LC No. _____
HB/SB _____[1]

REPORT AND RECOMMENDATION OF THE STATE ADMINISTRATION AND VETERANS' AFFAIRS INTERIM COMMITTEE (SAVA) TO THE 2013 LEGISLATURE AS OF NOVEMBER 2012[2]

Proposal No. 3
Proposing Entity: Montana Police Protective Association (MPPA)
Short Title: Revising the Definition of "Compensation" in MPORS

Retirement system(s) affected
Municipal Police Officers' Retirement System (MPORS)

Proposal summary
This proposal would revise the definition of "compensation" for all members in MPORS so that the following types of compensation will be included in the calculation of retirement benefits:

- overtime pay;
- holiday pay;
- shift differential pay;
- compensatory time pay; and
- payments in lieu of sick and annual leave.

Fiscal implications
A specific actuarial study was done on this proposal. This study is attached for reference. In general, because the amount of compensation on which contributions are made is increased, employee, employer, and state contributions to the trust fund also increase. The net result is that the actuary expects that an additional 0.9% of payroll will be available to pay down the system's unfunded liabilities and will reduce the amortization schedule from 25 years to 22.4 years based on the system's FY 2011 actuarial valuation. However, the actuarial study also shows that the funded ratio of the plan will decrease from 55.23% to 51.95% due to the fact that the change will apply to past service and will thus add about $25.3 million to the system's unfunded actuarial liabilities.

Effect on other Montana retirement systems
Under current law, MPORS and FURS are the only two public safety retirement systems that do

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[2] Report issued pursuant to 5-5-228, MCA.

STATE ADMINISTRATION & VETERANS' AFFAIRS
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Exhibit 18

not include the types of pay listed above in the definition of "compensation". If this proposal is enacted, FURS will be the only system remaining that excludes this pay from "compensation" and the legislature can expect that FURS members will also seek parity.

<u>Soundness as matter of retirement policy</u>
This proposal meets the following policy guideline adopted by SAVA:

- Guideline U - The legislature should strive to ensure that retirement benefit formulas in the public safety retirement plans are similar.

Because this proposal creates an unfunded liability for past service, it does not meet the following policy principle adopted by SAVA:

- Principle II - Pension funding should be a contemporary obligation.

The legislature should be cautious of including compensation types that may allow "salary spiking", or the inordinate increase in compensation just prior to retirement. However, the danger of "salary spiking" is more keen when compensation is averaged over a very short period of time, such as 12 or fewer months. In MPORS, FURS, and HWPORS, highest compensation is averaged over 3 years. In SRS and GWPORS, the average was recently increased from 3 years to 5 years for members hired after July 1, 2011, which typically results in a lower benefit.

The following table summarizes the features of Montana's public safety retirement systems relevant to this proposal:

System	Compensation includes/excludes overtime, holiday, shift, comp, and in lieu of sick or vacation pay	Period for Highest Average Compensation Calculation	Social Security Coverage
MPORS	Excludes	3 years	No
FURS	Excludes	3 years	No
SRS	Includes	5 years	Yes
HWPORS	Includes	3 years	No
GWPORS	Includes	5 years	Yes

Comparison with other states

A comparison of how other state laws define "compensation" in their public safety retirement systems was not readily available.

Legal implications[3]

This proposal does not raise any legal or contract impairment concerns.

Testimony received

The proposal was presented by Mark Murphy on behalf of MPPA. Mr. Murphy testified that the MPORS is actuarially sound and that, according to an actuarial study commissioned by MPPA and provided to the committee, the proposal would actually improve the soundness of the system. He stated that MPPA believes the proposal will increase the average benefit by $100 a year and that it is funded within the current employer and employee contribution rates. Mr. Murphy also said that the proposal would make MPORS similar to SRS, GWPORS, and HPORS and noted that MPORS members are not covered by social security. He said that the proposal would help with recruitment and retention of qualified officers by allowing the officers to receive retirement credit for all the compensation paid to them. Mr. Murphy talked about the state contribution rate provided to MPORS, which originally was paid from insurance premium taxes. He said this funding source was adequate to pay any additional costs associated with the proposal.[4]

Melanie Symons, chief legal counsel for MPERA, said that the PERS Board's legislative committee did support the proposal in concept, but noted that the Board's legislative committee would want to take a look at the FY 2012 actuarial valuation to be assured that the most current fiscal picture continued to show the sufficiency of funding for MPORS. Ms. Symons also noted that for those members nearing retirement, their final average compensation would seem to "spike" because of the inclusion of these additional types of compensation in their benefit calculations. But she said that the associated cost of these higher benefits would smooth out over time and that the actuarial study did show the increased contributions to the retirement system would more than cover that cost.[5]

Ed Cleary, President of Montana State Fireman's Association, testified in support of the proposal. Doug Neail of the highway patrol also testified in support of the proposal. He related that during the tornado that struck Billings on Father's Day the overtime put in by highway

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[3] David Niss, Legal Memorandums dated May 21, 2012, January 5, 2012, August 14, 2009, August 28, 2009 (Addendum), and February 27, 1998, Montana Legislative Services Division, (406) 444-3064, or visit www.leg.mt.us and contact staff for the State Administration and Veterans' Affairs Interim Committee.

[4] State Administration and Veterans' Affairs Interim Committee meeting on August 8, 2012. Audio/video and summary minutes available from the Montana Legislative Branch website at http://www.leg.mt.gov.

[5] Ibid.

patrol officers who directed traffic counted toward compensation for retirement while the overtime put in by all of the police officers who had to climb through the Metra Center, which had been hit, and through all the rubble and who where more in harm's way than the highway patrol officers did not count for their retirement. He said it isn't spiking when law enforcement is called out to handle emergencies or disasters, it is a fairness issue.[6]

There were no opponents.

Committee discussion and recommendations
There were no questions from the committee.

[6] Ibid.

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REPORT AND RECOMMENDATION OF THE STATE ADMINISTRATION AND VETERANS' AFFAIRS INTERIM COMMITTEE (SAVA) TO THE 2013 LEGISLATURE AS OF NOVEMBER 2012[2]

Proposal No. 4
Proposing Entity: Montana Sheriff's and Peace Officer's Association (MSPOA)
Short Title: Revising Benefits Related to Beneficiaries Under the Sheriffs' Retirement System

Retirement system(s) affected
Sheriffs' Retirement System (SRS)

Proposal summary
Currently, members of SRS may choose to receive a lesser retirement benefit if they want to provide a continuing benefit to one or more designated beneficiaries, such as to a surviving spouse or to their children. There are three different options for calculating the reduced benefit depending on certain variables related to how much of a benefit reduction the member elects and how long the benefit is to be paid following the member's death. The MSPOA proposal would eliminate the current optional benefit provisions in SRS and replace them with a provision that would allow the designated beneficiary to continue to receive the same full retirement benefit the retired member was receiving (i.e., 2.5% x FAC[3] x years of service). The benefit would be paid for the life of the surviving spouse, or, if the surviving spouse died, to a dependent child (or children on a *pro rata* basis), for as long as the child or children was dependent.

Fiscal implications
An actuarial study was not conducted on this specific proposal. In general, this proposal will increase benefits and therefore increase plan costs. The proposal does not include a provision for funding the additional costs. Also, the change is applied to all members (current and future) and so will create an unfunded liability for past service. The system is currently considered actuarially unsound because its liabilities cannot be amortized in 30 years or less with current contributions.

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[2] Report issued pursuant to 5-5-228, MCA.

[3] Final Average Compensation.

Effect on other Montana retirement systems

The proposal will make the SRS benefit payable to designated beneficiaries the same as what is currently provided for in MPORS, FURS, and HPORS. The GWPORS will then be the sole public safety retirement system with the optional reduced benefit provisions. Each of these systems also has provisions related to how much is to be paid in the event of a member's death before retirement. These provisions vary among the public safety systems.

The following table compares benefits for designated beneficiaries and the death (or survivorship) benefits payable in each of the public safety retirement systems under current law:

System	**Benefit to designated beneficiary (when a retired member dies)**	**Death Benefit (if member dies before retirement)**
SRS	Member may elect optional reduced benefit in order to provide a survivorship benefit *(The proposal would change this to a continuation of the member's unreduced benefit)*	Non-duty related: • lump sum of accumulated contributions; or • 2.5% x HAC x yrs of service actuarially reduced from age 65 or as of the date the member would have completed 20. Duty-related: • 50% of member's HAC
GWPORS	Member may elect optional reduced benefit in order to provide a survivorship benefit	Non-duty related: • lump sum of accumulated contributions; or • actuarial equivalent of service retirement benefit formula. Duty-related: • with 25 yrs or less, 50% of member's HAC • with more than 25 yrs, 2% x HAC x yrs of service
MPORS	Continuation of member's unreduced benefit	Duty or non-duty related: • with less than 20 yrs, 50% of HAC • with 20 or more yrs, 2.5% x HAC x yrs of service
FURS	Continuation of member's unreduced benefit	Duty or non-duty related: • with less than 20 yrs, 50% of member's HAC • with 20 or more yrs, 2.5% x HAC x yrs of service
HPORS	Continuation of member's unreduced benefit	Non-duty related: • actuarial equivalent of early retirement Duty-related: • 50% of HAC

Soundness as matter of retirement policy

This proposal meets the philosophy underlying the following policy guideline adopted by SAVA:

- Guideline U - The legislature should strive to ensure that retirement benefit formulas in the public safety retirement plans are similar.

Because this proposal creates an unfunded liability for past service and provides no increased contribution to cover past or future costs associated with this benefit enhancement, it does not meet the following policy principle adopted by SAVA:

- Principle II - Pension funding should be a contemporary obligation.

Comparison with other states

A comparison of how other state laws handle benefits for designated beneficiaries and death or survivorship benefits in their public safety retirement systems was not readily available.

Legal implications[4]

This proposal does not raise any legal or contract impairment concerns.

Testimony received

A representative from MSPOA was unavailable to present the proposal for hearing.

Committee discussion and recommendations

There were no questions by the committee.

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[4] David Niss, Legal Memorandums dated May 21, 2012, January 5, 2012, August 14, 2009, August 28, 2009 (Addendum), and February 27, 1998, Montana Legislative Services Division, (406) 444-3064, or visit www.leg.mt.us and contact staff for the State Administration and Veterans' Affairs Interim Committee.

LC No. _____
HB/SB _____[1]

Report and Recommendation of the State Administration and Veterans' Affairs Interim Committee (SAVA) to the 2013 Legislature as of November 2012[2]

Proposal No. 5
Proposing Entity: Assoc. of Public Safety Communications Officials, Intl. (APSCO) - MT Chapter
Short Title: Allow dispatchers in PERS to join SRS

Retirement system(s) affected
PERS and SRS

Proposal summary
Currently public safety dispatchers are covered under PERS, which requires 30 years of service before a member is eligible for a full retirement. Under SRS, a member is eligible for full retirement after 20 years of service. The Montana Chapter of APSCO would like to allow current dispatchers the option of joining SRS and to require the new dispatchers join SRS instead of PERS. This proposal was previously considered by the legislature, but did not pass. It was introduced by Rep. Franke Wilmer as HB 31 in the 2009 Session and HB 328 in the 2011 Session.

Fiscal implications
Employer Contributions
In PERS:

- the state employer contribution is 7.17%;
- the local government employer contribution is 7.07%;
- the school district employer contribution is 6.8%; and
- the state contribution is 0.1%.

Under the proposal, employer contributions for current dispatchers who transfer to SRS and for new dispatchers who would automatically join SRS would increase to 10.115%, which is the employer contribution under SRS.

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Employee contributions:
In PERS, the employee contribution is 7.9%. Under the proposal, these employee contributions for current dispatchers who transfer to SRS and for new dispatchers who would automatically join SRS would increase to 9.245%, which is the employee contribution under SRS.

The fiscal note for HB 328 from the 2011 Session (which was based on the FY 2010 actuarial valuation) indicated that this proposal would have:

- increased the statutory shortfall in funding for SRS by 0.75%;
- decreased the statutory shortfall in funding for PERS by 0.04%;
- had a net increased cost to general fund of $7,611 in FY 2012; and
- had a net increased cost to local governments of $451,071 in FY 2012.

The fiscal note also indicated that the proposal would have covered 393 dispatchers in PERS and that there would be no change in the normal cost of benefits in either PERS or SRS under the proposal.

<u>Effect on other Montana retirement systems</u>
None.

<u>Soundness as matter of retirement policy</u>
This proposal relates to the following policy principle adopted by SAVA:

I. Pensions should provide the base of financial security in retirement.

The policy issue for the legislature to consider is whether the nature of the job required of a public safety communications officer is such that the person's working career is 20 years rather than 30 years. Public safety personnel are typically covered in 20-year retirement systems.

In PERS, the retirement benefit formula is 1.79% x highest average compensation (HAC) over 5 years) x years of membership service. This provides 53% of HAC after 30 years. In SRS, the retirement benefit formula is 2.5% x HAC x years of service. If the legislature determines that the appropriate working career for a dispatcher is 20 years, then to meet the adopted policy principle stated above, dispatchers would need to be covered under SRS, which would provide the member with 50% of HAC after 20 years of service.

<u>Comparison with other states</u>
According to the summary presented by the Montana Chapter of APSCO, Wyoming public safety communications officers belong to the same retirement system as other law enforcement officers and similar legislative proposals have either been passed or were proposed in the following states: OR, AK, NY, NM, OK, FL and MA.

<u>Legal implications</u>
This proposal does not raise any legal or contract impairment concerns.

Testimony received

Testimony to SAVA on this proposal was received on August 8, 2012.

Proponents:

Ms. Kimberly Burdick testified on behalf of the Montana Chapter of APSCO as Montana's national representative on the national executive council of APSCO. She noted the high turn over rate in this profession because of the stressful environment and the realization that they cannot expect to be able to continue to work in this career for 30 years. She referenced studies and reports that reveal the high cost of turn over and training. She said the proposal for a 20-year retirement will promote recruitment and retention and benefit public safety through effective dispatching of first responders. She also noted that dispatchers require the same type of training as law enforcement officers. Ms. Burdick explained the high turn over and training costs and the anticipated savings that could result from retention of experienced dispatchers.

Ms. Susan Bomstad, president of the Montana Chapter of APSCO, testified as a proponent and handed out material showing the high cost of turn over and also referenced a PTSD study examining the high stress associated with being a dispatcher.

Ms. Melanie Symons testified that the PERS Board supported the proposal.

Mr. Ed Clearly of the State Fireman's Association supported the proposal.

Opponents:

None.

Committee discussion and recommendations

Committee questions led to discussion about the option available to current dispatchers to either stay in PERS or move to SRS. If the member moved to SRS, the member would have the option of purchasing service in SRS at the member's cost, not the employer's cost.

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REPORT AND RECOMMENDATION OF THE STATE ADMINISTRATION AND VETERANS' AFFAIRS INTERIM COMMITTEE (SAVA) TO THE 2013 LEGISLATURE AS OF NOVEMBER 2012[2]

Proposal No. 6
Proposing Entity: Senator Art Wittich
Short Title: Provide incentives for voluntary transfer to PERS-DC plan

Retirement system(s) affected
The systems with the greatest unfunded liabilities.

Proposal summary
This is a conceptual proposal to provide monetary incentives to public employees who voluntarily transfer to the PERS-DC plan within a defined window of time for the election. Sen. Wittich indicated he wanted to fund the proposal from the general fund.

Fiscal implications
No other details were provided in the proposal. Therefore the fiscal implications are unknown. Generally, financial risk would be shifted from employers to employees with respect to the employees who elect to transfer to the DC plan.

Effect on other Montana retirement systems
This proposal does not raise any "leapfrogging" issues.

Soundness as matter of retirement policy
This proposal relates to the following policy principle adopted by SAVA:

I. Pensions should provide the base of financial security in retirement.

The policy issue for the legislature to consider is whether the DC plan will provide a sufficient base of financial security in retirement. The committee or legislature may wish to request a fiscal analysis of the DC plan contribution rates and expected long-term investment returns in the investment choices available to plan members to get a sense of whether contribution rates are sufficient for DC plan members to earn a "base of financial security in retirement".

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Comparison with other states

Staff is unaware of any other states that have considered a similar proposal. However, six states, including Montana, offer state government employees a choice between a DB and DC plan when their employees are initially hired: Colorado, Florida, Indiana, North Dakota, Ohio, South Carolina, and Utah. A DC plan is mandatory in Alaska, Michigan, and Washington D.C.[3]

Legal implications

This proposal does not raise contract impairment concerns as long as the transfer remains optional. However, the IRS may not look favorably on opening a window for election to transfer to the DC plan. MPERA will likely need to request information from its tax counsel to provide the legislature with information about whether there is an IRS plan qualification concern.

Testimony received

Senator Wittich was unavailable to present his proposal and no one presented testimony.

Committee discussion and recommendations

Due to the lack of testimony on the proposal, there were no questions from the committee.

[3] Ron Snell, "Checklist of State Defined Benefit, Defined Contribution, and Hybrid Plans for State Employees and Teachers", National Conference for State Legislatures, August 2012.

LC No. _____
HB/SB _____[1]

REPORT AND RECOMMENDATION OF THE STATE ADMINISTRATION AND VETERANS' AFFAIRS INTERIM COMMITTEE (SAVA) TO THE 2013 LEGISLATURE AS OF NOVEMBER 2012[2]

Proposal No. 7
Proposing Entity: Senator Dave Lewis
Short Title: Require that all new public employees hired into a PERS-covered position be covered in the PERS Defined Contribution (DC) plan.

Retirement system(s) affected
PERS

Proposal summary
This is the same proposal that Sen. Lewis introduced in the 2011 Session in SB 328.

Fiscal implications
The covered payroll for the DB plan would steadily decrease, which would increase the percentage of pay required to fund the plan. A special actuarial analysis provided by MPERA's actuary is attached. If the annual required contributions (ARC) were made each year to fund the PERS Defined Benefit (DB) plan unfunded liabilities on a rolling 30-year amortization schedule, the amount required to fund the DB plan would steadily decrease each year from about $200 million to $139 million by 2036 and by then the system would be 93% funded. It is important to keep in mind that the actuarial assumptions are based on rolling 30-year amortization period, so no progress would be made toward a shorter amortization schedule. Also, this assumes an investment rate of return of 7.75%. However, as there are more retirees than active members in the DB plan, system assets would need to be more conservatively invested, so it is like that increased contributions would be required to offset any investment returns of less than 7.75%.

Effect on other Montana retirement systems
This proposal does not raise any "leapfrogging" issues, but may raise equity concerns because it covers only PERS members and not members of TRS.

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Soundness as matter of retirement policy

This proposal relates to the following policy principle adopted by SAVA:

I. Pensions should provide the base of financial security in retirement.

The policy issue for the legislature to consider is whether the DC plan will provide a sufficient base of financial security in retirement. The committee or legislature may wish to request a fiscal analysis of the DC plan contribution rates and expected long-term investment returns in the investment choices available to plan members to get a sense of whether contribution rates are sufficient for DC plan members to earn a "base of financial security in retirement".

Comparison with other states

Six states, including Montana, offer state government employees a choice between a DB and DC plan when their employees are initially hired: Colorado, Florida, Indiana, North Dakota, Ohio, South Carolina, and Utah. A DC plan is mandatory in Alaska, Michigan, and Washington D.C.[3]

Legal implications

This proposal does not raise any legal or contract impairment concerns as long as the transfer of current DB plan members remains optional.

Testimony received

Proponents:

Sen. Lewis testified that DB plans are dinosaurs rapidly heading toward extinction and that DC plans are the wave of the future. He said the fiscal note is what raises the controversy. Sen. Lewis referenced *Governing* magazine and a quote from an Indiana legislator related to how important it is to take a long-term view of pensions. Sen. Lewis also noted the changes to GASB accounting standards to make it easier to make a transition from a DB to DC plan. He noted that in a DB plan, 70% of the funding comes from investment earnings. However, the investment earning assumption is 7.75% and when they are less, it is the employer (i.e., taxpayer) who makes up the difference in a DB plan. He said we have to talk about serious changes and move toward a DC plan and that we need to be thinking about future generations and that a DC plan is a more viable plan for the long term.

Opponents:

Ms. Melanie Symons testified that the legislative committee of the PERS Board was opposed to the proposal because it does nothing to help the DB plan and that unfunded liabilities will actually escalate.

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[3] Ron Snell, "Checklist of State Defined Benefit, Defined Contribution, and Hybrid Plans for State Employees and Teachers", National Conference for State Legislatures, August 2012.

Mr. Diane Fladmow on behalf of MEA-MFT testified against the proposal saying that the proposal would make the DB plan liability worse.

Committee discussion and recommendations

In response to questions, Sen. Lewis said his idea is not to require full funding of the DB plan immediately but to spread the costs over a longer-term according to GASB standards.

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REPORT AND RECOMMENDATION OF THE STATE ADMINISTRATION AND VETERANS' AFFAIRS INTERIM COMMITTEE (SAVA) TO THE 2013 LEGISLATURE AS OF NOVEMBER 2012[2]

Proposal No. 8
Proposing Entity: MACo
Short Title: Revise membership of the PERS Board to represent local employers.

Retirement system(s) affected
All systems administered by the PERS Board.

Proposal summary
The proposal is for the PERS Board to be restructured and balanced so that employers and members or beneficiaries are equally represented. The proposal would expand the membership of the board. The full membership of MACo will not consider this proposal until September.

Fiscal implications
Currently, the PERS Board consists of seven members appointed by the governor. Under section 2-15-1009, MCA, the members are:

> "(a) three public employees who are active members of a public retirement system. Not more than one of these members may be an employee of the same department and at least one of these members must, no later than July 1, 2003, be a member of the defined contribution plan created pursuant to Title 19, chapter 3, part 21.
>
> (b) one retired public employee who is a member of the public employees' retirement system;
>
> (c) two members at large; and
>
> (d) one member who has experience in investment management, counseling, or financial planning or who has other similar experience.
>
> (3) The term of office for each member is 5 years."

Members are entitled to compensation of $50 a day (unless they are salaried public employees) and travel expenses.

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Under the proposal, compensation and travel expense costs would increase depending on the number of board members added.

Effect on other Montana retirement systems
None.

Soundness as matter of retirement policy
None of the principles and guidelines adopted by SAVA on January 27, 2012, directly relate to the composition of the administrative boards of the retirement systems. However, the following guideline does relate to board members as trustees:

> Guideline K - The legislature should establish strict fiduciary standards and conflict of interest laws to govern the conduct of trustees as they manage the assets of the retirement system.

Comparison with other states
Sheryl Wood, Associate Director of MACo, testified to SAVA on August 8, 2012, that MACo would provide the legislature with research about pension board membership in other states. Seven of 18 states who responded to MACo's national survey reported retirement board membership with local employer representation: Colorado, Maryland, Nebraska, New Hampshire, North Carolina, and Oregon.[3]

Also at the August 8 SAVA meeting, SAVA member Sen. Jent urged the various state and local stakeholders to talk to one another and discuss their concerns. Responding to this suggestion, MACo coordinated a stakeholder meeting, which was held on August 27, 2012, and was summarized in a memorandum provided to SAVA.[4]

Legal implications
This proposal does not raise any legal or contract impairment concerns.

Testimony received
Proponents:
Sheryl Wood, Deputy Director, MACo, testified, that counties are struggling to provide basic services and that providing a quality retirement system is important to counties. She said that it seems that employers are not involved in the decision-making and that there should be more collaboration. She said she had received 15 responses from a survey of retirement boards in other states and that 11 of them had employer representatives on the board. Sheryl testified that experience in matters of local finance was important.

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[3] MACo survey of National Council of County Association Executives, August 2012.

[4] Memorandum by Sheryl Wood, MACo Associate Director, to SAVA Members dated October 30, 2012.

Mark Murphy, Montana County Attorney's Association, testified in support of the proposal. Mr. Murphy raised an issue with respect to contracts with local governments and unilateral changes to the contract.

Opponents:

Ms. Melanie Symons, testified that the legislative committee of the PERS Board opposes the proposal as presented by MACo. She said that the committee does agree with the need to work collaboratively and that the Board works hard to ensure that happens. She said a structural change to the Board is not necessary. Ms. Symons noted that under Article VIII, Section 15 of the Montana constitution, the Board has the duty to to administer the system as fiduciaries of system participants and their beneficiaries. She said any member of the Board would have the same duty and would be obligated to act on behalf of members. She also said there are more than 550 employers who participate in the system. She noted that the Board's meetings are open to the public and anyone can come and participate in the meeting.

Committee discussion

In response to a question from Sen. Jent, Ms. Symons stated that in PERS, more than 50% of the system's estimated 30,000 members work for local governments. Sen. Jent also noted that local government entities are funded by various fees and funding sources and it gets complicated quite quickly, which needs to be considered when employer contributions are to be increased. The committee's questions and discussion then turned to whether MACo could reach out to the governor's office, the retirement boards, and other stakeholders and that the communication is a two-way street. A suggestion was made that a working group should be convened so that the boards, unions, the governor's office, and other stakeholders could discuss concerns and come back to SAVA with a proposal for what local governments should contribute.

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REPORT AND RECOMMENDATION OF THE STATE ADMINISTRATION AND VETERANS' AFFAIRS INTERIM COMMITTEE (SAVA) TO THE 2013 LEGISLATURE AS OF NOVEMBER 2012[2]

Proposal No. 9
Proposing Entity: Senator Ron Arthun
Short Title: Establish a cash balance plan for new hires and allow voluntary enrollment by current public employees.

<u>Retirement system(s) affected</u>
PERS and TRS

<u>Proposal summary</u>
According to the Employee Benefit Research Institute: "A cash balance plan is a "hybrid" type of pension plan--i.e., one that takes on the characteristics of both a defined benefit plan (that pays a specified amount based on a predetermined formula) and a defined contribution plan (that provides an individual account for each participant, based only on amounts contributed or allocated to the account).

"Legally, a cash balance plan is a defined benefit plan, governed by the same rules that govern traditional defined benefit plans under the Employee Retirement Income Security Act of 1974 (ERISA). A cash balance plan offers some of the popular advantages of a traditional plan, such as flexible employer funding and a retirement benefit that generally provides little or no investment risk for the plan participant."[3]

According to the professional *Journal of Accountancy*, "a cash balance plan looks like a defined contribution plan to the participant. A hypothetical account is maintained for each participant, the company makes annual notional contributions, and interest is credited on the account. The contribution to the account is either a flat dollar amount or a percentage of compensation. The interest credited is either a fixed rate (for example, 5%) or tied to an index, such as the 30-year

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[2] Report issued pursuant to 5-5-228, MCA.

[3] Danny Devine, "Cash Balance Plans Pros and Cons Outlined", Employee Benefit Research Institute, June24, 1999, at http://www.ebri.org/publications/prel/index.cfm?fa=prelDisp&content_id=422

Treasury bond rate."[4] However, the contributions are actually pooled as part of the investment fund and actual investment returns are credited to the fund and benefits are still paid out based on a defined benefit formula.

Fiscal implications

Unknown without an actuarial analysis.

Effect on other Montana retirement systems

Because the proposal covers only the two main retirement systems (TRS and PERS), there may be concerns of "inequity" with the other purely DB retirement plans. Nonetheless, arguments may also be made that the other systems are and should be designed to meet the particular needs of the employees covered in those systems.

Soundness as matter of retirement policy

The following principle adopted by SAVA on January 27, 2012, relates to this proposal:

Principle I - Pensions should provide the base of financial security in retirement.

Further analysis is needed to determine whether this proposal would provide a cash balance benefit sufficient to conform to this principle.

Comparison with other states

According to a report by the National Conference for State Legislatures, public employee retirement plans in three states recently adopted cash balance plans: Kansas, Nebraska, and Louisiana. These cash balance plans cover general classified employees and/or teachers. None cover public safety employees. Both Kansas' and Louisiana's cash balance plans established a new tier within their current defined benefit (DB) plans. Thus, Kansas and Louisiana are still able to use employer contributions to continue to pay the DB plan's overall liabilities. Nebraska's old plan was a DC plan, which does not have unfunded liabilities.

Among these three plans, employee contribution amounts range from a low of 4% of salary in Kansas for employees with less than 5 years of service, to a high of 8% in Louisiana. Employer contribution amounts range from a low of 3% of salary in Kansas for employees with less than 5 years of service to a high of 9.37% in Kansas.

Each state has a different way of calculating how additional interest or dividends are to be credited. Kansas credits employee accounts with a 5.24% interest. Nebraska credits the greater of the federal mid-term rate plus 1.5% or 5%.

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[4] Raymond D. Berry, "Plan Design in the Balance: Weighing the Pros and Cons of Cash Balance Plans", *Journal of Accountancy*, January2009. See http://www.journalofaccountancy.com/Issues/2009/Jan/PlanDesignInTheBalance.htm

With respect to funding its liabilities, Kansas is funding its unfunded liabilities by increasing employer contributions incrementally to 10.57% by FY 2017 and by adopting a cash balance plan that will lower employer contributions for new hires based on years of service. This allows more of the employer contributions to be used to fund the previously unfunded liabilities.[5]

Legal implications

This proposal does not raise any legal or contract impairment concerns as long as it applies only to new employees.

Testimony received

Proponents:

Senator Arthun testified he had been examining cash balance plans for a couple of years and had discussed the issue with legislators in Kansas. He stated that the advantages of a cash balance plan are that it allows for a smooth accrual of benefits over an employee's career, provides benefit portability, avoids the gaming found in DB plans (such as salary spiking), and offers a middle ground between a DB and DC plan because although the employer still carries the investment risk, that risk is lessened because the difference between the interest credited to the employee accounts and the actual rate of return accrues to the benefit of the pension fund to pay off unfunded liabilities and keep the system actuarially sound over the long term.

Opponents:

None.

Committee discussion

Questions and discussion related to how to set the interest amount to be credited to employee accounts. Sen. Arthun responded that he had not yet decided on what rate he would set, but he said that Kansas had set a 5.24% while Nebraska has set a cap of 5%. He indicated he desired to keep it simple and subsequently instructed staff to use a set 5% rate.

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[5] National Conference of State Legislatures, "Pensions and Retirement Plan Enactments in 2012 Legislatures", August 31, 2012.