TESTIMONY OF REBECCA FRICKE

Senate Bill 2227 – Relating to Employee Elections to Waive Future Participation in the PERS' Retirement System

Good Morning, Madam Chair and members of the Committee. My name is Rebecca Fricke and I am the Executive Director of the North Dakota Public Employees Retirement System, or NDPERS. I appear before you today in opposition of Senate Bill 2227. However, if Section 1 were amended to remove the ability for the participant to have a choice on participation, then the NDPERS Board's position would be neutral on the bill.

Section 1 of Senate Bill 2227 gives eligible employees receiving a retirement benefit, or what we refer to as return to work employees, the option to rejoin or waive future participation in the retirement plan if the employee returns to work for the same employer and is appointed by an elected state official to an unclassified position for the duration of the elected official's term until a successor is appointed.

Employees are given a one-time irrevocable election within the first thirty days of initial hire on whether to receive compensation or make pre-taxed elections into a 401(a) governmental retirement plan. Giving a retiree of the plan who has returned to eligible employment with the same employer the opportunity to either join or waive gives them a choice to receive full compensation (by not having any retirement contributions withheld) or to contribute to the plan, thus creating an impermissible cash or deferred arrangement (CODA) concern with the IRS. As written, Senate Bill 2227 jeopardizes the qualified plan status of the NDPERS retirement plan.

If the desire is to have a specific population of return to work employees not be eligible for participation in the retirement plan, thus eligible to continue receiving their retirement benefit, then the bill would need to be amended to remove them from being able to participate in the plan at all. If the bill were amended to remove the election, it would eliminate the CODA concern, and the PERS Board would change from an opposition position to a neutral position on the bill. It would be important to note that whatever language is adopted needs to ensure there are not unintended consequences of excluding a group of employees from participation in the retirement plan. So the language drafted needs to be narrow enough to ensure you are only impacting the employees you are hoping to impact.

The analysis from both our actuary and federal tax compliance consultant is attached for your review. Included in the review from the federal tax compliance consultant is an overview of the ramifications to the retirement plan if the tax qualification status is jeopardized.

This concludes my testimony and I'd be happy to answer any questions you may have.

P: 312.456.9800 | www.grsconsulting.com

January 17, 2025

Representative Austen Schauer, Chair
Legislative Employee Benefits Programs Committee
North Dakota State Government

Re: North Dakota Public Employees Retirement System Legislative Studies – Provisions from Bill No. 25.1187.01000

Dear Representative Schauer:

In accordance with your request, we have analyzed the impact of Bill No. 25.1187.01000 on the North Dakota Public Employees Retirement System (NDPERS). Our review is actuarial in nature; we are not attorneys and cannot provide legal advice.

Systems Affected

Public Employees Retirement System and Retiree Health Insurance Credit Fund

Summary

Bill No. 25.1187.01000:

- Allows an employee who has already accepted a retirement benefit to waive future participation in the retirement plan and the retiree health program and maintain retirement status while working, including continuing to receive retirement benefits.
    - The employee must be eligible for normal retirement.
    - The employee must return to work with the same employer they were employed with at the time they retired.
    - The employee must be appointed by an elected state official to an unclassified state position for the duration of the elected state official's term, or until a successor is appointed.
    - The employee will not be required to make future employee contributions.
    - The employee's employer will not be required to make future contributions on behalf of the employee.

Actuarial Impact of Bill 1187

Currently, members returning to work full-time with the same employer they retired with would have their pension benefits suspended, and at their subsequent retirement, their retirement benefit would be recalculated to include accruals during their re-employment period. With Bill 1187, pension benefits would no longer be suspended, and additional benefits would not be accrued.

Based on previous actuarial analysis, the proposed change in Bill 1187 would result in higher plan liabilities. The cost of continuing benefits without suspension is expected to be higher than suspending and recalculating benefits. The specific cost would depend on the number of members affected by the legislation, as well as their specific circumstances (age, length of service, length of suspension of benefits, earnings before and after initial retirement, etc.). Due to the need for the employee to be appointed by an elected state official, we expect the number of employees impacted by this bill to be low.

In addition to comparing the expected liability of a retiree without a suspension of benefits to a retiree with a suspension of benefits plus additional accruals while re-employed, we have also considered the impact of filling a position with a return to work retiree instead of hiring a new employee.

- Employees newly enrolled into the Main System on January 1, 2025 and later will enter the Defined Contribution Plan.
- An employee in the Defined Contribution Plan will be eligible for employer contributions to their Defined Contribution Plan account, and if they are employed by the State, their employer will also contribute the Actuarially Determined Employer Contribution and “spillover” contributions to the Main Plan.
- If a current retiree returns to work, and meets the criteria of this bill, employer contributions to a retirement plan will not be required, and the retiree will not accrue any additional pension benefit.
- The overall cost to the state (salary + benefits) is highly dependent on the demographics of the retiree returning to work and the hypothetical new employee that would have been hired for that position. In particular, the total cost comparison would be dependent on the salary of the two employees. A new hire may earn a lower salary than an experienced retiree returning to work.
- The expected Main Plan cost is simply the cost of the retiree’s annuity, whether a return to work retiree or new employee is hired.
- As noted above, we expect the number of employees impacted by this bill to be low.

Policy Issue Analysis

Benefits Policy Issues

- Adequacy of Retirement Benefits

  Members impacted by this bill will continue to receive their retirement benefit, but will not accrue any additional retirement benefit while working.

- Competitiveness

  No impact.

- Benefits Equity and Group Integrity

  This bill applies only to employees appointed by an elected official to an unclassified position. Retirees who are not appointed by an elected official to an unclassified position will be subject to different rules.

- Purchasing Power

  Receiving both a retirement benefit and a salary will increase the purchasing power of members impacted by this bill.

- Preservation of Benefits

  No impact.

- Portability

  No impact.

- Ancillary Benefits

  No impact.

- Social Security

  Social Security benefits may be reduced before Social Security full retirement age if a retiree earns more than the yearly earnings limit. The yearly earnings limit no longer applies after reaching full retirement age.

Funding Policy Issues

- Actuarial Impacts

  Based on previous actuarial analysis, the proposed change in Bill 1187 would result in higher plan liabilities. The specific cost would depend on the number of members affected by the legislation, as well as their specific circumstances (age, length of service, length of suspension of benefits, earnings before and after initial retirement, etc.). Due to the need for the employee to be appointed by an elected state official, we expect the number of employees impacted by this bill to be low.

- Investment Impacts

  No impact.

Administration Issues

- Implementation Issues

  Based on input from NDPERS and their federal compliance consultant, we understand Bill 1187, as currently written, would put the qualification status of the plan at risk.

- Administrative Costs

  No impact.

- Needed Authority

  The bill appears to provide appropriate levels of administrative and governance authority to the PERS Board to implement the changes made by the bill.

- Integration

  None.

- Employee Communications

  Employers and/or NDPERS will need to communicate with employees impacted this bill, so that they understand their benefits and compensation.

- Miscellaneous and Drafting Issues

  No Impact.

Disclosures and Additional Information

We have reviewed the bill and provided a policy issue analysis from our perspective as actuaries. However, the policy issue analysis should not be considered to be comprehensive and there may be additional benefits policy, administration issues or legal issues that are not discussed in this letter.

The signing actuary is independent of the plan sponsor.

Bonita J. Wurst and Abra D. Hill are Members of the American Academy of Actuaries (MAAA) and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion herein.

Please let us know if you have any questions.

Sincerely,

Bonita J. Wurst

Abra D. Hill

Bonita J. Wurst, ASA, EA, MAAA, FCA
Senior Consultant

Abra D. Hill, ASA, MAAA, FCA
Consultant

cc: Rebecca Fricke, NDPERS
Joshua Murner, GRS

IceMiller

MEMORANDUM

TO: **Rebecca Fricke, North Dakota Public Employees Retirement System**

FROM: **Audra Ferguson and Robert L Gauss, Ice Miller LLP**

DATE: **January 17, 2025**

RE: **Bill Draft 1187: Retiree Reemployment Election**

This Memorandum is provided in confidence and subject to the attorney-client privilege. We have not provided copies to anyone other than the individual named above. To preserve the attorney-client privilege, you should disclose the contents of this Memorandum only to persons making decisions on the matters discussed herein.

Please allow this memorandum to response to your email on January 15, 2025 regarding us to provide federal law analysis of Bill Draft 1187. As set forth below, as written, Bill Draft 1187 creates an impermissible cash or deferred arrangement ("CODA").

I. DRAFT BILL 1187

Draft Bill 1187 proposes to add the following additional language:

> d. An employee eligible for normal retirement who accepts a retirement benefit under this chapter and subsequently becomes employed with the same participating employer the employee was employed with at the time the employee retired under this chapter may elect to permanently waive future participation in the retirement plan and the retiree health program and maintain that employee's retirement status if the employee is appointed by an elected state official to an unclassified state position for the duration of the elected official's term until a successor is appointed. An employee making this election is not required to make any future employee contributions to the public employees retirement system nor is the employee's employer required to make any further contributions on behalf of that employee.

(Emphasis added.)

II. EVOLUTION OF THE IRS' POSITION ON EMPLOYEE CHOICE AND CODAS IN 2005-2006

In 2005 and 2006, the IRS began a review of its ruling position on giving current plan participants in a qualified governmental plan an election on whether or not to participate in the plan. There were two primary concerns the IRS identified with respect to arrangements involving employee elections between retirement plans, optional retirement plans, or design options:

- Code Section 414(h)(2), which allows certain employee contributions to governmental plans to be "picked-up" and treated as pre-tax contributions (the "taxation issue"); and

- Code Section 401(k)(4)(B)(ii), which generally prohibits a governmental plan from having a "cash or deferred election" – i.e., the ability of a plan participant to choose to have amounts contributed to a plan on a pre-tax basis, or to receive those amounts as cash compensation (the "qualification issue").

Prior to 2005, the IRS had issued private letter rulings ("PLRs") which allowed pick-up contributions for existing employees who were permitted to choose a new benefit tier, as well as for employees who were making a service purchase. Over time, the rulings had become more and more expansive in allowing the employee contributions for these purposes to be treated as pre-tax. However, after new Treasury Regulations ("Treas. Reg.") were issued for Code § 401(k) plans in 2004 (effective for plan years on and after January 1, 2006), the IRS began reviewing its position with regard to pick-up contributions in qualified 401(a) (non-401(k)) plans. As discussed in Section I.B. (below), Treas. Reg. § 1.401(k)-1(a)(3) defines a "cash or deferred election" and provides an exception for one-time, irrevocable elections, as follows:

> (v) *Certain one-time elections not treated as cash or deferred elections.* **A cash or deferred election does not include a one-time irrevocable election made no later than the employee's first becoming eligible under the plan or any other plan or arrangement of the employer that is described in section 219(g)(5)(A)** (whether or not such other plan or arrangement has terminated), to have contributions equal to a specified amount or percentage of the employee's compensation (including no amount of compensation) made by the employer on the employee's behalf to the plan and a specified amount or percentage of the employee's compensation (including no amount of compensation) divided among all other plans or arrangements of the employer (including plans or arrangements not yet established) for the duration of the employee's employment with the employer, or in the case of a defined benefit plan to receive accruals or other benefits (including no benefits) under such plans. Thus, for example, employer contributions made pursuant to a one-time irrevocable election described in this paragraph are not treated as having been made pursuant to a cash or deferred election and are not includible in an employee's gross income by reason of § 1.402(a)-1(d).

(Emphasis added).

In other words, a governmental plan may allow a one-time, irrevocable election for pre-tax employee contributions by members, **but that election must be made upon first becoming eligible under the plan or any plan of the employer** (often, this is at the commencement of employment but could be after the expiration of a waiting period). In your case, it would be upon first becoming employed by an employer and being covered by Plan 3. After that one-time irrevocable election (or after the first eligibility under the plan has passed), the employee is not permitted to modify the pick-up election or have a new election opportunity so long as the

employee is employed by that employer or a related employer (for instance the State likely is consideration the employer for all its departments agencies). **The 401(k) regulations, effective in 2006, changed the wording with respect to one-time irrevocable elections from elections made at various times during a career (e.g., when eligible for a different plan) to elections made upon first eligibility for any retirement plan (as noted above)**.

The most critical shift in "formal" guidance on picked-up contributions during this period is found in Rev. Rul. 2006-43, which sets forth the current requirements for a valid pick-up, and the IRS' current ruling position. Under Rev. Rul. 2006-43, mandatory employee contributions to a governmental retirement plan can be picked-up and treated as pre-tax contributions only if:

(1) the employer takes formal action to provide for the pick-up (or if state or local law or the plan requires the pick-up), **and**

(2) the employee has no election with respect to the amount or duration of the contribution after the employee's initial employment.

Rev. Rul. 2006-43 allows the one exception – an election with respect to picked-up contributions **if** that election is made when the employee **is first eligible under any plan of the employer**.

Thus, the IRS and U.S. Department of Treasury ("Treasury") agree that a one-time irrevocable election at the time the employee is first eligible under any retirement plan of the employer is permissible. Consequently, the policy reflected in Rev. Rul. 2006-43 involves elections by existing employees with respect to pre-tax contributions. Importantly, IRS and Treasury have not raised concerns with regard to elections involving **post-tax employee contributions** by any employees, whether new or existing.

III. OVERVIEW OF ONE-TIME IRREVOCABLE ELECTIONS IN CODE AND REGULATIONS AS APPLICABLE TO 401(a) PLANS

IRS Announcement 94-101 discussed the one-time irrevocable election exception under Treas. Reg. 1.401(k)-1(a)(3)(v) as follows:

> Although any choice between cash and a deferral is technically a CODA, the regulations, at Section 1.401(k)-1(a)(3)(1)(iv), provide an exception. **A one-time irrevocable election by the employee, when first hired or first eligible for any plan of the employer, is deemed not to be a choice between cash and a deferral. Once such an election is made, it cannot be changed**. Thus, if an employer terminated a money purchase pension plan and replaced it with a different money purchase pension plan, an employee who elected to receive a 5% contribution under the old plan may only receive a 5% contribution from the new plan. In addition, a change in status, such as from associate to partner or union employee to supervisor does NOT give rise to another one-time irrevocable election. **Once an employee has participated in ANY plan of the employer, the one-time election is unavailable**.

(Emphasis added).

In summary, the current regulations under Code § 402(g)(3) state that an employee contribution is not an elective deferral if the contribution is made pursuant to a one-time irrevocable election made at the initial eligiblity to participate in any retirement plan of the employer. The regulations under Code § 402(g)(3) define elective deferral to have the same meaning as under the § 401(k) regulations. Treas. Reg. § 1.401(k)-1(a)(3)(iv) provides that a one-time irrevocable election is not an elective deferral if it was made no later than the employee's first becoming eligible under **the plan or any other 401(a) or 403(b) plan of the employer**. "Employer" for this purpose means the employer and all related employers under Code §§ 414(b), (c) or (m). **Thus, participants who have irrevocably elected to participate in one retirement plan offered by the employer cannot at a later time elect to change their pre-tax employee contribution rate or to participate instead in another plan sponsored by the employer or a related employer without violating the previous one-time irrevocable election exemption.** Moreover, participants must make their one-time irrevocable election at the time they first become eligible under *any retirement plan* sponsored by that employer.

IV. MOST RECENT IRS RULINGS

Starting in 2014, the IRS began clearing out a number of pending private letter rulings ("PLRs"). These new rulings give practical examples of the IRS and Treasury views of employee choice, and application of the above-described statutes and regulations. PLRs are binding only on the entities they were issued to, but can be very helpful in seeing the IRS's application of the regulations:

- PLR 201540014 outlines appropriate pick-up mechanics in a situation where there is no employee choice, but which would also apply if a choice exists.

- PLR 201532036 describes an employee choice process **with different amounts of employee contributions** depending on the employee's election. The conclusion is that to offer employees who are already participating in one plan an election to stay in that plan or go to another plan would be an impermissible cash or deferred arrangement.

- PLR 201529009 demonstrates one acceptable way to structure an election – make pre-tax employee contributions the same regardless of what plan is elected. **If the employee pre-tax contributions are always the same regardless of what coverage the employee selects, there is no election problem**.

- PLR 201443035 reviews irrevocable elections and what constitutes an acceptable one-time irrevocable election in terms of timing. The IRS views this very narrowly – **the election must occur only before the employee is covered in any retirement type plan of the employer**.

- The rulings also stress that these limitations only apply if the employee contributions are **pre-tax**. **If the employee contributions are always post-tax, there is no election problem.**

- PLR 201720009 confirmed the rulings in PLR 201529009 that an election for a current employee between two plans in which the employee's rate of contribution is the same regardless of which plan the employee selects will not constitute a cash or deferred arrangement.

In summary, at this point, the IRS provides very limited exceptions for an employee election that would not constitute an impermissible CODA. The allowable employee contribution change exceptions are as follows:

- ***Employer Mandate*** – the employer mandates a contribution rate change across all members under a plan (e.g., all employees are mandatorily moved to a new tier or new plan with a different contribution rate, with no employee choice).

- ***Level Contribution*** – the employee contribution rate is the same across all applicable plans subject to the choice.

- ***Post-Tax Contribution*** – the lowest pre-tax employee contribution rate in a set of plans subject to an election is treated as picked-up (pre-tax), and any incremental rate among that set of plans is treated as post-tax employee contributions.

V. ANALYSIS OF DRAFT BILL 1187

Draft Bill 1187 gives retirees who return to work with the same employer from which they retired, the option to waive participation in the retirement plan (and the mandatory pre-tax employee contribution) and continue receiving his/her benefit or cease receiving his/her retirement benefit and participate in the retirement plan and make the mandatory pre-tax employee contribution. The election to make the mandatory pre-tax contribution or not make the mandatory pre-tax contribution is an impermissible CODA and creates a plan qualification concern because the retiree is being reemployed by the same employer and has already been eligible to participate in a retirement plan of that employer. As a reminder, maintaining qualified status is critical to receiving significant federal tax benefits for plan members. There is no other way (under federal law) to qualify members for these tax benefits. These tax benefits include:

- Employer contributions are not taxable to members as they are made (or even when vested); taxation only occurs at distribution.

- Earnings and income are not taxed to the trust or the members until distribution.

- Favorable tax treatment may be available to members when they receive plan distributions, e.g., ability to rollover eligible distributions.

- Employers and members do not pay employment taxes on employer contributions (even if the positions are Social Security covered) when contributions are made or when benefits are paid.

These advantages would generally not apply to a non-qualified plan.

As such, Draft Bill 1187 should not be passed as written.

Instead, below are the options available if the legislature would like to allow former employers to rehire retirees:

- **Mandate into NDPERS**: The rehired retirees could be mandated into NDPERS. This would remove the impermissible "election."

- **Mandate Ineligibility to Participate in NDPERS**: The rehired retirees could be determined to be ineligible to participate in NDPERS. Again, this would remove the impermissible "election."

Certainly, we understand the retirement systems' concern about changing the return to work laws for a subset of retirees as this can increase the complexity of administering the plan. In order to simplify and streamline administration, the group of retirees eligible for the amendment could be defined narrowly, including limiting the population to certain job descriptions and may even include a "window" of time in which the return to work amendments will be applicable.

We hope this helps to provide some guidance. Of course, if we can address any additional questions, please do not hesitate to let us know.