.

Section 401(a) — Internal Revenue Code (IRC) Section — Qualified defined benefit plan for government employees. For example, New Jersey pension plans, such as TPAF, PERS, PFRS, etc.

- 401(a)(4) requirement: The amount of the plan's benefits must be nondiscriminatory; the availability of the plan's benefits, rights and features must be nondiscriminatory;

and the timing of the amendment adding the window feature must not have a discriminatory effect.

- 401(a)(17) requirement: Limit on maximum annual compensation.

Section 403(b) — Internal Revenue Code (IRC) Section — Section 403(b): One of defined contribution plans. It extends tax deferral to public school employees and those of other tax-exempt organizations for annuity purchases. A 403(b) tax-sheltered annuity is a retirement plan available to these employees. Benefits may be provided through employer contribution or through employee salary reduction. For example, SACT tax exempt contributions from Boards of Education and Higher Education.

Section 415.— Internal Revenue Code (IRC) Section — Section 415 limits:

- Limit for annual additions to a defined contribution plan
- Limit for the max annual benefit in a defined benefit plan

Section 457(b) — Internal Revenue Code (IRC) Section — A type of defined contribution plan. It allows employees of state and local governments (or non-profit tax-exempt organization) to defer a portion of their income in a deferred compensation plan that is not taxable until a distribution is made. For example, NJ State Employees Deferred Compensation Plan.

SHBP — State Health Benefits Program — Program provides medical coverage to employees, retirees, and their dependents. It includes a basic indemnity type plan (Traditional Plan), a point-of-service plan (NJ PLUS), and several HMOs. Chapter 125, P.L. 1964 extended the program to include employees of local government. Statutes can be found in the New Jersey Statutes Annotated, Title 52, Chapter 14, Article 17.25 et. seq. Rules governing the operation and administration of the program may be found in Title 17, Chapter 9 of the New Jersey Administrative Code.

SHBP Rx — Prescription Drug Plan (PDP) — Plan was initiated by the State effective December 1, 1974. The passage of Chapter 41, P.L. 1976 extended coverage to all eligible State employees. The State Health Benefits Commission offered the plan to local employers on July 1, 1993. Employees and their eligible dependents are covered by the plan in the same manner as the State Health Benefits Program. The Division of Pensions and Benefits became responsible for its administration in November 1976. Statutes can be found in the New Jersey Statutes Annotated, Title 52, Chapter 14, Section 17.29(F). This is a 2-tiered co-payment plan (Generic/brand name) with retail and mail-order provisions. Rules governing the operation and administration of the program are found in Title 17, Chapter 9, of the New Jersey Administrative Code.

SHBP Rx (Retiree) — Retiree Prescription Drug Plan — Established by the State Health Benefits Commission as a 5-year pilot plan in calendar year 2000 for SHBP retirees enrolled in the Traditional Plan and NJ PLUS. This is a 3-tiered co-payment plan (generic/preferred brand/all other brand) with retail and mail-order provisions. The plan has an annual out-of-pocket limit for participant co-payment expenditures. Both the co-payments and annual out-of-pocket limit have automatic yearly escalators based upon certain indicators. Rules governing the operation and administration of the program are found in Title 17, Chapter 9, of the New Jersey Administrative Code.

SHBP Dental — Employee Dental Plans — Program was initially established February 1, 1978 and further expanded in June 1984. All eligible State employees may enroll for themselves and their eligible dependents by paying the premium calculated to meet half of the cost of the plan. The Employee Dental Expense Benefits Plans include a traditional indemnity plan and consists of ten

separate Dental Plan Organizations. Statutes can be found in the New Jersey Statutes Annotated, Title 52, Chapter 14, Section 17.29(F). Rules governing the operation and administration of the program may be found in Title 17, Chapter 9, of the New Jersey Administrative Code. The program was extended to local employers on January 1, 2005.

SHBP Retiree Dental — Retiree Dental Expense Plan — Established January 1, 2005 by the State Health Benefits Commission. All eligible SHBP retirees may enroll for themselves and their eligible dependents by paying the full premium, which is generally deducted from the monthly retirement check. The New Jersey Retiree Dental Expense Benefits Plan is a traditional indemnity plan administered by Aetna.

SPRS — State Police Retirement System — Created by Chapter 89, P.L. 1965 as a successor to the State Police Retirement and Benevolent Fund. All uniformed officers and troopers of the Division of State Police in the New Jersey Department of Law and Public Safety are required to enroll. This system is maintained on an actuarial reserve basis. Statutes can be found in the New Jersey Statutes Annotated, Title 53, Chapter 5A. Rules governing the operation and administration of the system may be found in Title 17, Chapter 5 of the New Jersey Administrative Code.

Tax\$ave — A benefit program for State employees, authorized under Section 125 of the Internal Revenue Code, initially established in July 1996. The benefit consists of three components: the Premium Option Plan that allows employees to use pre-tax dollars deducted from their pay for health or dental benefit premiums they may be required to pay for coverage; the Unreimbursed Medical Expense Plan Flexible Spending Account Plan that allows employees to use up to \$2,000 pre-tax dollars annually deducted from their pay for medical expenses not reimbursed by their medical or dental insurance; and the Dependent Care Spending Account Plan that allows employees to use up to \$5,000 pre-tax dollars annually deducted from their pay for dependent care expenses required to permit the employee and spouse to work. Statutes can be found in New Jersey Statutes Annotated 52:14-15.1a. Rules governing the Tax\$ave can be found in Title 17, Chapter 1, Subchapter 13 of the New Jersey Administrative Code.

TPAF — Teachers' Pension and Annuity Fund — Fund was reorganized by Chapter 37, P.L. 1955. The retirement benefits of this defined benefit system are coordinated, but not integrated with, Social Security. This fund is maintained on an actuarial reserve basis. The employee contribution rate is 5%. Membership is mandatory for substantially all teachers or members of the professional staff certified by the State Board of Examiners, and employees of the Department of Education who have titles that are unclassified, professional and certified. Statutes can be found in the New Jersey Statutes Annotated, Title 18A, Chapter 66. Rules governing the operation and administration of the system may be found in Title 17, Chapter 3 of the New Jersey Administrative Code.

APPENDIX 6

SALARY DISTRIBUTION

Distribution of employees on the State's Centralized Payroll, which includes full time, part time, hourly and per diem as well as those that are inactive (not receiving a paycheck due to leave of absence, etc.)

Salary Range	
As of Pay Period 20/2005	
Salary < \$25,000	8,537
Salary \$25,000 - \$49,999	39,552
Salary \$50,000 - \$74,999	27,039
Salary \$75,000 - \$99,999	11,160
Salary \$100,000 - \$124,999	1,250
Salary \$125,000 - \$149,999	636
Salary > \$150,000	165
TOTAL	88,339

The following reflects active employees, excluding inactive, part time, hourly and per diem

Salary Range	
As of Pay Period 20/2005	
Salary < \$25,000	2,735
Salary \$25,000 - \$49,999	37,563
Salary \$50,000 - \$74,999	26,403
Salary \$75,000 - \$99,999	11,068
Salary \$100,000 - \$124,999	1,231
Salary \$125,000 - \$149,999	632
Salary > \$150,000	163
TOTAL	79,795

APPENDIX 7

BENEFIT ENHANCEMENT LAWS SINCE 1999

The Fiscal Impact of Enacted Pension Legislation

Law	Effective Date	Description	Fiscal Impact (in millions)							
			State			Local				
			Additional Accrued Liability System	Amount	Add'l Normal Cost System	Amount	Additional Accrued Liability System	Amount	Add'l Normal Cost System	Amount
Chapter 108, P.L. 2003	7/1/2003	Phases in local employers' payments to PERS and PFRS over five years and increases the PFRS special retirement benefit from 70 to 75 percent of final salary upon the pension system attaining a funded level in excess of 104 percent	PFRS*	\$ 67.00	PFRS*	\$ 5.30	PFRS*	\$ 447.30	PFRS*	\$ 31.2
Chapter 134, P.L. 2003	1/9/2003	Provides a State payment of \$15,000 annual survivor's pension when volunteer emergency services worker suffers accidental death on duty.			CPF**	\$ 0.000015				
Chapter 140, P.L. 2003	8/1/2003	Credits all prior PERS service of county prosecutors in Prosecutors Part at no additional cost.	PERS**	\$ 0.03						
Chapter 23, P.L. 2002	5/30/2002	Provides an early retirement incentive program for certain State employees who retire between April 1, 2002 and July 1, 2002.	PERS	\$ 645.39						
Chapter 4, P.L. 2001	4/16/2001	Increases the special retirement pension from 60 to 65 percent of final salary for certain retired public safety officer members of PERS, CPFPP and PFRS.	PERS	\$ 0.10			PERS	\$ 0.60		
Chapter 86, P.L. 2001	5/8/2001	Provides a pension benefit to survivors of certain PFRS members dying prior to the effective date of Chapter 428, P.L. 1999 (January 1, 1998).	CPFPP	\$ 0.47			PFRS	\$ 75.80		
Chapter 127, P.L. 2001	6/28/2001	Expands certain veterans' benefits to certain participants in the Lebanon Crisis of 1958.	PFRS	\$ 5.30			PFRS	\$ 16.45		
Chapter 128, P.L. 2001	6/28/2001	Extends TPAF, PERS and PFRS veteran's status to certain participants in peace-keeping operations in Somalia and Republic of Bosnia and Herzegovina.	PERS	\$ 0.08			PERS	\$ 0.17		
Chapter 133, P.L. 2001	10/1/2001	Provides a 9.09 percent increase to TPAF and PERS retirement benefits for active members and retirees; revises calculation of assets and establishes benefit enhancement fund. Reduces TPAF member contribution rate to 3%.	TPAF	\$ 2,685.6			TPAF	\$ 71.2		
Chapter 201, P.L. 2001	8/8/2001	Provides full PFRS credit at State cost for certain members who transferred from PERS to PFRS under Chapter 247, P.L. 1993.	PERS	\$ 17.60			PERS	\$ 69.80		
Chapter 259, P.L. 2001	12/6/2001	Establishes the Workers Compensation Judges Part in PERS.	PERS	\$ 5.20			PERS	\$ 0.20		
Chapter 318, P.L. 2001	1/3/2002	Provides a pension benefit to survivors of certain PFRS members dying prior to the effective date of Chapter 428, P.L. 1999 (January 1, 1995).	PFRS	\$ -			PFRS	\$ 0.4		
Chapter 350, P.L. 2001	1/6/2002	Changes compensation base of SPRS accidental death benefit pension for surviving spouses and children.	SPRS	\$ 4.9			SPRS	\$ 1.0		
Chapter 353, P.L. 2001	1/6/2002	Provides a 9 percent increase to TPAF and PERS disability and veterans retirement benefits for active and retired employees.	TPAF	\$ 226.1			TPAF	\$ 2.5		
Chapter 366, P.L. 2001	1/7/2002	Creates Prosecutors Part with other benefits in PERS.	PERS	\$ 123.3			PERS	\$ 185.9		
Chapter 415, P.L. 1999	1/18/2000	Provides a reduction in the employee contribution rate for State and local PERS members	PERS	\$ 7.3			PERS	\$ 27.8		
Chapter 428, P.L. 1999	1/18/2000	Enhances retirement benefits for PFRS members	PERS	\$ -			PERS	\$ 117.3		
		Total		\$ 4,548.1				\$ 113.0		
										\$ 95.3

* Pursuant to this legislation, the additional costs will kick in when the PFRS funded level exceeds 104%.

** Cost represents the cost per individual that would qualify pursuant to the legislation.

APPENDIX 8

VALUE OF MEMBER CONTRIBUTIONS TOWARDS TOTAL RETIREMENT BENEFIT COSTS

The Benefits Review Task Force has asked the Division of Pensions and Benefits to develop information concerning the ratio of funding of a member's retirement benefits that would be attributable to the member's own annuity savings fund contributions and interest earned on those contributions.

The Division, with the assistance of Buck Consultants, has prepared the following estimates concerning the Public Employees' Retirement System (PERS), the Police and Firemen's Retirement System (PFRS), and the Alternate Benefits Program (ABP). An estimate was not prepared for the Teachers' Pension and Annuity Fund (TPAF), however, TPAF retirement benefits and contribution levels are generally comparable to the PERS.

Since the defined benefit retirement systems do not capture information concerning investment gains/losses at the individual member level, our approach was to estimate the benefits of members retiring with a certain number of years of service credit, and compare the value of member contributions, with assumed earned interest, against the value of the retirement benefit. For the defined benefit programs, we have incorporated Buck's assessment of the actuarial value of the cost-of-living adjustment payable to retirees and the value of employer-paid post-retirement medical coverage (PRM).

To create the estimates for PERS and PFRS, it was necessary to establish a series of assumptions as follows:

- Assume PERS member contributions were 5% of base salary for the entire career.¹
- Assume PFRS member contributions were 8.5% of base salary for the entire career.²
- Assume return on investment of PERS and PFRS member contributions of 8.25% over the course of the member's career.³
- Assume PERS and PFRS salaries would rise over the course of the member's career in keeping with the salary assumption annual rates of increase used for the actuarial evaluations.⁴
- Assume PERS and PFRS post-retirement CPI increase of 3.0%, compounded annually for the cost-of-living adjustment.⁵
- Assume current year's average PRM premium increasing by 7.0% per year compounded annually.

The following estimates were prepared using the above assumptions.

PERS

A	PERS Service Retirement Benefit at Age 60	25 Years of Service	20 Years of Service	15 Years of Service	10 Years of Service
B	Final Year Salary	\$55,000	\$55,000	\$55,000	\$55,000
C	Annual Maximum Retirement Allowance (without COLA)	\$23,700	\$19,000	\$14,200	\$9,500
D	Total Value of Member Contributions plus Interest as a Percentage of Retirement Benefit	45%	43%	40%	37%
E	Value of D with COLA Added to Value of Retirement Benefit	40%	37%	35%	33%
F	Value of D with COLA and PRM Costs Added to Value of Benefit	25%	NA	NA	NA

PFRS

A	PFRS Special Retirement Benefit at Age 60	30 Years of Service ⁶	25 Years of Service	20 Years of Service
B	Final Salary	\$70,000	\$70,000	\$70,000
C	Annual Retirement Allowance (without COLA)	\$49,000	\$45,500	\$35,000
D	Total Value of Member Contributions plus Interest as a Percentage of Retirement Benefit	58%	49%	48%
E	Value of D with COLA Added to Value of Retirement Benefit	51%	43%	42%
F	Value of D with COLA and PRM Costs Added to Value of Benefit ⁷	37%	31%	NA

ABP

The ABP is a defined contribution plan. Members must contribute 5% of their base salary and the State is required to contribute an amount equal to 8% of the base salary. The member controls the investment selections for all contributions. The benefit payable to the member at retirement is based upon the total value of the account, including all investment gains and/or losses. Since the member contributes

5/13ths and the State contributes 8/13ths, then the value of the member's contributions and earnings would represent approximately 38% of the total value of the member's retirement benefit.

ABP retirees do not receive a separate COLA. Since a sample ABP retirement benefit could not be computed, the impact of the additional value of State-paid PRM is not calculated here. Were it to be included, the percent of funding for the retirement benefit from the member's own contributions would decrease substantially in a manner similar to the PERS and PFRS estimates.

The above PERS and PFRS estimates provide a general overview of retirement system funding based upon the most common types of retirement. Individual cases could vary considerably. The calculations performed here assume that salary increases, on average, rise within certain parameters until the point of retirement. The retirement formulas are based upon the 3 highest years or the last year of base salary. Individuals who receive substantial salary increases for the years that will be used in their retirement calculations would contribute far less to the overall value of their retirement benefits. Other individuals, such as those who purchase a significant amount of full-cost service to add to their retirement system service (i.e. federal time) would contribute a higher percentage to the cost of their benefit. However, in many instances the purchase of additional service allows a member to qualify for an additional benefit, such as employer-paid PRM, that would not have been available without the purchase.

¹ The assumptions used in the above estimates assume the PERS member at age 60 had contributed to the retirement system at a flat 5% of salary for 25 years, which would imply a retirement system entry age of 35. The flat 5% contribution rate for all members of the PERS and TPAF was not established until July 1, 1994, however. The assumption is somewhat overstated for someone retiring today because of the history of member rates. If the retirement calculations represented here were actual cases, the average employee contribution rate would be somewhat less than the 5% assumption used here. Until July 1, 1994, PERS and TPAF members contributed to the retirement system at rates based upon an employee's age at entry in the retirement system. Further, prior to July 1994, these rates were offset 2-2.5% for all employee contributions based upon all salary below the Social Security maximum, and full rates were charged only after a member exceeded the maximum for the year. The offset was part of the original legislation establishing these retirement systems and reflected the integration of the systems with social security. Originally, an offset against the member's retirement allowance for the receipt of social security benefits was also required. While Chapter 67 of the Law of 1966 repealed the retirement allowance offset, it did not repeal the offset to the rate of contribution. Prior to 1979, when unisex rates were established, the employee contribution rates established by the Actuary were required by statute to be sufficient to provide an annuity equal to one-half of the retirement allowance, and separate rates existed for males and females. The flat rate of 5% was established in 1994. It was temporarily reduced to 4.5% effective 1/1/98 (Chap. 115, PL 1997) and then further reduced to 3.00%. Rates had returned to 5% for all PERS/TPAF groups by 1/1/05.

² The PFRS flat rate of contribution of 8.5% of base salary was not established until April 1990. The same legislation that established the 8.5% rate also increased the 25-year benefit formula for Special retirement from 60% to 65% of the last 12 months of salary. Prior to 1990, members contributed at rates based upon age at entry into the system. Initially these rates ranged from 5.73% of salary if enrolled at age 20, to 8.62% at age 54, but were subsequently increased by 1% as of 7/1/68 and again 7/1/79. Unlike PERS and TPAF, there was no offset in the PFRS rate for social security. Because of entry age restrictions, most members enter the PFRS below the age of 35 (generally the maximum allowed entry age). A PFRS member retiring in 2005 after 25 years of service would have contributed at that rate for the majority of his or her career; prior to 1990 the member's rate would have been 8.5% if he or she enrolled in PFRS at age 27.

³ 8.25% represents the retirement systems' interest rate assumption for actuarial valuation purposes.

⁴ Average annual salary increase assumptions of 5.45% for PERS and 5.95% for PFRS were used. A final salary was selected, and then salaries over the course of the career were developed by applying the annual rate of salary increase to the last year's salary to determine the annual salaries upon which contributions would have been based from the point of enrollment in the retirement system to retirement.

⁵ The COLA adjustment is based upon 60% of the change in the consumer price index from the date of retirement. Payment commences in the 25th month after retirement. For the purposes of this estimate, the 3.0% assumption per year for valuation purposes was used; 60% of that would produce a factor of 1.8%.

⁶ The significant increase from the 25 year example is due to the 1% per year accrual from 65% of pay at 25 years to 70% of pay at 30 years. The accrual is much lower than in the previous years, but members still pay the full 8.50% of pay.

⁷ Most, but not all, local public employers pay for PRM coverage for PFRS retirees with 25 years of service.

APPENDIX 9

OUR PROCESS

The Benefits Review Task Force (“Task Force”) developed its recommendations on how to accomplish the goals enumerated above, through a thorough public process that ultimately involved five public meetings held across the State, and numerous working sessions.

The Task Force heard from dozens of members of the public; two former State Treasurers and many other officials; numerous advocacy groups (education, business, labor, seniors, environment, civil rights, urban, etc.); and over a dozen scholars and other experts. In total, more than 85 people testified at the meetings, more than 245 people attended the meetings.

To further facilitate public involvement, the Task Force established a Web site (<http://www.state.nj.us/benefitsreview/>) that contains links to audio for each public meeting, and that received emails from the public. Over 120 e-mails to the Task Force Web site were received. Also, over 140 pieces of correspondence were received through the postal service.

The public comment period ran until the date of the completion of this report through a variety of means, including e-mail to the Task Force Web site. Other sources of input compiled by the Task Force came from examination of advocacy group and other Web sites, e-mail to Acting Governor Richard J. Codey, letters, agency reports and studies, citizen telephone calls and faxes.

The Task Force Members are deeply appreciative to the public for this input, which they feel was invaluable to their deliberations.

Please see the immediately following pages for lists of the meetings and commenters.

BENEFITS REVIEW TASK FORCE PUBLIC MEETINGS

Date	Time	Location	Who/Purpose
Thursday 7/7/05	2:15pm-5:15pm	Rutgers' Winants Hall	Public and Advocates
Thursday 7/14/05	5:00pm-8:00pm	Mercer Community College	Public
Tuesday 8/2/05	1:00pm-4:00pm	Bergen County College	Public, Treasurer, Advocates and Experts
Tuesday 8/2/05	5:00pm-8:00pm	Bergen County College	Public
Thursday 8/4/05	2:30pm-4:00pm	South Jersey Transportation Authy.	Public

COMMENTERS TO BENEFITS REVIEW TASK FORCE MEETINGS

(in order of appearance)

July 7, 2005, Rutgers University, New Brunswick

Richard Loccke, Attorney, AFL-CIO
Robert Pursell, Area Director, CWA
Lisa Ciccone, Business Representative, IFPTE
Rochman Mahumad, SEIU
Anthony F. Weiners, Executive Vice-President, PBA
Bill Lavin, President, Fireman's Mutual Benefit Assn.
Ron Bakley, National Trustee, Fraternal Order of Police
Wyatt Earp, Intl. Brotherhood of Electrical Workers
Troy Ferus, President, NJ State Corrections Assn.
L. Mason (Lou) Neely, League of Municipalities
Philip Kirschner, President, Business & Industry Assn
Jim Leonard, Vice President, Chamber of Commerce
Rich Goldberg, President, Commerce & Industry Assn

July 14, 2005, Mercer County College, West Windsor

Dr. Larry Nespoli, President, NJ Council of County Colleges
Dr. Joseph T. Hancock, Legislative Consultant, NJ Association of School Administrators
Joseph W. Krajnik, President, Uniformed Fire Fighters Assoc. of Jersey City, Local 1066, AFL/CIO
Philip Bow, Trenton
Curt S. Wary, Director of Labor Relations, NJ School Boards Association
William H. Horton, Jr., President, Public Works Association of New Jersey
Joe Golowski, CWA Local 1034, West Trenton
Francis A. "Frank" Forst, Former Organizer Highway workers and Turnpike workers
Adeline Schmidt, President of the Tax Collector's and Treasurer's Association of NJ
Franceline Ehret, President, NJ Turnpike Employees' Union, Local 194, I.F.P.T.E., AFL/CIO
Jim Marketti, President, Communications Workers of America, Local 1032
Gregg M. Edwards, President, Center for Policy Research of New Jersey
Dudley Burdge, Staff Representative, CWA Local 1032
Brua Fritzges, East Windsor
John Fullmen, Allentown
Veronica Chiarello, Trenton
Joseph Michelsohn, Kendall Park
Anthony Miskowski, Somerset
Eula Rivers, Trenton
Deb Cole, Trenton
Gloria Berry, Trenton
Doreen Griffin, West Trenton
Ed Hannaman, Ewing
William Aorton, Ramsey
Rae Roeder, Trenton

Fred C. Karr, Freehold
Tracy Grabiak, Jobstown
Bob Corby, Robbinsville
Barbara Harper, Trenton
Mary Ann Mesics, Trenton
Paul Curcio, Elizabeth
Nikk Criss, Ewing

August 2, 2005 day session, Bergen Community College, Paramus

Michael Madonna, President, PBA
Marty Barrett, former National Officer, PBA
Anthony Weiners, Executive Vice President, PBA
Clifford Goldman, former New Jersey State Treasurer
George Lovaglio, Buck Consultants, Treasury Actuary
Joyce Powell, Incoming President, NJEA
Len Koch, Director of Research, NJEA
James Schroeder, Director of Government Relations, NJEA
John Servais, Senior Consultant, Hewitt Associates

August 2, 2005 evening session, Bergen Community College, Paramus

Shameko K. Palmer, Trenton
Richard E. Ditmer, Sr., Mt. Holly
Richard Morgan, DHS
Frank Power, Bergen County
Pat Pignatelli, HOA, Sparta
Donald J. Segal, Actuary, Emerson
Bill Kozar, Pompton Plains
Stanley Kaminski, Lyndhurst
Nancy Tyson, Trenton
Tamesha Long, Trenton
Gerry Drummond, Dumont
Dennis Testa, Hackensack
Joseph Golowski, Hamilton Square
Regina Jackson, Trenton
Richard Brooks, Trenton
Bill Maloney, Hamilton
Maureen Taffe, Hackensack
Peter Helff, Dumont
James Keeney, Jr., Ramsey
Hetty Rosenstein, Newark
Chris Babcock, Ringwood
Jeff Sheldon, Paramus
Kecia Carkhum, Paramus
Philip Savoie, Hawthorne

August 4, 2005, South Jersey Transportation Authority, Elwood

William Haggett, President & CEO, AmeriHealth Insurance
Debra DiLorenzo, President, Chamber of Commerce of Southern New Jersey
William Lavin, President, Firemen's Mutual Benevolent Association
Christopher Carew, New Jersey Conference of Mayors
Dianne Spencer Brown, Trenton
Denise Gore, Trenton
Paul Curcio, Trenton
Peter Maurer, Trenton
Janel Frink, Trenton
Charity James, Trenton
Bridget Lynch, Trenton
Joe Golowski, Hamilton Square
Rae Roeder, Princeton
Darris McNeill, Trenton
Mary R. Walker, Trenton
Annette N. Agabito, Burlington
Valorie Jones, Trenton
Thomas Palermo

Others Who Provided Input

Michael Horn, former New Jersey State Treasurer
Paul Fronstin, Ph.D., Employee Benefit Research Institute
Honorable Leonard Lance, Senate Minority Leader
Honorable Alex DeCroce, Assembly Republican Leader
Dr. Peter Orszag, Senior Fellow, Brookings Institution
Carol Banks, Horizon Blue Cross Blue Shield
Dr. Teresa Ghilarducci, University of Notre Dame
Dr. Jack Van Derhei, Fellow, Employee Benefit Research Institute
Ari Jacobs, Partner, Hewitt Associates
Alan Gubatosi, Northeast Healthcare Practice Leader, Hewitt Associates
Karl Klein, President, Superior Officers Association
Sugit CanagaRetna, Policy Advisor, Council of State Governments

