EXHIBIT 3
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SB 328

SB328 – DC Plan
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House State Administration
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Senate Bill No. 328 – Require PERS New Hires to be in Defined Contribution Plan

Overview

- This bill impacts only the Public Employees' Retirement System (PERS). PERS is the largest of the eight defined benefit plans administered by the Public Employees' Retirement Board (PERB).

- PERS covers state agencies, counties, cities, local government agencies and non-teaching staff in the University System and school districts.

- PERS Membership

PERS Membership		
State Agencies	10,815	38%
Universities	2,626	9%
Counties	5,438	19%
Cities	3,238	11%
Other Agencies	1,207	4%
School Districts	5,510	19%
	28,834	

- The PERS offers both a defined benefit (DB) and a defined contribution (DC) plan. The DC plan is an attractive plan for young employees who have time to grow their retirement.

- The average new hire to PERS is 40 years old. Time is not on their side when it comes to saving for retirement. DC plans are not beneficial for most PERS members.

- The average PERS member:
  - is 48.9 years of age
  - earns $38,281/year
  - has 9 years of service credit
  - retires at 59.2 years of age
  - retires with 19 years of service credit
  - earns $1,049/ month in retirement.

- As of June 30, 2010 there were 28,834 active members in the DB and 2,018 members in the DC. (6% of total PERS membership has chosen the DC)

<u>Time Needed to Develop and Study New Plan</u>

- Major proposals of this type need time for research and development. A thorough study, with input from stakeholders, helps determine the impact of the changes, avoid unintended consequences, and implement best practices.

- This bill was not vetted through the SAVA interim committee.

- The 2009 Legislature passed HB 659 requiring an interim study the statewide retirement plans and providing an appropriation. An actuary was hired to provide several plan alternatives. SAVA did <u>not</u> propose closing the current defined benefit retirement plan and requiring a defined contribution retirement plan.

- Some states with DC plans have studied the benefits offered and concluded that the DC plans are costly and not meeting retirement goals. Nebraska and West Virginia have recently switched back to a DB plan from a DC plan.

Defined Contribution (DC) vs. Defined Benefit (DB) Plans

- DB plans have been around for over 100 years because they have many positive attributes, especially in the current economic environment. Montana's Public Employees' Retirement System has been in place for 66 years. .

- Traditional DB plans better ensure retirement security for employees. DB plans are also a cost effective recruitment and retention tool for employers to attract and keep qualified employees.

- Studies have shown that DC participants do not save enough for retirement. They take their money when they move from job to job rather than rolling it to their new employer's retirement plan. At the end of their career they often do not have enough to provide a lifetime benefit.

- During CY 2010, 167 members withdrew their funds from the PERS-DC plan. 66 of those members rolled their contributions to other qualified plans (IRA, TSA, ROTHs), 101 members took a full withdrawal of their funds.

- The average person does not know how to diversify their portfolios; are risk adverse and invest emotionally. We have seen this in both the PERS-DC plan and in the deferred compensation plan. Even with targeted education, members do not diversify their portfolios and remain in the default fund.

- DB plan assets are professionally managed; providing greater returns. DB plans also have the ability to withstand market fluctuations.

- DC plans cost more than DB plans to administer.
  PERS-DB expense/assets 70.6 bps or 0.71%
  PERS-DC expense/assets 110.2 bps or 1.10%

Advantages of a DB Plan

- DB plans are efficient. They:
  - are less expensive to administer
  - have pooled risk
  - are managed by investment professionals
  - have diversified portfolios
  - resulting in higher returns.

- Guaranteed, lifetime benefits reduce need for public assistance.

- Guaranteed, lifetime benefits support our local economy by allowing retirees to continue to purchase necessities during difficult economic times.

Closing the PERS-DB Plan

- Closing the PERS-DB plan to new hires is the worst alternative for addressing the current funding issues.

- Closing the PERS-DB plan does not reduce the unfunded actuarial liabilities (UAL).

- Since new hires will not be in the DB plan, the payroll base will begin to decline immediately. Less money will be available to pay down the UAL.

- The financial burden as a percent of payroll will accelerate. This will be compounded by a change in methodology for valuing the system now that it is no longer an open on-going retirement plan.

- The investment returns will not be sufficient to pay increasing retirement benefits on a declining payroll.

- The PERS-DB plan must continue to operate until that last new hire retires dies and the new hire's beneficiary dies. This could be 75+ years into the future.

- ❖ The fund will run out of money; creating a much deeper hole than we are in today.

SB 328 Technical Concerns

- ❖ This bill allows current non-vested DB members another election to join the DC plan while vested DB members cannot. This appears to be an equity issue.

- ❖ The non-vested members must be educated about their plan choice (there are 5,500 non-vested inactive members and 12,000 non-vested active members). Pubic retirement system assets are to be held in trust for the exclusive benefit of the members of the trust. The expense for this plan choice education is not addressed. The original plan choice education for the PERS-DC plan was provided through a loan to the DC plan.

- ❖ The bill requires the Governor to include the necessary funding of the PERS-DBRP in the preliminary budget. However, ***the funding source is neither identified nor guaranteed.*** This does not adequately address the funding issue. The fiscal note shows this money coming from the employer. This will impact the taxpayer.

- ❖ This bill removes the vesting requirement. Therefore, employer contributions are no longer forfeited when a member leaves covered employment before vesting. Forfeitures help offset administrative costs. PERS-DC CY 2010 forfeitures totaled $408,000.

- ❖ Section 19 – the interest rate for transfers is 8%. This is the rate for the original transfer period for current members, many of which were long time PERS members. This rate should not be more than the actuarial assumed rate of return of 7¾%. It should probably be even lower, reflecting short-term interest rates.

- ❖ The 2.37% plan choice rate (PCR) is repealed. The PCR pays the impact on the unfunded actuarial liability caused by DB members exiting the plan. Removing this funding source violates Article VIII, Section 15 of the Montana Constitution.

- ❖ Per the Montana Constitution, public retirement system assets, including income and actuarially required contributions, shall not be encumbered, diverted, reduced, or terminated.

Constitution Language – Article VIII Section 15

Constitution of Montana

-- Article VIII -- REVENUE AND FINANCE

Section 15. Public retirement system assets. (1) Public retirement systems shall be funded on an actuarially sound basis. Public retirement system assets, including income and actuarially required contributions, shall not be encumbered, diverted, reduced, or terminated and shall be held in trust to provide benefits to participants and their beneficiaries and to defray administrative expenses.

(2) The governing boards of public retirement systems shall administer the system, including actuarial determinations, as fiduciaries of system participants and their beneficiaries.

History: En. Sec. 2, Const. Amend. No. 25, approved Nov. 8, 1994.

Closing

- ❖ **This bill does not address the funding issues of the DB plan today.**

- ❖ **This bill does not adequately address the funding issues that arise from closing the DB plan.**

- ❖ **With this bill the PERS-DBRP goes broke long before the last benefits are paid out.**

- ❖ The Public Employees' Retirement Board respectfully and strongly recommends a "Do NOT Concur" on SB 328.