GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Pension Fund Fiscal Note 2023 Biennium

Bill #	SB0387	**Title:**	Generally revise teachers' retirement system
Primary Sponsor:	Hoven, Brian	**Status:**	As Introduced

Retirement Systems Affected: ☒Teachers ☐Public Employees ☐Highway Patrol ☐Police

☐Sheriffs ☐Firefighters ☐Volunteer Firefighters ☐Game Wardens ☐Judges

Check the box if "Yes".

☐Has this legislation been reviewed by the legislative interim committee?
☒Has the cost of this legislation been calculated by the system's actuary?
☐Does this legislation include full funding for any benefit revisions?

	July 1, 2020 Current System	July 1, 2020 With Changes	Increase/ (Decrease)
Present Value of Actuarial Accrued Liability	$6,310,005,000	$6,310,005,000	$0
Present Value of Actuarial Assets	$4,344,045,000	$4,344,045,000	$0
Unfunded Actuarial Accrued Liability (UAAL)	$1,965,960,000	$1,965,960,000	$0
Amortization Period (years) of UAAL	29.00	29.00	0.00
Change in normal costs	0.00%	0.00%	0.00%

	FY 2021 July 1, 2020	FY 2022 July 1, 2021	FY 2023 July 1, 2022	FY 2024 July 1, 2023	FY 2025 July 1, 2024
Employee Contribution Rate	8.15%	8.15%	8.15%	8.15%	8.15%
Employer Contribution Rate	9.17%	9.27%	9.37%	9.47%	9.47%
State Contribution Rate	2.49%	2.49%	2.49%	2.49%	2.49%
TOTAL Contribution Rate	19.81%	19.91%	20.01%	20.11%	20.11%

FISCAL SUMMARY

	FY 2022 Difference	FY 2023 Difference	FY 2024 Difference	FY 2025 Difference
Expenditures:				
General Fund	$0	$0	$0	$0
Pension Fund	$0	$0	$0	$0
Revenue:				
General Fund	$0	$0	$0	$0
Pension Fund	$0	$0	$0	$0
Net Impact-General Fund Balance:	$0	$0	$0	$0

Description of fiscal impact: Changes that affect only future active members impact only the normal cost rate of the employer. The future normal cost would begin to increase as the new Tier 3 members with a higher normal cost begin to comprise a material and growing percentage of all active members. Under SB 387, the active employer's normal cost rate would be expected to increase from 2.05% to 3.98% over the next 30 years. In contrast, the active employer's normal cost rate for current Tier 2 members is expected to decrease from 2.05% to 1.46% over the same projection period. This means that the employer's normal cost rate for Tier 3 members would be 3.98% of covered payroll in FY 2050 which would cost $39.3 million more per year to fund than the current Tier 2 benefit structure. As the employer normal cost increases over the projection period, there are less contributions available to amortize the system's unfunded actuarial accrued liability over the current plan without changes.

FISCAL ANALYSIS

Assumptions:

1. The data, methods and assumptions used to determine the impact of SB 387 are the same as those used in the July 1, 2020 valuation. The assumed mortality and interest rate are also used in determining the annuitization of the cash balance accounts.
2. SB 387 does not define the term "actuarial unsound" therefore a monthly interest credit that is equal to 6.50% compounded annually is assumed because it is in the middle of the allowable range provided for in section 20 of the bill.
3. SB 387 provides a Third Tier benefit structure that is a hybrid/cash balance defined benefit plan for members hired on or after the effective date of this act with the following plan provisions:
   - **Member Accumulated Contributions** - Sum of all amounts deducted from the compensation of a member credited to the member's individual account in an annuity savings account together with interest credits.
   - **Member Contribution Rate** – 8.15% of compensation. In addition to the normal contribution rate of 8.15%, a tier three member may contribute an additional 0.5% of the member's earned compensation.
   - **Interest Credit** – The employee's account earns a fixed rate of interest set by the Board that may not be lower than 4.00% or greater than 9.00%. The Board may not set the rate higher than 4% if the retirement system was judged to be "actuarially unsound" as of the date of the most recent actuarial valuation.
   - **Vesting** – A member credited with at least five full years of membership service upon which contributions have been made has a right to a future retirement benefit.
   - **Benefit Vesting Schedule:**

    - After five years of service, the member receives a 25% system match;
    - For 6 through 10 years of service, the member receives an additional 5% match after each full year of service; and
    - For 11 through 15 years of the service, the member receives an additional 10% match for each full year of service; and
    - A member with 15 or more years of creditable service must receive a 100% retirement system match of the member's accumulated contributions including the interest credit.
- **Non-Vested Termination** – A non-vested member who terminates from service prior to vesting is entitled to receive a lump sum payment of the member's accumulated contribution account.
- **Vested Termination** – A vested member who terminates is entitled to either a lump sum payment of the member's accumulated contributions plus a retirement system match of the member's accumulated contributions, subject to the benefit vesting schedule, or, if the member does not withdraw their accumulated contributions, an actuarial equivalent annuity of the member's accumulated contributions plus a retirement system match of the member's accumulated contributions, subject to the benefit vesting schedule, beginning at age 60. The member's accumulated contributions will continue to earn interest credits from the separation from service until distributions commence. A member who elects to contribute the additional 0.5% contribution and has accrued less than 30 years of credible service at the time of retirement, withdrawal, or death may not receive a contribution match on the additional 0.5% of earned compensation.
- **Service Retirement** – Age 60 and 5 years of service.
- **Retirement Benefit** –The member's accumulated contributions plus a retirement system match of the member's accumulated contributions, subject to the benefit vesting schedule, as an actuarial equivalent monthly annuity.
- **Death Benefits** – In the event of death prior to retirement of a non-vested member, the designated beneficiary is entitled to receive a lump sum payment of the member's accumulated contributions. The designated beneficiary of a vested member who dies prior to retirement is entitled to receive a lump sum payment of the member's accumulated contributions plus a retirement system match of the member's accumulated contributions, subject to the benefit vesting schedule, or to elect an Option A Joint and Survivor annuity beneft.
- **Disability Benefits** – A non-vested member who becomes disabled is entitled to receive a lump sum payment of the member's accumulated contributions. A vested member who becomes disabled is entitled to receive the greater of i) accumulated contributions plus a retirement system match of the member's accumulated contributions, subject to the benefit vesting schedule, as a lump sum distribution or an actuarial equivalent monthly annuity at the time of disability or ii) 25% of the member's average final compensation payable as an annuity.
- **Guaranteed Annual Benefit Adjustment (GABA)** - Tier three members are not eligible for GABAs.
- **Reemployment After Retirement** – A tier three member who is reemployed after receiving at least one benefit payment must be considered a new member with respect to the reemployment and will accrue a second retirement benefit based only on the member's accumulated contributions after reemployment. A tier three member will continue to receive his first retirement benefit while reemployed and accruing a second retirement benefit.

4. The 15-year graded vesting schedule provided in Section 19 of the bill meets the IRS threshold for vesting requirements and is the only vesting schedule considered in this analysis.
5. We have assumed in our analysis that future employees are similar demographically to recent new entrants to the system.
6. The increase in future normal cost is net of expected employee contributions which are 8.15%.

Long-Term Impacts:

1. The new benefit tier for members hired after the effective date of this act, is expected to increase the long-term cost of the plan incrementally over the next 30 years. The table below shows the projected employer normal cost under the current plan (Tier 2) compared to the normal cost rate under SB 387 (Tier 3) including the additional cost as a percentage of compensation:

	Normal Cost Rate (Including Expenses)				
July 1,	Current Plan	SB 387	Increase	Compensation	Additional Normal Cost
2020	2.05%	2.05%	0.00%	$ 880,667,528	$ -
2021	2.00%	2.00%	0.00%	880,962,929	-
2022	1.96%	2.09%	0.13%	885,111,857	1,150,645
2023	1.92%	2.15%	0.23%	891,012,199	2,049,328
2024	1.87%	2.21%	0.34%	898,697,906	3,055,573
2025	1.84%	2.26%	0.42%	908,065,338	3,813,874
2026	1.81%	2.32%	0.51%	918,915,900	4,686,471
2027	1.77%	2.38%	0.61%	930,805,944	5,677,916
2028	1.75%	2.44%	0.69%	943,784,314	6,512,112
2029	1.72%	2.51%	0.79%	958,168,608	7,569,532
2030	1.70%	2.58%	0.88%	973,700,831	8,568,567
2031	1.68%	2.65%	0.97%	990,336,898	9,606,268
2032	1.65%	2.72%	1.07%	1,008,052,645	10,786,163
2033	1.63%	2.79%	1.16%	1,026,500,762	11,907,409
2034	1.61%	2.87%	1.26%	1,045,938,348	13,178,823
2035	1.60%	2.95%	1.35%	1,066,650,335	14,399,780
2036	1.58%	3.03%	1.45%	1,088,742,644	15,786,768
2037	1.57%	3.11%	1.54%	1,112,213,680	17,128,091
2038	1.55%	3.18%	1.63%	1,136,667,775	18,527,685
2039	1.54%	3.26%	1.72%	1,162,938,886	20,002,549
2040	1.52%	3.33%	1.81%	1,191,484,263	21,565,865
2041	1.51%	3.40%	1.89%	1,222,100,772	23,097,705
2042	1.50%	3.46%	1.96%	1,255,060,323	24,599,182
2043	1.49%	3.53%	2.04%	1,290,257,099	26,321,245
2044	1.48%	3.59%	2.11%	1,326,164,995	27,982,081
2045	1.47%	3.65%	2.18%	1,362,869,131	29,710,547
2046	1.46%	3.72%	2.26%	1,400,429,379	31,649,704
2047	1.46%	3.79%	2.33%	1,438,970,680	33,528,017
2048	1.46%	3.85%	2.39%	1,478,559,496	35,337,572
2049	1.46%	3.92%	2.46%	1,519,463,059	37,378,791
2050	1.46%	3.98%	2.52%	1,562,013,611	39,362,743

Technical Notes:

1. The term "actuarial unsound" is not defined in SB 387 or otherwise in TRS law. This could create a conflict of interest that may prioritize the funding of the current unfunded liabilities at the expense of Tier 3 members by granting the minimum allowable interest credits to Tier 3 members which could result in litigation. The interest credit should be set by the legislature.
2. TRS tax counsel provided the following comments on IRS private letter rulings: Effective January 1, 2017, the IRS eliminated the staggered five-year remedial amendment cycle for individually designated qualified retirement plans. See Rev. Proc. 2016-37. However, the IRS will accept determination applications for (1) initial plan qualification, (2) plan termination, and (3) other circumstances determined by the IRS. Because SB 387 adds a new tier and does not create a new plan, the new tier is not eligible for a new determination letter. Additionally, tax counsel does not believe the IRS would be willing to issue a private letter ruling regarding the qualified status of the new tier. Thus, they do not think the IRS will approve or disapprove of Section 19 of the bill.

3. If a private letter ruling is unattainable, the language in Section 24(2) requiring the board to certify to the governor and the secretary of the state the date on which Tier 3 receives a favorable ruling or determination from the IRS would never happen and the effective date in Section 26 of the bill would never occur. A delayed effective date to July 1, 2023 which would allow enough time for the TRS Board to adopt rules, actuarial factors and implement programming changes necessary to administer Tier 3 members is necessary in place of current Section 26 language.
4. Tier 3 members who join the system at an advanced age (e.g. age 60) would be required to work until age 75 before reaching full vesting which may not comply with IRS pre-ERISA vesting requirements. It is recommended that that the bill incorporate full vesting at the Tier 3 normal retirement age which is age 60.
5. The 15-year graded vesting schedule provided for in section 19 of the bill meets the IRS safe harbor thresholds for vesting. Subsection 2 of Section 19 which provides for an alternate 10-year cliff vesting should be removed from the bill.

NO SPONSOR SIGNATURE

	3.25	KA	3-24-21
Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*