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Bill No. SB 328

SB328 – DC Plan
2011 Legislative Session
Senate State Administration Committee
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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.

- PERB believes that "one size does not fit all". They believe in providing the plan choice available to members today.

- The PERS currently allows new hires 12 months to choose between the defined benefit retirement plan (DBRP) and the defined contribution retirement plan (DCRP).

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

Value of Defined Benefit Plans

- PERB believes that a defined benefit plan is advantageous for most PERS members.

- ❖ Defined benefit (DB) plans provide lifetime benefits – promoting individual retirement security.

- ❖ DB plans are designed to withstand market volatility.

- ❖ 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.

- ❖ Markets are improving.
  - FY 2010 rate of return – 12.87%.
  - FY 2011 through January 2011rate of return – 17½%.

- ❖ Cost and benefits are shared.

- ❖ Pensions assist with recruitment and retention.

- ❖ 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.

<u>Why Defined Contribution Plans not as Beneficial for Montana PERS Members</u>

- ❖ The DCRP is a good, attractive plan for young employees who have time to grow their retirement.

- ❖ PERS members are older and don't have the benefit of compounding interest over time.

- 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.

Closing the PERS-DBRP

- Closing the PERS-DBRP to new hires is the worst thing you can do to address the current funding issues.

- Closing the PERS-DBRP does not change the normal cost rate in the DB plan.

- A stable membership and income stream is needed to fund the continuing PERS-DBRP.

- Closing the plan means there will no longer be an increasing payroll to amortize the unfunded actuarial liability.

- Closing the PERS-DBRP to new entrants will require dramatic increases in contributions to fund the unfunded liabilities.

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

- The PERS-DBRP 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.

- ❖ Closing the current plan has a detrimental impact on the PERS-DBRP funding:
  - Payroll decreases from $1.15B to $0.31B in 2030.
  - Funding status plummets from 74% today to 7% in 2030.
  - Actuarial Accrued Liability increases from 5.24B to 8.65 B in 2030
  - Annual required contributions (ARC) increases from 22.3% today to 223.5% in 2030.
  - The fund will run out of money; creating a much deeper hole than we are in today. <Handout – Assets vs. Liabilities>

- ❖ The current method of calculating the amortization payment will need to be changed to reflect a closed system which will require significant contribution rate increases.

- ❖ Currently a member must be vested to be eligible for disability benefits. Under this proposal disability benefits are available on day one. The disability trust fund will not be sufficiently funded over time.

- ❖ You may have attended the presentation on the Utah Hybrid plan by Senator Dan Liljenquist. The take-aways from his presentation:
  - Utah recognized they wanted a secure retirement plans for their public servants.
  - Utah created a new "tier" to ensure that funding continued for the DB plan.
  - Utah realized that contributions needed to be increased to pay the ARC.
  - Utah committed to continued funding of the current plan.

<u>SB 328 Positive Aspects</u>

- ❖ The bill recognizes there is a contract right for current members.

- ❖ The bill recognizes the need to pay the unfunded actuarial liability in the DBRP; however, the funding is not adequately addressed.

- ❖ The bill recognizes the need to request IRS approval.

SB 328 Technical Concerns

- ❖ Section 1 – speaks of "additional contributions" – does this mean members can contribute over the 'defined' amount?

- ❖ Section 2 – allows an election for "certain members" – non-vested members. Is this an equity issue?

- ❖ Section 4 & 5 – addresses the Governor include the necessary funding of the PERS-DBRP in the preliminary budget. This does not adequately address the funding issue.

- ❖ Section 6 – "initially hired" defined. Should this be in PERS definitions rather than Chapter 2, which addresses all retirement plans administered by the PERB? This might avoid unintended consequences.

- ❖ Section 9 & 21 – members vest immediately. There are no longer forfeitures of employer contributions if a member leaves covered employment before vesting. Forfeitures help offset administrative costs.

- ❖ 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%. Perhaps, it should be based on a short-term earnings rate.

- ❖ Section 22 – Employer allocation. The plan choice rate (PCR) is repealed. The PCR is pays the impact on the unfunded actuarial liability due to members leaving the defined benefit plan. The proposal does allocate 0.27% of employer contributions to the DBRP and to the long-term disability plan trust fund. However, the language "in the following order" is removed. It is unclear how it should be allocated.

❖ The current plan choice rate unfunded actuarial liability (PCR-UAL) is $14,687,168. This is the remainder of the UAL left behind upon plan implementation when current members had the option to choose between the PERS-DCRP and the PERS-DBRP. Members choosing the PERS-DCRP left behind this PCR-UAL that still needs to be paid. This proposal repeals the PCR and does not address paying off that PCR-UAL.

Summary

❖ Proposals of this sweeping change need time for research and development.

❖ The SAVA Interim Committee studied the retirement plans. They devoted money and time to the funding issue. They did not propose a required defined contribution retirement plan.

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

❖ The Public Employees' Retirement Board respectfully recommends a "Do NOT Pass" on SB 328.

❖ I will remain available for questions.

❖ Thank you.