



# BDR 23-184 AB 190

## NON-EXECUTIVE AGENCY FISCAL NOTE

AGENCY'S ESTIMATES

Date Prepared: March 5, 2015

Agency Submitting: Public Employees' Retirement System

Items of Revenue or Expense, or Both	Fiscal Year 2014-15	Fiscal Year 2015-16	Fiscal Year 2016-17	Effect on Future Biennia
Contribution rate impact (Expense)		\$790,173,006	\$790,173,006	\$751,929,898
Administrative costs for pension processing system (Expense)		\$18,596,560		
Request for private letter ruling (Expense)		\$35,000		
Total	0	\$808,804,566	\$790,173,006	\$751,929,898

### Explanation

(Use Additional Sheets of Attachments, if required)

The System's independent actuary valued the change in retirement plans as described in BDR 184. The cost estimate is based upon the description and assumptions set forth in the attached letter and is limited by the restrictions set forth in the letter. The System was not able to fully calculate agency administrative costs (additional personnel etc.) due to the limited time frame and the significant responsibilities required in the BDR. The BDR calls for implementation date of July 1, 2016 which accelerates all computer design costs into the first year of the biennium. Estimated contribution costs above would be split one-half to employers and one-half to employees under the current contribution rate mechanism for employees in the closed plan

Name Tina Leiss

Title Executive Officer



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February 4, 2014

Ms. Tina Leiss  
Executive Officer  
Public Employees Retirement System of the State of Nevada  
693 West Nye Lane  
Carson City, NV 89703

**RE: Analysis of BDR 23-184**

Dear Tina:

Per your request, we have analyzed the proposed provisions regarding the changes for Public Employees Retirement System (PERS or System) as described in Bill Draft Request (BDR) 23-184.

The bill would implement the following changes to the benefit structure of the System:

- **Hybrid Plan:** The bill would require that the Public Employees Retirement Board (Board) establish a hybrid plan consisting of both a defined benefit plan and a defined contribution plan. Participation in the hybrid plan would be mandatory for new employees hired on or after July 1, 2016. Existing members of the System as of June 30, 2016 would be permitted to elect to transfer to the hybrid plan. Both the defined benefit plan and defined contribution plan would be required to include specific benefit provisions, as follows:
  1. The defined benefit plan must:
    - (a) cap annual benefits at 133 percent of the average Social Security wage base during the member's 36 consecutive months of highest compensation;
    - (b) prohibit purchase of additional service credit;
    - (c) set employer and employee contribution rates as described below;
    - (d) provide a monthly service retirement allowance equal to the member's average compensation multiplied by 1 percent for each year of service, for regular members, or 1.5 percent for police officers and firefighters; and

- (e) establish a minimum retirement age for unreduced benefits that is the full retirement age of the member under the Social Security Act, for regular members, or 10 years less than Social Security retirement age for police officers and firefighters.
2. The defined contribution plan must:
- (a) accumulate contributions in an individual trust account for each member and comply with applicable requirements of federal law for tax-qualified governmental retirement plans;
  - (b) utilize a third-party administrator selected by the Board;
  - (c) provide an option for lifetime annuity payments from the plan;
  - (d) prohibit loans;
  - (e) require employers to contribute 6 percent of each employee's compensation for regular members, or 9 percent for police officers and firefighters; and require employees to contribute the same percentage of compensation each payroll period; and
  - (f) permit employees to contribute supplemental amounts to the plan.
- **Employer Contribution Limits:** This bill would limit employer contributions to the defined benefit plan of the hybrid program to 6 percent of an employee's compensation, requiring employees to contribute an amount equal to the actuarially determined rate, less the employer's 6 percent contribution.
- **Additional Contributions from Local Governments:** This bill would require that the Board annually determine and report the estimated amount of unfunded liability of the System that is attributable to members employed by the State and the amount attributable to members of each public employer that is a local government, respectively. In addition, each public employer that is a local government would be required to contribute an additional 6 percent of compensation on behalf of its employees to reduce the unfunded liability of the System for each year that such unfunded liability exceeds 15 percent.

## Costs

This analysis is based on the limited information provided in this bill at this time. There are comprehensive changes mentioned in this bill, but there is a lack of details regarding:

- The complete plan provisions of the hybrid plan (i.e., COLAs, Early Retirement Factors, survivor and disability benefits);
- The details on the mechanics of transfers of PERS current members into the hybrid plan (how benefits under the current plan will be frozen and how assets will be transferred from the current plan to the hybrid plan); and
- Whether or not the additional 6 percent contribution from local governments would be applied before or after the cost sharing mechanisms have been applied.

These results will need to be adjusted as more details are available.

The bill would require that all new employees after July 1, 2016 participate in the new hybrid plan and allow for current PERS members to leave the current plan and join the hybrid plan. It is difficult to predict the number of PERS members that will elect to join the hybrid plan. It is possible that a portion of PERS current members will elect to join the hybrid plan on June 30, 2016 in order to avoid contributing the higher member contribution rates for the current plan that are discussed later. However, due to lack of details in the bill, we have assumed that none of PERS current members would elect to join the hybrid plan.

Since new hires after July 1, 2016 would enter under new plan provisions and only a portion of the costs for the Unfunded Actuarial Accrued Liability (UAAL) would be paid on an open payroll base, the current funding structure would be altered and the costs of the current PERS plan would change. This would essentially add a new “tier” of benefits to the current system.

Since the bill appears to close (or partially close) the existing PERS plan, there will be an effect on the current plan costs as well.

Currently, the Unfunded Actuarial Accrued Liability (UAAL) amortization component is 11.12% of payroll for Regular employees and 12.74% for Police/Fire employees. This is the rate that will be sufficient to pay off the UAAL for current members under the current funding policy as long as all actuarial assumptions are met (including the payroll growth assumptions) in future years. The UAAL rates were developed assuming that the UAAL will be paid off as a level percent of total payroll, including future new members.

If the current plan were closed to new members and the payroll for the hybrid plan members would not be used in the amortization of the current UAAL, the payroll for the current plan would ultimately decline rather than grow during the remaining funding period. As a result, the amortization component would have to be determined as a level percent of declining payroll. While the underlying UAAL would be unchanged, this would create a significant increase in the UAAL rates as a percent of payroll.

The effect on the actuarially determined contribution of closing the PERS plan to new entrants is shown below.

**Actuarially Determined Contribution Requirements**  
**As of July 1, 2014**

	<u>Current Plan Contribution Rate</u>	<u>Closed DB Plan Contribution Rate</u>
<b>Regular Employees</b>		
Employer-Pay	27.99%	43.12%
Employee/Employer Pay	28.95%	44.08%
<b>Police/Fire Employees</b>		
Employer-Pay	39.65%	55.31%
Employee/Employer Pay	40.80%	56.46%

Note that even though the bill provides for an additional 6 percent UAAL contribution on an open payroll base for local governments, this does not account for all of PERS' payroll base. In addition, this amount is not enough to offset the increase in UAAL rates shown in the rates above (roughly 15.1% of pay for Regular Employees and 15.7% of pay for Police/Fire Employees). In other words, the UAAL would not be paid off over the expected number of years that current PERS members are expected to be employed. As a result, the UAAL may never be fully paid off under the current funding policy.

Since the closure of the system will create an immediate increase to the cost of the plan for current members, it is possible that many PERS members will elect to transfer to the hybrid plan before the higher contribution rates take effect. To the extent that the transfer removes assets from the system, this could have a negative effect on the plan's funding levels. It is impossible to predict the effect of these potential transfers without more detail on the methodology that will be used in these transfers.

### **Contributions**

The bill would change the contribution structure for hybrid plan participants by limiting the employer contribution to 6% of covered payroll, with the remainder of contributions to be paid by employees. This is a departure from the current policy of splitting the contributions equally between employers and employees, and will result in significantly different contribution levels for participants in the current PERS plan vs. hybrid plan members.

The bill requires each employer that is a local government to pay additional employer contributions towards the unfunded liability of the System. Our analysis assumes that all non-State agencies are considered local governments for the purposes of the bill.

## Other Considerations

The bill would require that the new hybrid program be structured in a manner that ensures that members are not subject to contributions to the retirement program of the Social Security Act. Although the design of the hybrid program provides elements that could enable the new plan to meet minimum benefit requirements for members to avoid paying Social Security contributions, not all such requirements are satisfied by the provisions of the bill. Thus, it appears that the Board would be responsible for designing the hybrid plan in a manner that satisfies minimum benefit requirements for this purpose.

In addition, the bill would require that the defined contribution plan both provide for mandatory employee contributions through pre-tax payroll deductions and permit employees to contribute supplemental amounts to the plan in excess of the mandatory employee contributions, subject to limitations under federal law. The bill does not specify the type of defined contribution plan that the Board must establish for this purpose. However, while a 401(a) plan is the only type of retirement plan that allows public employers to pick up mandatory employee contributions on a pre-tax basis, governmental entities may not establish a new plan with a 401(k) feature, which is a type of plan that permits elective employee contributions into private sector plans. Generally, elective employee contributions are only permitted under a 457(b) plan for governmental employers. However, a 457(b) plan may not be a feasible vehicle for the other benefits required under the defined contribution plan. For example, the mandatory employee and employer contribution amounts would likely exceed dollar limits in a 457(b) plan for many members.

The hybrid plan established under this bill would provide a significant portion of benefits for new employees via a defined contribution plan. As described in detail in our 2010 report that analyzed and compared the adequacy of benefits under a defined benefit plan versus a defined contribution plan, a defined contribution plan generally does not provide the same level of benefits per dollar of cost as a defined benefit plan. The main reasons for this are as follows:

- Defined benefit plans provide significant cost-sharing by spreading mortality risk over a large pool of members. Defined contribution accounts are individually assigned and must be managed so that the retiree does not outlive their benefits.
- In practice, individually managed accounts can expect higher administrative costs and lower investment returns than a longer time horizon, professionally managed defined benefit plan.
- Defined contribution accounts suffer from “leakage” as funds are used for purposes other than retirement.
- There is a higher cost of annuitization at market annuity rates or else members must assume the longevity risk of benefits.
- Defined contribution plans cannot provide pre-retirement death benefits or disability benefits at comparable costs and benefit levels as provided under a defined benefit plan.

This means that the hybrid plan may not provide benefits to new employees that are as much as the benefits provided to existing members. In other words, employees of similar age, service, compensation levels would receive unequal retirement benefits. This may impact the competitiveness of benefits offered by PERS as compared to other similar statewide retirement systems, particularly for career employee positions.

### **Compliance**

The bill would permit existing members of PERS to elect to transfer to the new hybrid plan. However, existing members electing to transfer to the new hybrid plan would be voluntarily reducing the amount of their mandatory employee contributions. Based on recent actions and informal guidance from the federal government agencies, Internal Revenue Code rules may prohibit members from making an election related to PERS benefits that reduces the amount of mandatory employee contributions deducted from their salary. Therefore, it is not clear whether the provision of the bill permitting existing members to transfer to the hybrid plan would be permissible under applicable federal law. We recommend that you consult with legal counsel on this issue.

Please note that we have not reviewed this legislation for compliance with applicable State of Nevada law. We recommend that you address all State law issues with the System's counsel.

I look forward to discussing this with you further.

Sincerely,



Brad Ramirez, FSA, MAAA, FCA, EA  
Vice President Consulting Actuary

/cz

cc: Cheryl Price

Attachment