Utah State Retirement Overview
by Kara Glaubitz, CPPA Graduate Assistant

Introduction
In the current economic climate, retirement security has become an increasing concern for many Americans. Utah’s Retirement System for public employees helps the state compete against the private sector to recruit and retain effective workers. While many private firms have shifted away from defined benefits toward defined contribution plans, most state retirement systems, including Utah’s, have maintained their defined benefit plans [1] [2]. Utah’s primary plan for the majority of state employees is a noncontributory defined benefit plan, with a small portion of exempt employees solely participating in a defined contribution plan.

Types of Retirement Plans
Defined benefit (DB) plans establish benefits based on a predetermined formula factoring in years of service, final average salary, and a multiplier. Funds for defined benefit plans come from contributions from employers, employees, or both. These funds are then invested by professionals and used to support employees upon retirement. Actuaries are responsible for estimating the contribution levels required to support this system. Prefunding the system allows investment income to pay for a sizeable portion of the needed revenue.

In defined contribution (DC) plans, contributions are made during employment years, by the employer, employee, or both, to individual retirement accounts, typically a 401(k) account. These funds are usually invested under control of the employee. The value of these investments at the time of withdrawal is determined by the market.

A significant advantage to DB plans is the security they provide. These plans provide a guaranteed benefit for the lifetime of state employees and their spouses under certain circumstances. Retirees cannot outlive their benefits, as is possible with DC plans. DB plans assign the financial risk of bad investments to employers, whereas DC plans shift the risk to employees. This can be especially troublesome because some employees with more control over their retirement savings may not invest as wisely as professionals hired to manage DB plans. Ultimately, poor individual investments may lead to retirees with insufficient funds through retirement years [3]. DB plans also have the advantage of economy of scale, pooling the resources of thousands of employees and diversifying investments to diminish investment risk.

Table 1: Types of Primary Retirement Plans by State

<table>
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<tr>
<th>State</th>
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<th>Mandatory Defined Contribution</th>
<th>Mandatory Combined DC/DB</th>
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Tennessee X
Texas X
Utah X
Vermont X
Virginia X
Washington X
West Virginia X
Wisconsin X
Wyoming X


Both DB and DC plans may be either contributory or noncontributory. Contributory plans may require employee contributions in addition to employer contributions. Noncontributory plans do not require any contributions from employees. Employers make any necessary contributions to fund employee benefits based on a percentage of salary determined annually by an actuary. This percentage of salary is the contribution rate.

Utah’s Retirement System
Utah’s state retirement is divided into six different systems: the public employees noncontributory, public employees contributory, public safety, firefighters contributory, judges, and governors and legislators. The overwhelming majority of state employees are members of the public employees noncontributory system, a DB plan. The Utah Retirement System defined benefit is calculated as 2% per year of service multiplied by the average of an employee’s highest paid three years times years of service.

Example of Defined Benefit Calculation

Employee has 30 years of service with the highest paid three years listed below

Employee’s highest paid years

Year 1 Year 2 Year 3 Avg. of 3
($40,240 + $45,000 + $48,803) / 3 = $44,681

2% x 30 x $44,681 = $26,808 annual retirement benefit
Generally, Utah public employees are eligible for full retirement benefits after 30 years of service, or after 20 years of service as a Public Safety employee. Employees of any age with 25 years of service have the option to purchase future service credit in order to retire up to five years early with a slight benefit reduction. At age 60 in Utah, public employees may retire with a 20% reduction in annual benefits, or with a 10% annual reduction at age 62. Full benefits are given after the standard retirement age of 65.

The Utah Retirement System consisted of 181,994 members as of December 31, 2008. Of these members, just over 106,261 are active employees who may be eligible for retirement, 33,595 are former employees who will receive previously earned retirement benefits upon reaching retirement age, and 42,138 are retirees currently collecting benefits. Just over half of the active membership, those currently working for the state who may one day be eligible for retirement, are employed in public or higher education. Nearly 30% are employed by counties, municipalities, and local districts and almost 20% are employed by the state.

Retirement funds come from several sources. The Utah State Retirement System is supported mostly through investment earnings and employer contributions. These two sources make up over 90% of the State Retirement System’s revenue. This money is augmented with employee contributions and taxes and fees set aside specifically for this purpose. Utah assesses court fees to help pay retirement benefits for judges and a tax on fire insurance to supplement firefighters’ benefits. Due to the volatility of investment earnings year by year, actuaries are needed to predict contribution levels required to support future retirement benefits. Utah contracts with Gabriel Roeder Smith & Company Consultants and Actuaries to perform this task. Contribution levels are calculated with consideration of expected return on investment, estimated employee turnover, expected time of retirement, and life expectancy of future beneficiaries. Actuaries make recommendations to the Utah State Retirement Board of Trustees, who then choose to accept, reject, or modify the advised levels. Overly pessimistic assumptions cause public dollars that could be used elsewhere to instead be tied up in investments. On the other hand, when actuarial assumptions are overly optimistic and investment income is less than expected, there is a financial shortfall that must be met, necessitating an increase in the contribution rate. Although both positive and negative actuarial errors have consequences, overly optimistic errors tend to cause greater problems [5].

In light of the current economic situation and resultant budget constraints, many states are facing difficulties in funding benefits for retirees. In 2008, Utah’s Retirement System suffered net investment losses of 23%. This loss, combined with the expected annual gain of 7.75%, is a considerable hit to the state retirement system’s investment moneys [6]. The investment loss was greater than the gains experienced in the previous three years combined [7]. A number of states are addressing this problem through various reductions in benefits packages, increased employee contributions, or enacting early retirement incentives to reduce the workforce [1]. In Utah, there has not yet been legislation passed to alter retirement benefits in order to reduce costs, but further discussions of how to ensure the solvency of the Utah Retirement System can be expected in the upcoming legislative session.

In other articles this month are views on the Utah State Retirement system from the Utah League of Cities and Towns (click here), the Utah Association of Counties, (click here), and the Utah Public Employees Association (click here).

This article was based in part on a presentation prepared by Benjamin N. Christensen, Policy Analyst for the Utah Office of Legislative Research and General Counsel. To view this presentation, go to http://www.le.state.ut.us/asp/interim/Commit.asp?Year=2009&Com=INTRIE


