

HB 659 Study: Acquiring Actuarial Services - Background and Decision Tool (for discussion during the October 1, 2009, conference call)

Background

At its June 26 organizational meeting, the State Administration and Veterans' Affairs Interim Committee (SAVA or Committee) approved a motion to use the expertise of the existing actuaries under contract to the Public Employees' Retirement Board (PERB) and the Teachers' Retirement Board (TRB) to satisfy SAVA's need for actuaries to provide cost estimates of any changes made during the HB 659 study. SAVA discussed but decided not to hire an outside consultant to guide the members in the study, although this decision was not accompanied by a formal motion and vote.¹

The Legislative Council also met on June 26. At that meeting, it segregated the \$200,000 appropriation in HB 659 until SAVA approved an operating plan indicating how it planned to use the money. At this time, the appropriation has not yet been directed to SAVA.

Shortly after the June organizational meeting and in pursuit of guidelines for drafting a Memorandum of Understanding (MOU) between SAVA and the two retirement boards to carry out the Committee's desire to rely upon the boards' actuaries, legislative staff requested a legal opinion from SAVA's staff attorney, David Niss. The opinion was requested to determine the process through which SAVA could enter an MOU with the boards and explore any other options that exist for the Committee. This memo was issued September 2, 2009.

This paper is written in light of the legal memo (September 2 memo) and the need to submit an operating plan to the Council for approval. It is designed to help you:

- (1) submit an operating plan to the Council to satisfy its need to operate oversight over legislative spending; and
- (2) direct staff on how best to provide SAVA with actuarial and possibly consulting services; or
- (3) direct staff to acquire more information about options available to SAVA for acquiring actuarial and possibly consulting services.

Discussion

The extent of the changes that SAVA anticipates making to the state's existing retirement plans will determine what type of services for which SAVA wishes to contract and how SAVA will proceed in the contract process. Although this point seems only tangentially related to the matter at hand (acquiring an actuary and obtaining the HB 659 appropriation), it is actually at the heart of the Committee's work.

¹Audio minutes from June 26, 2009, SAVA meeting, approx. 5:35:17.

On page 4 in section C of his September 2 memo, Mr. Niss states the type of contracting process through which SAVA can and will retain actuarial services depends on two factors:

- (1) what the Legislature truly knows about the cause of the problem(s) it's attempting to solve; and
- (2) the degree of change that the Legislature feels is necessary to solve the problem(s).²

If the current problem with the system(s) is known to the Legislature and the potential solution(s) "requires only small adjustments to a limited number of aspects of the system(s)" then perhaps an MOU with actuaries from the boards might suffice to provide the necessary information. However, if the Legislature isn't sure of the problem's cause and/or the solution or has questions about the adequacy of the current PERB and TRB actuaries to propose credible solutions, perhaps a process that allows the committee to explore other actuarial and even consulting options might serve it better.³

The following examples of the two very different solution paths might help clarify the issue:

Path 1: If the Committee wishes to change a system solely by amending one factor, such as the retirement age, the service multiplier, or the GABA, that change is limited in scope and can be "costed out" with relative ease.

Path 2: If the Committee anticipates making a larger, more systemic change to a retirement system, designing those changes will most likely require expertise staff cannot provide.

Consider the work done by the 1997-1998 Committee on Public Employee Retirement Systems (CPERS). CPERS suggested to the Legislature a defined contribution (DC) plan as an alternative to the existing defined benefit (DB) plan in the Public Employees' Retirement System (PERS). It hired an outside consultant to help it design and implement the DC plan. The consultant conducted focus groups, worked closely with members to determine their goals for the new plan, and ultimately proposed three models for CPERS to consider. Because these models were suggesting a new system--which is what a broader redesign of any of the state's current retirement systems anticipates--they were markedly more complex than less extensive changes, such as adjusting a retirement age or any other single factor in an existing plan.

Although SAVA will not need to emulate the exact CPERS process, which was

²David Niss, Memorandum to Dave Bohyer re: Your Request for an Opinion Whether SAVA May Contract for Actuarial Services, etc., September 2, 2009.

³Ibid.

lengthy and involved, the experience did create a useful road map for future legislative committees in considering large-scale retirement system design changes. For example, each of the three alternative designs presented to CPERS addressed in some fashion the following questions about plan structures:

- how to finance new benefits;
- how to address the then-current unfunded benefit liabilities;
- how any DB/DC plans would integrate;
- if the plan is portable and how to maintain or enhance that feature;
- how much control over investments to give employees;
- who selects the level of contributions from employees;
- how benefits are paid at retirement;
- whether to allow service purchases;
- what tax laws apply to the new plans;
- what additional features a plan needs to include, if any;
- how are retiree health benefits funded, if at all;
- when are employees eligible for retirement;
- will the plan have a GABA and how will it operate;
- when do employees vest;
- how will terminal leave be handled;
- how to include part-time employees;
- will loans be given through the system;
- what provisions will the system include for disability; and
- will the systems include death benefits.⁴

Although this laundry list is meant to highlight some of the questions members will need to anticipate for a redesign, the actual process of creating a workable plan is much more complex than simply answering the questions. As a result, *if the Committee wishes or anticipates wishing to go further than "tweaking" the current systems, it should consider hiring a plan design consultant to assist it with a redesign. Committee staff do not possess the necessary skills or expertise to design an entirely new retirement system.*

This decision on the extent to which SAVA wants to change the current retirement systems becomes relevant to the discussion about obtaining actuarial services when you consider that many actuarial firms also have business relationships with, or contain within their firm, plan design consultants. If the Committee anticipates making broad changes or even if the members want to reserve the option to make significant changes later on in the interim then it might make sense to contract with an actuarial firm that also has the capability and desire to suggest plan design changes. It would also be able to provide SAVA with the "number crunching" abilities the Committee would need for any changes or redesigns for the systems and later for the

⁴This list was developed from options presented by ASA in "Report #1: Assessment and options for change," to the 1997-1998 Committee on Public Employee Retirement Systems at its March 5-6, 1998, meeting.

proposed legislation from stakeholders who wish to introduce their own changes to the systems. This review is statutorily required and anticipated in the SAVA work plan to occur in late spring or early summer. SAVA has a separate \$50,000 appropriation to pay for this review.

Even if SAVA does not anticipate making a major revision to any of the state's retirement systems but wants to hire its own independent actuary, it should consider instructing staff to develop a contracting process that leaves open the possibility of acquiring plan design suggestions later in the interim. The obvious caveat here is that time is limited. Any plan design process will probably take several months to complete between Committee goal-setting, the consultant's research and drafting process, and any presentation and discussion of the suggested options.

The bottom line is that while SAVA does not need to decide the extent of the changes it wishes to make to any retirement system in this conference call, it should consider making that decision a priority for its October meeting.

Options

In order to give SAVA staff clear direction on how to proceed in obtaining actuarial--and potentially, consulting--services for the Committee's work, please consider the decision tools on pages 5-8 of this paper. Again, note that final decisions about how and with whom to contract for what services *do not* need to be made in today's conference call. However, in order to obtain for SAVA the range of services available and costs for those services, the staff needs your approval to implement a search and contract process that ideally results in options for the Committee to consider at its October meeting.

Although the choices are split into two categories--actuarial services and contracting services--for ease of presentation, please be aware that the options available to SAVA overlap those artificial lines. For example, it is possible that SAVA will wish to hire an independent actuary, while keeping open the option that the actuary might provide plan design consulting if the Committee decides it would like to explore broad design changes that would require such expertise. SAVA could also decide to use the existing TRB and PERB actuaries to "cost out" plan changes, but could request staff to explore options for hiring a plan design firm to craft and suggest design changes. Alternatively, the Committee could hire its own actuary to cost out smaller, more limited changes to one or more retirement systems and decline to explore or to hire an outside consultant.

The decision will rest ultimately on:

- (1) the members' views of the problem(s) afflicting the retirement systems, if any;
- (2) the members' views of the extent of the changes needed to a particular system, if any; and
- (3) their desire to maintain some flexibility for decisions at later meetings.

Decision tool

A. Actuaries

1. Continue with plan to sign MOU with PERB and TRB to use their actuaries.

Requires from the Committee:

a. *specificity about its expectation for work to be performed*; i.e., does SAVA want the actuaries to calculate the costs of changes SAVA suggests or does it want the actuaries to suggest plan changes in addition to running numbers?

b. *a level of confidence* that the PERB and TRB actuaries will produce numbers and possibly plan design changes with which the Committee feels comfortable, given a potential for a conflict of interest or an appearance of a conflict of interest between an actuary working for a retirement system and also for a legislative committee.

Pros:

- ▶ could expedite the redesign process, especially if SAVA has limited changes in mind.
- ▶ is likely less expensive than hiring an independent actuary.
- ▶ PERB and TRB actuaries will have to cost out the plan changes, regardless of whether SAVA chooses another actuary.

Cons:

- ▶ potential for conflict of interest (or even the appearance of a conflict) because actuaries are contracted to a retirement board that may or may not agree with the changes desired by SAVA and may take a position against the changes being costed out by its own actuary.
- ▶ potential that design advice received is less independent than that obtained by an actuary/consultant working for SAVA.
- ▶ creates the need for very detailed MOU between SAVA and PERB and/or TRB to protect the Committee's interests.
- ▶ even with a detailed MOU, it is difficult to anticipate all potential problems that could arise when a firm is working for an Executive Branch agency and a Legislative Branch committee at the same time.

Actions staff will take if directed to implement this option or a variation of it:

- ▶ working with TRB and PERB staff, draft MOU that includes most, if not all, of the provisions suggested by Mr. Niss in the September 2 memo and any expectations from the Committee about work to be performed by the actuaries.
- ▶ present draft MOU to the Committee, ideally at the October meeting.

2. Reconsider decision to sign MOU with PERB and TRB and begin process to hire independent actuary to "cost out" plan design changes.

Requires from the Committee:

a. *ability to suggest changes* to the systems or create its own retirement plan design, whether by hiring an independent consultant, by hiring an actuary with plan design capabilities, or on its own.

b. *a motion to reconsider its June decision to use the PERB and/or TRB actuaries* and allow staff to obtain further information about the type and cost of actuarial services available.

c. *willingness to wait to receive more information* in October and possibly not have an actuary at the ready to cost out changes until November or December.

d. *a decision about what services will be required from an actuary.*

Pros:

- ▶ actuary hired would work solely for the Committee.
- ▶ potential for conflict of interest reduced and can be eliminated with specific contract provisions.
- ▶ HB 659 appropriated \$200,000 for SAVA to obtain consulting services, as necessary.
- ▶ can also use the actuary to obtain actuarial reviews of any proposals submitted by retirement plan stakeholders, as required of SAVA by 5-5-228, MCA.
- ▶ a contract with an independent actuary can likely be combined with a contract to provide plan design consulting services to the Committee, if desired.
- ▶ likelihood of having changes to cost out before December is small.

Cons:

- ▶ SAVA would have to revisit earlier decision to use existing relationships.
- ▶ probably more expensive than an MOU arrangement.
- ▶ might take more time to get actuary "on board" due to hiring process.

Actions staff will take if directed to implement this option or a variation of it:

- ▶ draft contract template of services required of an actuary for SAVA (most likely would include reviewing retirement legislation later in the interim).
- ▶ solicit actuary firms on file with the Department of Administration and TRB, PERB, and LSD staff to evaluate which actuaries are interested.
- ▶ obtain cost options based on the contract template.
- ▶ present options to SAVA, hopefully at the October meeting, for a decision.
- ▶ complete contracting process and work closely with hired actuary.

B. Consultants

1. Formalize decision to forego hiring consulting services to assist SAVA with plan design options.*

Requires from the Committee:

a. *a decision* that it will not need and thus does not want to explore options for assistance with in-depth plan design changes.

Pros:

- ▶ staff will not spend time exploring options for consulting or consulting/actuarial combination services.
- ▶ limits the future choices available to SAVA to smaller changes to the systems, not broader design changes.
- ▶ puts into the record a more informal decision from the June meeting.

Cons:

- ▶ the Committee effectively decides to stick with small changes to the existing systems rather than a broader redesign.
- ▶ offers SAVA less flexibility to decide on larger changes later in the interim.

Actions staff will take if directed to implement this option or a variation of it:

- ▶ none anticipated.

* Selecting this option still requires the Committee to make a decision about how it wants to handle acquiring its actuarial expertise.

2. Request staff to explore options and costs for hiring a plan design consultant or an actuary with plan design capabilities.

Requires from Committee:

- a. *a desire to explore significant changes* to the existing retirement systems.
- b. *a willingness to use a substantial amount* of the HB 659 appropriation if a consultant is hired.
- c. *a willingness to make a decision in October* about its goals, including its need for a design consultant, for any redesign of a retirement system.

Pros:

- ▶ allows SAVA and staff to acquire information about the services offered by and the costs of a plan design consultant.
- ▶ allows SAVA to acquire information about the feasibility of using one actuarial firm for both suggesting any design changes and costing out any Committee-requested changes.
- ▶ does not commit SAVA to a contract with a consultant at this point.
- ▶ reserves the option for SAVA to consider broad design changes at the October meeting or later if combined with a contract with an actuary with design capabilities.
- ▶ if a contract is signed, it would provide SAVA with expertise and perspective on retirement system redesign alternatives, which staff cannot provide.

Cons:

- ▶ staff will need to spend time developing a process by which SAVA can obtain more information about available services and costs.
- ▶ if a contract is ultimately signed, members will need to work with consultants to flesh out goals for any redesign and respond to suggested changes.

Actions staff might take if directed to implement this option or a variation of it:

- ▶ explore options available for hiring actuaries with plan design capabilities.
- ▶ develop a contract template, including services the Committee will or might require.
- ▶ solicit actuary firms on file with the Department of Administration and TRB, PERB, and LSD staff to evaluate which actuaries are interested.
- ▶ obtain cost options based on the contract template.
- ▶ present options to SAVA, hopefully at the October meeting, for decision.
- ▶ complete contracting process, if requested by Committee, and work closely with consultant/actuary.

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