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Dangerous Trends Require Action

Rising mandatory expenditures in the state of Vermont mean that there are less discretionary dollars to support important programs to serve needy Vermonters. And in these difficult economic times, that is unfortunate news indeed. Yet, these “promises” made to certain constituencies must be kept. At issue, however, between debt service, retirement plans for state employees and teachers, and other post-employment benefits, is that those promises have become unsustainable. It is time to recognize the nature and severity of the problem and begin talking about how to change from the path we’re on.

The state is responsible for two significant retirement benefits: a defined benefit pension plan and other post retirement benefits (i.e. medical insurance). The pension plan includes three major constituencies - state workers, teachers, and municipal workers, though the latter has no state liability since these are all funded at the municipal level, but may have some of the same risks as the other two. The private sector and most not-for-profit institutions have essentially done away with these benefit plans because they are expensive to maintain and the risk/liability will forever remain with the employer or, in our case, the state or municipality.

There are essentially two types of pension plans....a defined contribution, which is similar to a 401 (K) plan, and a defined benefit plan where the retiree is basically guaranteed a certain benefit at the time of retirement for his or her life. As of June 30, 2008 the state employees defined pension plan covered 94 percent of the state’s 8442 workers. Prior to July 1, the workers contributed 3.35 percent of their pay; this changed to 5.1 percent as of July 1. The state is responsible for the balance necessary to fund the benefits paid to retirees for their life. In 2008 the state paid approximately \$23 million (this is projected to increase to \$40 million in 2015) from the general fund into the retirement fund. The state workers can retire after 30 years of service or age 62 and receive a lifetime benefit of 50 percent, based on the highest three consecutive years pay. For workers employed after June 30, 2008 the retirement age is 65 (or “Rule of 87”) and they receive a lifetime benefit of 60 percent of their highest three consecutive years.

Although the wages for the teachers are determined at the local level, the state is required to pay their pension plan costs. As of June 30, there were 10,685 teachers in the plan. The teachers pay 3.5 percent of their pay annually and the state is responsible for the balance necessary to fund the benefits paid to retirees for their life. In 2008 the state paid approximately \$40 million (this is projected to increase to \$52 million in 2015). Teachers

can retire after 30 years of service or age 62 and receive a lifetime benefit of 50 percent of their highest three consecutive years pay. Over the years the state has not been fully funding the teachers plan.

As a result of the recent decline in the investment markets and the under-funding of the teachers plan, the state has unfunded pension liabilities, as computed by the state actuary, of over \$466 million as of June 30. This is just about a three-fold increase in just five years. With further market declines since June, these liabilities are certain to be much higher. This will require the state to pay even more to assure the financial integrity of the plans.

When it comes to the other post-retirement benefits (i.e. medical insurance) the situation is more alarming.

Retired state workers pay 20 percent of the cost of the premiums, which covers the retiree and all dependents. The teachers pay 20 percent as well, but their coverage is not extended to dependents; to cover them they must pay the full cost. The state has adopted a "pay as you go" policy that essentially means they pay in only the current benefits and do not fund for future liabilities, as is recommended for a sound fiscal plan.

In 2008 the state paid in about \$17 million for the state workers, but nothing for the teachers. This left a liability, for just 2008, of \$29 million for the state workers and \$60 million for the teachers. The state actuary has calculated the unfunded liability for both plans at June 30, 2008 to be \$1.6 billion. This is projected to increase to over \$4 billion in thirty years, if we continue to fund these plans as we have in the past. That's "b" for billion.

By now, I think you get the picture...Vermont is currently on a path that is not financially sustainable. So, what are the alternatives we have so that we do not go bankrupt? There are several options: Fully fund the pension and benefits, but where do we get this money? Reduce the work force; cut the benefits to more closely align to those in the private and not-for-profit sectors; freeze or eliminate some or all of the plans; or, require the local governments to fund the costs for the teachers.

There are certainly other options and these are put on the table to show just how significant the magnitude of the problem is that we all face today in our state. Not addressing the issues now will only require future generations of Vermonters (our children) to pay for the promises we have made but failed to fund.

We need the leadership of the legislature, the administration and the unions to come together and identify a common solution to these vexing issues now. The current economic climate is precisely the motivation for changing current practice toward a more sustainable system.

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