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Vermont State Employees' Retirement System

July 2010

Retiring *TIMES*

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Salary Reduction Impact on Retirement Benefit Examined

Average Final Compensation Calculation is Explained

There has been much concern and confusion surrounding the actual impact of the recent salary reductions and how they affect a member's pension calculation, particularly anyone retiring within the next few years. This article is intended to clarify the impact and alleviate a general misconception that employees should retire sooner, rather than later, as their benefits will be less if they wait.

"Employees are contacting the Retirement Division and are expressing concern that this temporary salary reduction will result in a lower average final salary that will then be used to determine pension benefits," explained Cynthia Webster, Director of Retirement Policy and Outreach for the Treasurer's Office.

An employee's pension check is based on the average of the member's highest consecutive years of earning. For

most State employees (retirement groups A and F) the top three years of consecutive earnings are used. For those employees working within law enforcement (group C), the highest two consecutive years of earnings are used to determine the Average Final Compensation or AFC. For example, based on annual cost of living increases of 1.8 percent, an employee making \$40,000 in fiscal year 2008 would make \$40,720 in fiscal year 2009 and \$41,453 in fiscal year 2010. The 3 percent pay reduction would mean that same employee's salary would be reduced to \$40,209 in fiscal years 2011 and 2012. If this employee retired on July 1, 2010, the AFC would be \$40,724 (the average of fiscal years 2008-2010).

If that same employee elects to retire effective July 1, 2011, the AFC would be \$40,794 (the average of fiscal years 2009-

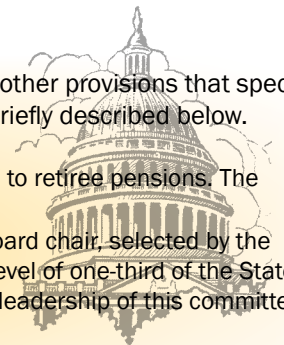
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Other Legislative News . . .

Besides the AFC calculation amendment discussed in the story above, Act 139 contained three other provisions that specifically applied to the Vermont State Employees' Retirement System. The three amendments are briefly described below.

- **Retiree Cost of Living Adjustment (COLA):** Eliminates the possibility of a negative COLA being applied to retiree pensions. The change applies only to January 2011.
- **Vermont Pension Investment Committee (VPIC):** Amends the statute to provide for an independent board chair, selected by the other six voting members of the VPIC, and provides that the chair may be compensated up to a level of one-third of the State Treasurer's salary. The purpose of this change is to encourage continuity of expert and effective leadership of this committee that is responsible for investing the assets of the three Vermont public pension systems.
- **Spiking:** For anyone retiring on or after July 1, 2012, the amendment restricts the total number of compensable hours that may be used to determine Average Final Compensation (AFC) to no more than 120 percent of the average of the total hours worked for the five years preceding the AFC period. This change ensures that one year of extraordinarily higher pay does not artificially inflate the final retirement benefit calculation.



Investment Choices Expanded in Defined Contribution Plan

As the economic climate remains challenging for investors, the need to diversify asset allocations has never been more important. Recently, State and municipal employees who participate in the defined contribution plan saw their investment choices expanded. Five new funds were added to both the State and municipal DC plans.

As of March 31, the DC plans had a combined 1,191 participants and \$53.9 million in assets. The plans are modeled after private sector 401(k) plans and is available to VSERS exempt employees and for employees of municipalities choosing this option within the VMER system. Fund line-ups are negotiated by the Treasurer's Office for the VSERS employees and by the VMERS Board of Trustee for municipal members and are included in the contract with the plan administrator, Fidelity Investment.

"As we examined the investment choices for the DC plan participants, we wanted to give participants more choices and a greater opportunity to see their retirement investments grow," said Steve Wisloski, Director of Investment and Debt Management for the Treasurer's Office.

Choosing the right asset allocation is important because it impacts whether you meet your financial goals.

—Steve Wisloski, Director of Investment and Debt Management

Diversification is the practice of spreading money among different investments. By including asset categories and investment returns that move up and down under different market conditions within a portfolio, an investor can protect against significant losses. The DC plans available to State and municipal employees offer domestic and international equities, fixed income, balanced funds, target-date funds, and a stable value alternative. DC plan participants select from these alternatives based upon their tolerance for risk and their return objectives.

In April 2010, the State DC plan added three index funds (total bond market, balanced, total international stock market), a managed international fund, and a socially responsible investment (SRI) alternative. The specific funds added are: Vanguard Total Bond Market Index Fund, Vanguard Balanced Index Fund, Vanguard Total International Stock Index Fund, Columbia Acorn International Fund, and PIMCO Total Return Fund III (an SRI fund). Also in April, the municipal DC plan added three index funds (total bond market, extended domestic stock market, and total international stock market), a managed small-cap value stock fund, and a managed international fund. The specific funds added are: Vanguard Total Bond Market Index Fund, Spartan Extended Market Index Fund, Vanguard Total International Stock Index Fund, Lord Abbett Small-Cap Value Fund, and Columbia Acorn International Fund. The municipal DC plan also removed the Fidelity Fund and the Fidelity Growth Strategies Fund that had been providing below-average returns compared to similar funds in their respective classes.

Employees can get more information through the Fidelity web page at www.MySavingsAtWork.com.

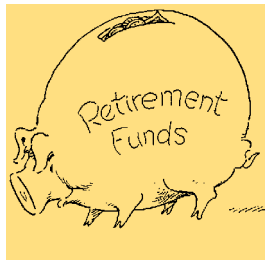
UPDATES FROM THE RETIREMENT DIVISION: Retirement Numbers & Health Benefit

Record Number of System Employees Retire

The months of June, July and August are typically the busiest months of the year for the Retirement Division staff. This year looks to be exceptionally busy as we are anticipating having more than 500 individuals retiring effective July 1. Of

this number, teachers make up the greatest share of new retirees at approximately 420, followed by 39 State employees and 50 municipal employees. One goal of the division is to process all retirements in a timely manner to ensure all new retirees receive their first pension payments by July 31. To give you a perspective of the volume of retirees for the month

of July, we are currently averaging 900 new retirees in total each year across all three systems. The 500+ retirees we have for July 1 account for approximately 55 percent of all new retirees in one year. In addition to processing new retirements, the staff also must close the fiscal year and record the current year contributions and corresponding service credit for all active employees in each of the three retirement systems. There are currently 781 reporting entities and more than 25,000 contributing employees in the three systems. Once the fiscal year has closed and all of the data has been posted, the priority of the division is to review and verify the actuarial data that is used to generate the annual benefit statements for active employees. With 45,000 active, vested and retired members our staff-to-member ratio is one staff person for every 3,750 members.



Recent Retiree Update

	2010	2009	2008	2007	2006
JANUARY	75	65	52	59	51
FEBRUARY	16	23	11	23	14
MARCH	25	24	15	24	19
APRIL	27	18	21	28	20
MAY	23	14	17	16	28
JUNE	33	33	12	20	18
JULY		45	43	28	34
AUGUST		12	37	22	28
SEPTEMBER		189	26	22	30
OCTOBER		25	27	20	12
NOVEMBER		24	23	21	20
DECEMBER		24	12	19	22

Adult Children to Maintain Health Benefit Longer

Passage of the new federal health care legislation will allow for health insurance coverage for dependents up to the age of 26. The State of Vermont, through their contract with CIGNA, will begin offering coverage effective January 1, 2011. Full information will be coming for all active employees and retirees in the open enrollment information that will be mailed out later this calendar year.

Director's Corner

by Cynthia Webster, Director of Retirement Policy & Outreach



Our office spends a lot of time talking with members who are approaching retirement about what they can expect to receive in retirement. We provide an estimate of benefits that outlines what a member will receive on a monthly and annual basis under all of the six options available. However, that is only a part of the story.

The estimate of benefits that is sent to members looking to retire

provides a quote of the gross amount available based on the member's group plan; total creditable service; final average salary; and age at retirement. For many members, the actual amount received on the last working day of each month may be considerably less in retirement--depending on what deductions they need and want.

What deductions may be taken out of a monthly pension?

Federal and State Taxes: The majority of the monthly pension payment will be taxable. The exception is money contributed by the member prior to 1998 when the mandatory contributions became pre-tax deductions. If a member has already paid taxes on contributions, those contributions will not be taxed again in retirement. However, for most retirees, between 95 and 100 percent of their pension will be taxable. It is up to the retiree whether he or she wishes to have federal and state taxes withheld. The vast majority prefer to have taxes taken out monthly instead of running the risk of owing tax when their returns are filed. Tax withholdings may be changed at any time after retirement by completing new tax withholding forms.

Medical Insurance: The same medical plans available to active State employees are available to retired VSERS employees. For non-Medicare eligible retirees and/or dependents, the plans available are Total Choice, Selectcare, Healthguard PPO, and the Safety Net Plan. The two plans available for Medicare-eligible retirees and/or dependents are Total Choice and Healthguard PPO. Retirees must have the medical coverage for themselves and all eligible dependents at the time of retirement in order to carry the medical coverage into retirement. If a member chooses to keep medical coverage upon retirement, the appropriate medical premium will be deducted from the monthly pension. The State system currently pays 80 percent of the premium for the retiree and all covered dependents as long as the retiree is alive.

Dental Insurance: Two dental plans are available to all retirees and their eligible dependents. Monthly premiums range from \$39.99 for single person coverage for Plan A to \$135.20 for family coverage for Plan B. If a retiree wants dental coverage, he or she must sign up for it at the time of retirement. Coverage may always be dropped after retirement, but it cannot be picked up at a later date.

From the

Retirement Book



A purchase of service is a valuable tool that may assist some members in being able to retire earlier with a higher pension benefit. There are several types of allowable service that may be purchased for credit in the VSERS. Eligible service that may be purchased include State employment in Vermont (that is not already part of your retirement account); State employment in another state; teaching in a public or private school in Vermont or another state; municipal employment in Vermont or another state; restoration of a prior membership; and military, VISTA or Peace Corps service with a minimum of 15 years of creditable service. "Air time" (not representing any type of service) may be purchased once you have attained 25 or more years of service. In all cases, you cannot purchase service if you have a benefit available to you from another system for that same service. Service may be granted if you were on an approved leave of absence for professional study or acceptance of an exchange position, military duty, or out on an approved workers' compensation claim. You also may restore service credit lost while on an approved leave of absence for any other reason if it occurred after July 1, 2007. All service, with the exception of "air time" must first be verified before it can be purchased. You may download an "Application to Purchase Service Credit" form from our web site at www.VermontTreasurer.gov/retirement/state-calculators. The web site also will allow you to calculate the cost to purchase each year of service, depending on your status of employment on July 1, 2008.

(Salary Reduction Impact Continued)

2011), which is higher than it would have been a year earlier. If the employee works another year, we would use the AFC of \$40,794 calculated for fiscal years 2009-2011, as that would still result in the highest three consecutive years of earnings. Please note that this is just one example. Individual circumstances, retirement goals, as well as years of service, will also affect the actual retirement benefit.

An employee's pension check is based on the average of the member's highest consecutive years of earning. For most State employees, the top three years of consecutive earnings are used.

An amendment in Act 139 of the miscellaneous retirement bill, was passed by State Legislators in the last session to temporarily mitigate the impact of the pay reduction. The amendment addresses this issue for employees who retire after June 30, 2011. If the employee's AFC calculation for retirement includes salary from fiscal years 2011 or 2012, those salary figures must not be less than the salary recorded for fiscal year 2010. However, this provision is contingent on a plan being put in place that makes this change cost-neutral to the retirement system. The VSEA, Treasurer's Office, and other interested parties will be discussing this plan in the coming months.

Based on the current VSEA contract, the pay reduction and step freeze continues through June 30, 2012. A new contract will then be negotiated.

For more information on how a VSERS member's retirement benefit is calculated, go to www.VermontTreasurer.gov and click on the "Retirement" link on the main page. Once on the Retirement System page, you can select the VSRS link and check out your individual group plan. As always, we encourage members to contact our office with any questions regarding their retirement plans.

Vermont's Economic Response

Fortitude and foresight required in solving our economic challenges

by Jeb Spaulding, Vermont State Treasurer

The last few years have been tough all around. Many Vermonters have lost their jobs; some their homes and businesses. Others have taken pay cuts, experienced reductions in government assistance, and watched their retirement savings take a nose dive.

On the State government front, the Governor and State legislators just tackled one of their toughest budget years. With fortitude and a commitment to finding workable solutions, they successfully developed a budget plan that closed a \$150 million hole in the budget for the fiscal year begun on July 1. They produced a plan for a balanced budget, cut spending while working to minimize cuts to the most vulnerable, fully funded the pension plans, made selective investments in future job creation, and utilized some rainy day funds while still maintaining additional reserves for future needs. I do not believe many, if any, other states passed a balanced budget this year, while still maintaining reserves and avoiding broad-based taxes. I commend them for their work.

It is essential that Vermont leaders and citizens coalesce around a long-term strategic economic plan that identifies the large-scale trends and conditions that will impact this state in the future.

I would also like to recognize State employees and teachers for similarly facing tough economic challenges and working toward solutions. State employees are now experiencing a three percent two-year pay reduction. Teachers are now working with revised pension and retiree health plans and contributing more of their pay for those plans. Those steps alone made a \$20 million dent in the \$150 million deficit that had to be addressed. I thank them for their sacrifice and commitment to resolving our fiscal challenges, and look forward to working together to meet the remaining challenges ahead. In particular, my office will be working with the VSEA between now and January to identify potential savings in the Vermont State Employees' Retirement System. Our outlook will remain on the long-term as we examine current retirement benefits and future fiscal realities.

Recently, Vermont's leading economists said that they believe our state is now out of recession. This recovery, however, has been tentative and fragile – and is largely dependent upon federal fiscal and monetary stimulus to date. State revenues appear to have stabilized and are projected to increase by some \$70 million this fiscal year and another \$80 million next year. Our official State unemployment rate is the fourth lowest in the country. Our home foreclosure rate is very low comparatively and, in some parts of the state, there are signs of life in real estate and tourism markets. Vermont remains the only New England state with a triple-A bond rating.

With economic conditions slowly improving, it's tempting to assume that building a State budget for next year will be easier. Unfortunately, that will not be the case. The new Governor and legislature will be tackling their toughest budgetary challenges since the downturn in the economy. Why is that? The biggest reason is because the hundreds of millions of dollars in temporary stimulus money from the federal government will end this year.

These funds have strategically been used by Vermont to produce balanced budgets for the past two years. In addition, with reductions in capital gains taxes and implementation of federal health care reform, even with the inflow of State generated taxes on the upswing, Vermont will face a budget gap of approximately \$120 million next fiscal year. And closing next year's budget gap will be harder because, as the saying goes, all of the low-hanging fruit has been picked. Most constituencies already have been impacted by budget cuts. Additional savings or revenues will be harder to find.

If budget makers are able to produce a plan to balance expenditures and revenues next year, Vermont should then be on a more stable and positive financial trajectory. At the same time, it is also essential that Vermont leaders and citizens coalesce around a long-term strategic economic plan that identifies the large scale trends and conditions that are going to affect us in the next five, 10, and 15 years. This plan must be focused, specific, widely understood, and supported. This plan must identify Vermont's assets and liabilities, as well as our relative market position and comparative advantages in the northeast, U.S., and the world. From such assessment, we can compose concrete actions that allow us to take advantage of economic opportunities and insulate ourselves from future economic threats. Vermonters have already demonstrated they have the fortitude and the willingness to sacrifice to achieve workable short-term solutions. Now, it's time to develop a strategy that works for the long run.



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Choosing a retirement option

VSERS Retirees Choose From Six Options

We are often asked what retirement options are most popular with retirees in the Vermont State Employees' Retirement System. When you retire you will be asked to choose how you would like to receive your retirement benefit. There are currently six payment options. Below is a brief description of each option, including one that is no longer offered, and the percentage of retirees who have chosen that payment option at retirement.

40% Chose - Maximum Benefit Option (Basic)

The basic or maximum benefit, is payable for your life with no benefit or refund of contributions to a designated beneficiary at your death. This option provides the highest starting monthly benefit payment for a retiree of all of the options. For individuals who do not choose a retirement option by the time they are 70 1/2 years of age, are vested, and are not working for the State, they will automatically be signed up to receive the maximum benefit option.

24% Chose - Option 1 Guaranteed Annuity Return

In a contributory system, there will always be accumulated member contributions in your account. A contribution



refers to the money you personally contribute towards retirement. That amount is usually automatically deducted from your regular paycheck. By choosing option 1, the guaranteed annuity return, you receive a monthly benefit that is slightly lower than the basic benefit described above. However, upon your death, your beneficiary will receive a lump sum payment equal to the amount of contributions left in your retirement account minus the

total of the annuity payments that already have been paid to you prior to death. This option generally results in a payment to your beneficiary if you die within 13 or 14 years after retiring.

6% Chose - Option 2

This option was discontinued starting July 1, 2009. Six percent of our current retirees did select this option before it was discontinued. It is very similar to the basic benefit option, but allowed for a lump sum payment to a beneficiary upon the retiree's death. However, because the monthly benefit was essentially the same as the basic benefit, unless a retiree died

shortly after retirement there were usually no contributions left in the retirement account to pay a lump sum payment to the beneficiary.

7% Chose - 100 Percent Survivorship

This option provides for your beneficiary to receive the same monthly allowance for life that you were receiving, should you pre-decease your designated beneficiary. However, in exchange for this option, your starting monthly retirement benefit is less than the basic benefit by an average of between 10 and 25 percent, depending upon the difference in your ages. The beneficiary designation by the retiree at the time of retirement CANNOT subsequently be changed.

10% Chose - 100 Percent Survivorship Pop-Up

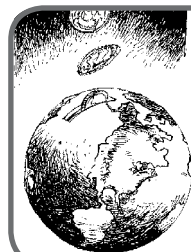
The 100 percent pop-up option provides a benefit that is slightly lower than the 100 percent survivorship option explained previously, but allows for your monthly allowance to go up (pop-up) if your beneficiary pre-deceases you. This pop-up function may also apply in situations where there are court-order stipulations contained in a domestic relations settlement.

4% Chose - 50 Percent Survivorship

This option differs from the 100 percent survivorship option in that your beneficiary receives 50 percent or half of the benefit that you were receiving, should you pre-decease your designated beneficiary. This option does not reduce your starting monthly retirement benefit as much as the 100 percent survivorship option does. On average, the benefit reduction from the basic benefit option is between 5 and 15 percent, depending on the difference in your ages. The beneficiary designated by the retiree at the time of retirement CANNOT subsequently be changed.

9% Chose - 50 Percent Survivorship Pop-Up

As in the earlier pop-up option, this option provides lower initial payments to you and your beneficiary, but with an increased benefit should your beneficiary die first, or based on the stipulations contained in a domestic relations order. Since you are opting to have your monthly retirement benefit go up (pop-up) by 50 percent if your designated beneficiary dies before you, your starting monthly retirement benefit will be somewhat more than under the 100 percent survivorship pop-up option.



What is

Socially Responsible Investing?

Socially responsible investing is choosing to invest in companies that operate ethically, provide social benefits, and are sensitive to the environment. In June 2007, three socially conscious funds were added to the 457 Plan. You can learn more about these funds by going to www.VermontTreasurer.gov/retirement/state-vsrs.

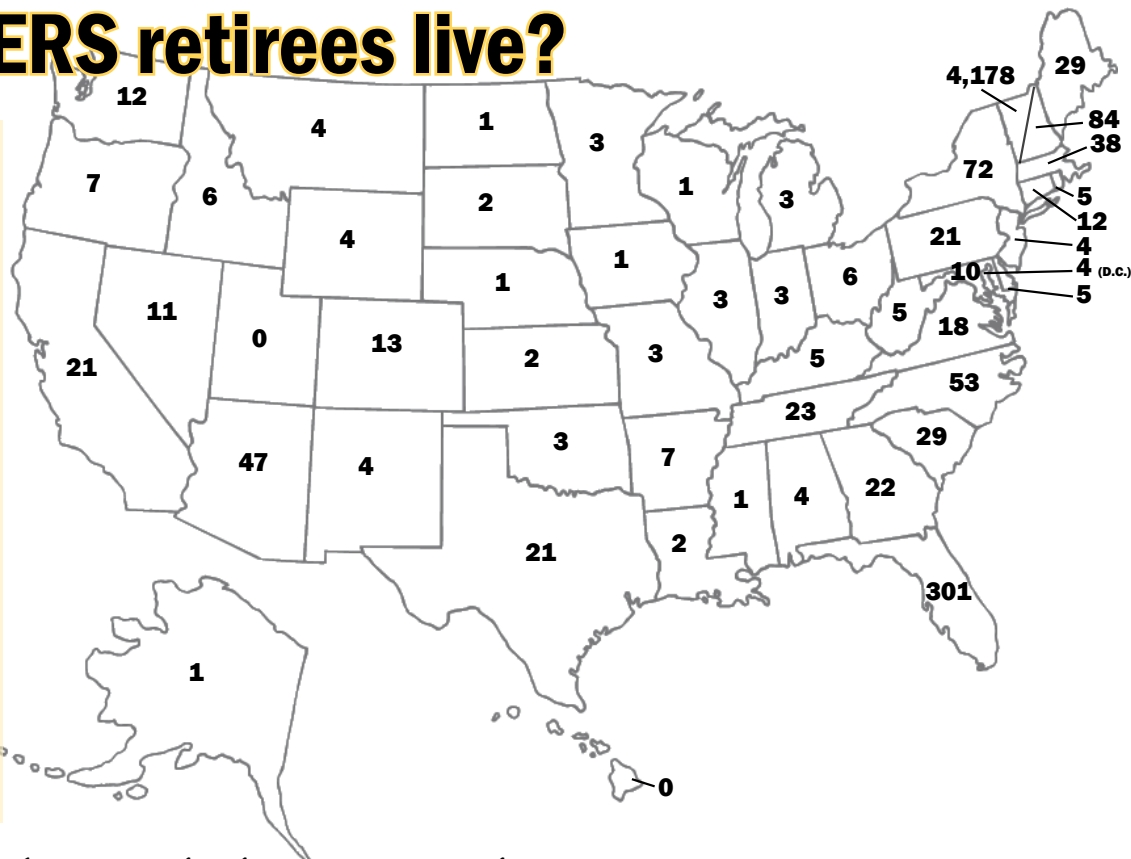
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Where do VSERS retirees live?

Hundreds of State employees retire each year from their jobs. While the perception is that many retirees leave Vermont for warmer climates, the majority choose to remain in the Green Mountain state. At right is a map of the United States and the number of VSERS retirees living in each state. More than 80 percent of VSERS retirees claim Vermont as their permanent residence. The second most popular place of residence is Florida, followed by New Hampshire, New York, and North Carolina. It appears many retirees share the same warm sentiment expressed by President Calvin Coolidge about his home state, Vermont.



"I love Vermont because of her hills and valleys, her scenery and invigorating climate, but most of all because of her indomitable people." -- Calvin Coolidge