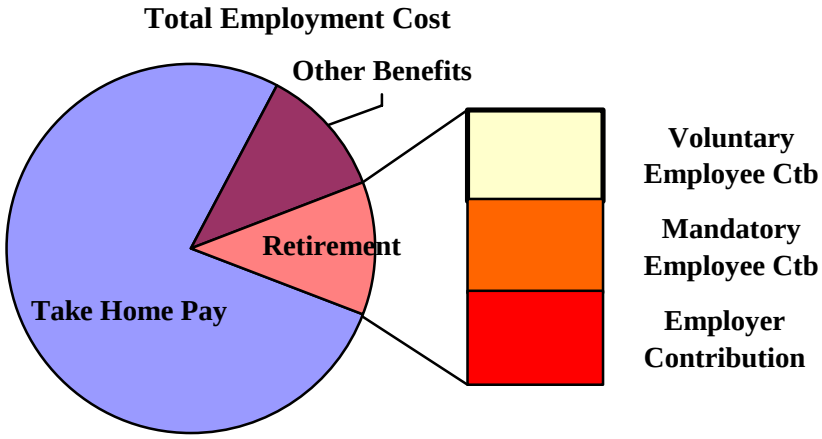
The following graph illustrates a breakdown of the total financial costs of employing someone:



When designing the retirement component, the state and local governments (SLGs) might consider two approaches:

A. Set the Retirement slice to achieve the desired replacement rate, retirement age, and career length goals. Within the retirement slice, determine the right proportion of voluntary employee contributions, mandatory employee contributions, and employer contributions. The advantages of voluntary vs. mandatory contributions were discussed in an earlier meeting of the Commission. The advantages of mandatory employee vs. employer contributions are discussed in one of the other readings for this meeting. Then adjust cash compensation (and therefore take home pay) to achieve the desired level of total employment cost.

   Example: Cash compensation is $40,000. Other benefits are $8,000. Assume that a 12% of pay retirement contribution will achieve our retirement goal. Suppose we determine that one third of that contribution, i.e. 4% of pay, should come from voluntary employee, mandatory employee, and employer contributions. This gives a total employment cost of $40,000 + $8,000 + 4% x $40,000 = $49,600. Assume we then determine that we need to provide a total package worth $52,000 to attract the right employees, so we increase cash compensation to $42,308, to get total employment cost of $42,308 + $8,000 + 4% x $42,308 = $52,000.

   Pro: Allows SLGs set the ideal mix of retirement contribution types

   Con: Have to work across agencies to adjust cash compensation, for example if the General Assembly adjusts retirement contributions then local governments will need to adjust their cash compensation practices to bring everything back into balance

B. Assume that someone else is setting cash compensation and other benefits at the right level. Then set the employer retirement contribution at the desired competitive level and adjust employee contributions to achieve the retirement goal.

   Example: Cash compensation is $40,000. Other benefits are $8,000. We determine that our labor market competitors have employer retirement contributions averaging around 8% of pay and we want to target the average (rather than above or below the average). We set the

employer contribution at 8% of pay. We know that we need 12% of pay contributions to achieve the retirement goal, so we try to get an additional 4% of pay between voluntary and mandatory employee contributions.

Pro: Cash compensation, other benefits, and retirement contribution decisions can each be considered in isolation, so no one needs to have expertise in all areas

Con: May not achieve ideal mix of retirement contribution types

If the Commission wishes to follow approach B, here is some data on employer contribution rates at some of our labor market competitors. These combine contributions to both DB and DC plans.

Labor Market Competitor	Contribution Rate	Normal Cost[1]
State and local governments	12.2%[2]; 10.0%[3]	8.8%[4]
Neighboring states (VA, GA, SC, TN)	10.5%	7%
Federal government (civilian)	16%[5]	16%
Large private employers (>500 EEs)	7.1%	6.9%[6]
Medium private employers (100-499 EEs)	4.8%	
Small private employers (<100 EEs)	3.3%	

The employer costs for our current retirement benefits (DB and DC) are:

Group	FY 10 Contribution Rate	Normal Cost
TSERS General Employees	3.6%	6.3%
LGERS General Employees	4.8% to 12%, depending on DC contribution and accrued liability	6.3% to 12%, depending on DC contribution
Law-Enforcement[7]	Around 12%	Around 13.5%
ORP	6.8%	6.8%
Judicial	15.1%	17.3%

[1] Normal cost is the value of benefits earned during the year. The employers' actual contribution could be higher than the normal cost if the plan is underfunded or lower if it is overfunded. It could also be lower if they choose not to contribute the required contribution. Thus, the normal cost is probably a better measure of the true value of benefits. For a DC plan, the actual contribution and normal cost would be the same.

[2] U.S. Bureau of Labor Statistics, *Employer Costs for Employee Compensation*, Dec 2009, http://www.bls.gov/news.release/pdf/ecec.pdf, these figures are Retirement and Savings divided by Wages and Salaries. Government is from table 3 and includes non-Social Security systems. Private is from table 8.

[3] National Association of State Retirement Administrators, *Public Fund Survey*, FY08, median for Social Security-eligible workers is 8.7%. This is DB-only, so we added 1.3% from BLS for DC.

[4] The TSERS normal cost is 6.3% of pay. The 2008 Wisconsin Legislative Council comparative study and the Public Fund Survey show that the multiplier is a little below the average of other systems in Social Security, the final averaging period is longer, and the employee contribution is higher. 7.5% is a rough estimate of the average normal cost adjusting for these differences. Then we added the 1.3% from BLS for DC.

[5] OPM Annual Report (http://www.opm.gov/gpra/opmgpra/par2009/par2009.pdf) shows 11.2% employer normal cost for DB portion of FERS. Employer contribution to DC is up to 5%, so we used 16% for total. Military benefits replace 50% after only 20 years of service, so would have a much higher value.

[6] Towers Watson (formerly Watson Wyatt Worldwide), *Employer Commitment to Retirement Plans in the United States*, 2009.

[7] In other states and the federal government, benefits for law-enforcement are often more valuable than benefits for general employees, but we do not have a quantitative comparison.