BDR 23-843
SB 297

NON-EXECUTIVE AGENCY

FISCAL NOTE

AGENCY'S ESTIMATES

Date Prepared: April 2, 2017

Agency Submitting: Public Employees' Retirement System

Items of Revenue or Expense, or Both	Fiscal Year 2016-17	Fiscal Year 2017-18	Fiscal Year 2018-19	Effect on Future Biennia
Administrataive costs for pension processing system (Expense)		$23,154,000		
Design and legal consulting costs (Expense)		$185,000		
Additional staff costs implementation and administration (Expense)		$665,375	$748,839	$1,790,192
Contribution impact to school districts (Expense)			$5,852,637	$46,774,636
Contribution impact to local government excluding school districts (Expense)			$4,541,000	$36,196,639
Total	0	$24,004,375	$11,142,476	$84,761,467

Explanation (Use Additional Sheets of Attachments, if required)

The System's actuary valued the change in retirement plans as described in BDR 23-843. The cost estimate is based upon the description set forth in the attached letter and is limited by the restrictions therein. The provisions and actuarial assumptions required by BDR 23-843 may not be able to be legally implemented as set forth as they may be inconsistent with the Nevada Constitution, State and/or Federal law. Contribution rate impacts are based on shifting of current equal split of contributions between employer and employee to a shift of a greater portion of contributions to local government employers, including school districts, and to State employees. Costs to school districts and local governments will continue to grow with each biennium as more members have membership dates on or after June 30, 2018. Because of this shift, State employers will ultimately pay less in contributions for new hires with the difference being paid through increased contributions for State employees hired after June 30, 2018. The BDR is inconsistent in the description of payment of the current unfunded liability and any future unfunded liabilities associated with current employees and retirees making us unable to determine whether the current and any future UAAL will be paid in the time frame currently projected. If not, costs associated with the UAAL may increase in an amount that cannot be determined with the currently available information.

Name Tina Leiss

Title Executive Officer

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March 30, 2017

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 Senate Bill 297

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 Senate Bill (SB) 297.

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, 2018. Existing members of the System as of June 30, 2018 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 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;

(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; and

(f) provide for survivor, disability, early retirement benefits, and cost-of-living adjustments similar to those currently provided by the System.

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 unless the Board determines that the defined contribution plan can be fully implemented by the System on July 1, 2018 at a cost that is lower than a third-party administrator;

   (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 as employers 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 detail regarding how the additional 6 percent contribution from local governments would be applied with respect to the cost-sharing mechanisms between employee and employer. For purposes of this analysis, we have assumed that the additional 6 percent contribution from local governments would be applied towards the unfunded liability of the System as a whole, rather than towards the unfunded liability of a specific group of members.

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

The bill would require that all new employees after July 1, 2018 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. Because of the contribution rates for employees under the analysis below, it is possible that very few employees elect this option. In this analysis, we have assumed that none of PERS' current members would elect to join the hybrid plan.

Currently, the Unfunded Actuarial Accrued Liability (UAAL) amortization component is approximately 11.4% of payroll for Regular employees and 13.3% 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.

This bill limits the employer contribution for the defined benefit portion of the hybrid plan to 6% of covered payroll (plus an additional 6% from local government employers). Further, the bill requires that employees in the hybrid plan pay the remainder of the actuarially determined contribution rate, which is the amount necessary to both cover the normal costs of the defined benefit and reduce the unfunded liability of the System as a whole (including unfunded liability accrued before the establishment of the hybrid plan on July 1, 2018). In essence, new employees that enter the hybrid plan will continue to pay for the unfunded liability of the existing plan.

The total employer and employee contribution rates of the current PERS plan compared to those of the new hybrid plan are shown below.

Administrative Requirements

The bill would allow current System members to transfer into the hybrid plan. The bill specifies that members acknowledge in writing that they understand the differences between the calculations of the benefits payable with and without the transfer, the risks associated with the election to transfer, and the understanding that the transfer is irrevocable.

Assuming that transfer elections are available to active members only, this would require personalized calculations for each of the System's active members (105,000 members as of June 30, 2016). Producing and communicating these calculations would be a significant administrative effort for the System's staff.

The bill also would require the Board to determine whether the cost to administer the plan by the System would be less than the cost of administration from a third-party provider. The bill further lists the criteria for selection of the provider. In order to make this determination the System would be required to perform a detailed market search, including issuing a formal request for proposal. Evaluation of providers would require detailed analysis by the System's technical and legal staff.

Contributions

The bill would change the contribution structure for hybrid plan participants by limiting the employer contribution to 6% of covered payroll under the defined benefit plan, with the remainder of defined benefit 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 until the System is 85% funded, at which point the additional contributions would cease.

State Employees			
Regular Members	Pre-July 1, 2018 Members (Current Plan)		Post-July 1, 2018 Members (Hybrid Plan)
Employee/Employer Group			
Employer Contribution	14.50%		12.00%
Employee Contribution	14.50%		15.87%
Total	**29.00%**		**27.87%**
Employer-Pay Group			
Employer Contribution	14.00%		12.00%
Employee Contribution	14.00%		15.98%
Total	**28.00%**		**27.98%**
Police/Fire Members			
Employee/Employer Group			
Employer Contribution	20.75%		15.00%
Employee Contribution	20.75%		26.84%
Total	**41.50%**		**41.84%**
Employer-Pay Group			
Employer Contribution	20.25%		15.00%
Employee Contribution	20.25%		27.03%
Total	**40.50%**		**42.03%**

Local Government Employees			
Regular Members	Pre-July 1, 2018 Members (Current Plan)		Post-July 1, 2018 Members (Hybrid Plan)
Employee/Employer Group			
Employer Contribution	14.50%		18.00%
Employee Contribution	14.50%		9.87%
Total	**29.00%**		**27.87%**
Employer-Pay Group			
Employer Contribution	14.00%		18.00%
Employee Contribution	14.00%		9.98%
Total	**28.00%**		**27.98%**
Police/Fire Members			
Employee/Employer Group			
Employer Contribution	20.75%		21.00%
Employee Contribution	20.75%		20.84%
Total	**41.50%**		**41.84%**
Employer-Pay Group			
Employer Contribution	20.25%		21.00%
Employee Contribution	20.25%		21.03%
Total	**40.50%**		**42.03%**
*assumes excess contributions offset Local Government employee contributions			

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, in some cases, 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.

These cost estimates were made using generally accepted actuarial practices and are based on the June 30, 2016 actuarial valuation results, including the participant data and, unless otherwise noted, actuarial assumptions on which that valuation was based. In pricing the defined benefit component of the proposed hybrid plan, assumed rates of retirement were modified to reflect the later ages at which unreduced benefits would be available. Calculations were completed under the supervision of Mark Hamwee, FSA, MAAA, Enrolled Actuary.

I look forward to discussing this with you further.

Sincerely,

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

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cc: Cheryl Price