GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Pension Fund Fiscal Note 2023 Biennium

Bill #	SB0389
Title:	Generally revise public employees' 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	$8,234,002,983	$8,234,002,983	$0
Present Value of Actuarial Assets	$6,099,398,162	$6,099,398,162	$0
Unfunded Actuarial Accrued Liability (UAAL)	$2,134,604,821	$2,134,604,821	$0
Amortization Period (years) of UAAL	35.00	35.00	0.00
Change in normal costs	9.81%	9.81%	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	7.90%	7.90%	7.90%	7.90%	7.90%
State & MUS Employer Contribution R:	8.87%	8.97%	9.07%	9.17%	9.17%
State Contribution Rate	0.00%	0.00%	0.00%	0.00%	0.00%
Local Govt Contribution Rate	8.77%	8.87%	8.97%	9.07%	9.07%
State Contribution Rate	0.10%	0.10%	0.10%	0.10%	0.10%
School District Contribution Rate	8.50%	8.60%	8.70%	8.80%	8.80%
State Contribution Rate	0.37%	0.37%	0.37%	0.37%	0.37%
TOTAL Contribution Rate	16.77%	16.87%	16.97%	17.07%	17.07%

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: SB 389 would establish a tier three for new hires in the Public Employees' Retirement System effective after passage of this bill. 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 389, the active employer's normal cost rate would be expected to increase from 2.19% to 6.54% over the next 30 years. In contrast, the active employer's normal cost rate for current Tier 2 members is expected to decrease from 2.19% to 1.14% over the same projection period. This means that the employer's normal cost rate for Tier 3 members would be 6.54% of covered payroll in FY 2050 which would cost $152.5 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 389 are the same as those used in the June 30, 2020 valuation. The assumed mortality and interest rate are also used in determining the annuitization of the cash balance accounts.
2. 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.
3. **Member Contributions**: Member contributions are set at 7.9%. Each member's contribution must be reduced to 6.9% on Jan 1, following the systems actuarial valuation that determines reducing the employee contribution would not cause the amortization period to exceed 25 years.
4. **Additional contribution amount** -In addition to normal contribution rate, a tier three member can elect a one-time irrevocable election for an additional contribution of .5% of the member's earned compensation. If member elects additional .5% contribution and has accrued at least 30 years of creditable service at time of retirement, they will receive a contribution match on the additional .5% of earned compensation by the member.
5. **Employer contributions** are fixed in statute.

6. **Benefit vesting schedule** for retirement system contribution match of the member's accumulated contributions according to the following schedule:

Years of Service	Retirement Matching Percentage
Less than 5	0%
5	25%
6	30%
7	35%
8	40%
9	45%
10	50%
11	60%
12	70%
13	80%
14	90%
15 or more	100%

7. **Interest Credit-** Board shall establish annually an interest credit rate which must be compounded annually
   a. The rate may not be lower than 4% or greater than 9%.
   b. The board may not set rate higher than 4% if retirement system is not actuarially sound as of date of most recent valuation.
   c. SB 389 does not define "actuarial unsound" therefore a monthly interest credit of 6.5% is assumed because it is the middle of allowable range for interest credit.
8. **Service Retirement** - Age 60 and 5 years of service
9. **Retirement Benefit-** The member's accumulated contributions plus a service system match of the member's accumulated contributions, subject to the benefit vesting schedule, as an actuarial equivalent monthly annuity.
10. **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 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.
11. **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 his 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.
12. **Non-Vested Termination-** members who terminate from service prior to vesting are entitled to receive a lump sum payment of the members accumulated contribution amount.
13. **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.
14. **Guaranteed Annual Benefit Adjustment (GABA)-** Tier three members are not eligible for GABAs.

15. The 15-year graded vesting schedule provided in Section 5 of the bill meets the IRS threshold for vesting requirements and is the only vesting schedule considered in this analysis.
16. We have assumed in our analysis that future employees are similar demographically to recent new entrants to the system.
17. The increase in future normal cost is net of expected employee contributions which are 7.9%.

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 389 (Tier 3) including the additional cost as a percentage of compensation:

	Normal Cost Rate (Including Expenses)				
July 1,	Current Plan	SB 389	Increase	Compensation	Additional Normal Cost
2020	2.19%	2.19%	0.00%	$ 1,289,069,198	$ -
2021	2.09%	2.09%	0.00%	1,303,915,465	-
2022	2.00%	2.73%	0.73%	1,322,737,317	9,655,982
2023	1.91%	2.94%	1.03%	1,343,304,125	13,836,032
2024	1.83%	3.13%	1.30%	1,366,803,193	17,768,442
2025	1.75%	3.31%	1.56%	1,392,352,740	21,720,703
2026	1.69%	3.49%	1.80%	1,421,736,385	25,591,255
2027	1.62%	3.65%	2.03%	1,453,314,770	29,502,290
2028	1.56%	3.81%	2.25%	1,487,447,335	33,467,565
2029	1.51%	3.97%	2.46%	1,523,745,755	37,484,146
2030	1.46%	4.12%	2.66%	1,562,009,356	41,549,449
2031	1.41%	4.27%	2.86%	1,602,327,796	45,826,575
2032	1.37%	4.41%	3.04%	1,645,237,497	50,015,220
2033	1.33%	4.55%	3.22%	1,690,105,845	54,421,408
2034	1.30%	4.68%	3.38%	1,737,246,278	58,718,924
2035	1.27%	4.81%	3.54%	1,786,270,651	63,233,981
2036	1.24%	4.94%	3.70%	1,837,720,480	67,995,658
2037	1.22%	5.07%	3.85%	1,891,562,621	72,825,161
2038	1.20%	5.20%	4.00%	1,947,300,444	77,892,018
2039	1.18%	5.33%	4.15%	2,005,193,216	83,215,518
2040	1.17%	5.46%	4.29%	2,065,469,837	88,608,656
2041	1.16%	5.58%	4.42%	2,128,399,306	94,075,249
2042	1.15%	5.70%	4.55%	2,194,210,687	99,836,586
2043	1.14%	5.82%	4.68%	2,262,511,422	105,885,535
2044	1.14%	5.93%	4.79%	2,333,604,222	111,779,642
2045	1.13%	6.05%	4.92%	2,407,327,791	118,440,527
2046	1.13%	6.16%	5.03%	2,484,111,135	124,950,790
2047	1.13%	6.26%	5.13%	2,564,276,816	131,547,401
2048	1.13%	6.36%	5.23%	2,647,422,702	138,460,207
2049	1.14%	6.46%	5.32%	2,733,881,373	145,442,489
2050	1.14%	6.54%	5.40%	2,823,741,899	152,482,063

Technical Notes:

1. The term "actuarial unsound" is not defined in SB 389 or otherwise in MPERA 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. 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.

3. MPERA tax counsel provided the following comments on IRS private letter rulings: the IRS will accept determination applications for (1) initial plan qualification, (2) plan termination, and (3) other circumstances determined by the IRS. Because SB 389 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 5 of the bill.
4. If a private letter ruling is unattainable, the language in Section 10 (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 36 of the bill would never occur. A delayed effective date to July 1, 2023 which would allow enough time for the MPERA Board to adopt rules, actuarial factors and implement programming changes necessary to administer Tier 3 members is necessary in place of current Section 36 language.
5. The 15-year graded vesting schedule provided for in Section 5 of the bill meets the IRS safe harbor thresholds for vesting. Subsection 2 of Section 5 which provides for an alternate 10-year cliff vesting should be removed from the bill.

NO SPONSOR SIGNATURE

	3.29	KA	3-26-21
Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*