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January 22, 2009

Representative Bette Grande, Chair
Employee Benefits Programs Committee
State of North Dakota
Bismarck, North Dakota

Re: **Technical Comments – HB 1575**

The following presents our analysis of the proposed changes found in HB 1575:

Systems Affected: North Dakota Public Employees Retirement System

Summary: The proposed legislation will establish a new, supplemental defined contribution plan only for peace officers employed by the State of North Dakota bureau of criminal investigation with the following major design elements:

- Eligible employees may elect to participate in the plan and may elect to cease participation in the plan.
- Participating members will be required to contribute 2% of covered salary and the employer would be required to contribute 3% of covered salary of participating members to the new plan.
- Employer contributions become 100% vested upon completion of four years of service, or upon attainment of age 65 or a combined total of years of service and years of age equal to 85; 75% vested upon completion of three years of service and 50% vested upon completion of two years of service.
- Participating members may elect a distribution of their account balance upon death, disability or once they are no longer a participating member in various forms permitted by the PERS Board including a lump sum, rollover and periodic payments.

- The new plan will be administered and governed by the PERS Board.
- Participating members will direct the investment of their accounts among choices made available by the PERS Board
- Participating members who elect to participate in this plan by making the employee contribution to the North Dakota 457 Deferred Compensation Plan will vest in PEP contributions in the Hybrid Plan.

Actuarial Cost Analysis: The bill will have no impact on the actuarial costs of the Hybrid Plan.

Technical Comments: Our comments on the bill are as follows:

General

The bill provides that employer contributions for participating members will cease when the member attains age 65 or has a combined total of years of service credit and years of age equal to 85.

Section 623(j) of the Age Discrimination in Employment Act (ADEA) prohibits cessation or reduction in allocation of contributions to an employee's account in a defined contribution plan, or other discrimination in benefits, because the employee has attained a certain age. One exception to this general rule of law is where a governmental employer imposes a mandatory retirement age for public safety officers under a bona fide retirement plan. We do not know if the eligible employees under the new plan are subject to a mandatory retirement age rule from their employers.

Benefits Policy Issues

➢ Adequacy of Retirement Benefits

The bill will enhance retirement benefits for those peace officers employed by the State that elect to participate in the new plan. However, since this new defined contribution plan permits a lump sum benefit payable at termination of employment, rather than a minimum retirement age, the amount of benefits available for retirement may be decreased because it can be used for current consumption.

➢ Benefits Equity and Group Integrity

Under the bill, certain peace officers employed by the State may elect to participate in the new plan, which would increase retirement benefits to those employees. However, additional analysis would be necessary to determine the extent to which the benefits provided under the new plan, combined with benefits under the Hybrid Plan for such employees, are equitable with the total benefits provided under the Hybrid Plan to their peers (peace officers and corrections officers in the State) who are employed by political subdivisions. This peer group is eligible to receive both reduced and unreduced retirement benefits from the Hybrid Plan at earlier ages than the officers employed by the State.

- Competitiveness

The bill may increase the benefits competitiveness of the System only for peace officers employed by the State who elect to participate in the new plan.

- Purchasing Power Retention

A defined contribution plan does not provide guaranteed purchasing power retention after benefits are distributed. The ability to maintain purchasing power will depend on the investment performance of the distributed amounts.

- Preservation of Benefits

No impact.

- Portability

The bill generally provides a high degree of portability of retirement benefits under the new plan after termination of employment. For participants in the new plan, PEP benefits under the Hybrid Plan may become vested to the extent employee contributions are made to the North Dakota 457 Deferred Compensation Plan, while benefits under the new defined contribution plan would not be 100% vested until after four years of service.

In addition, since only certain peace officers employed by the State are eligible for the supplemental defined contribution plan, if an officer moves from State employment to employment as a peace officer or correctional officer for a political subdivision, the supplemental defined contribution benefits are not portable to the retirement plan for political subdivision officers, because they participate only in a defined benefit plan. Likewise, if an officer of a political subdivision moves to employment with the State, the additional benefits under the defined benefit plan are not portable to the State retirement plans (defined benefit and supplemental defined contribution plans).

- Ancillary Benefits

  - Pre-retirement death benefits and disability benefits provided under the new defined contribution plan would generally be less than similar benefits provided under a defined benefit plan structure because defined contribution plan benefits depend on the total amount of contributions made and investment performance of assets, while defined benefit plan benefits are not contingent upon such factors.

  - Social Security: No impact.

Funding Policy Issues

- Actuarial Impacts

As previously noted, the bill will not an actuarial impact on the Hybrid Plan.

➢ Investment Impacts

- Investment of the new plan assets will be participant directed among choices made available by the PERS Board. These choices could be established in a manner similar to the existing PERS Defined Contribution Plan.
- Asset Allocation: The bill does not create new investment asset allocation issues for the Hybrid Plan.
- Cash Flow Impacts: The bill creates new cash flow needs for the Hybrid Plan, since PEP benefits will be vested for participants in the new plan. However, this impact is expected to be minor.

Administration Issues

➢ Implementation Issues

A written plan document should be established for the new plan that incorporates all applicable federal law compliance requirements, including those under the Internal Revenue Code.

➢ Administrative Costs

The bill will require PERS to incur start-up costs and on-going expenses related to the administration, recordkeeping, investment and employee communication services provided for the new plan. The bill provides that all such costs and expenses shall be paid from the account balances of participating members. In addition, employer contributions for the State will increase by 3% of the covered salary of eligible employees who elect to participate in the new plan.

➢ Needed Authority

The bill appears to provide appropriate levels of administrative and governance authority to the PERS Board to operate the new plan.

➢ Integration

For employees who participate in a defined benefit plan, adding a defined contribution plan can be an effective addition to retirement benefits. Because the defined benefit amount is calculated and known before retirement, it provides a "backstop" for retirement income. The defined contribution benefit, which fluctuates with market returns, adds to this income. In order to achieve this cooperation between the plans, care must be taken in the design.

The current Main system defined benefit plan provides for unreduced benefits at age 65 or attainment of age plus service equal to 85. The proposed defined contribution plan provides for benefits at the same ages. Since the commencement ages are the same, the new plan appears to be a reasonable supplement to the current plan.

- <u>Employee Communications</u>

The bill will require employee communications to the peace officers employed by the State to describe the new, supplemental defined contribution plan available to them, including when and how election to participate may occur, major plan design elements (such as vesting, contribution levels and distribution rules), and investment options available.

- <u>Goals</u>

Retirement plans are mainly put into place to provide retirement income for participants. The way that they are structured can also serve to achieve certain employer goals. For example, subsidies paid at earlier ages can help to encourage earlier retirement.

It is unclear what the goals of the proposed plan are. If the goal is to encourage early retirement from active service, it is unclear if that goal will be accomplished. While the proposed defined contribution plan will serve to encourage retirements at or before age 65, the existing defined benefit plan will still reduce benefits until age 65 (barring eligibility for rule of 85). To the extent that participants choose to receive an unreduced defined benefit payment, the defined contribution plan will not affect behavior. This will especially be true of participants with small accumulated balances.

A previous version of the Draft Bill (No. 90118.0100) provided for full retirement benefits at age 55 as the affected participants were transferred to the PERS Hybrid Plan. The current version of the Draft Bill would likely provide less encouragement for these participants to retire at age 55 since the corresponding Hybrid Plan benefit would be reduced from age 65.

If the goal is simply to provide supplemental savings to current defined benefit participants, the goal will be achieved since the ages at commencement between the new plan and the existing plan match well. However, it is also likely that some time would have to pass before the benefits earned from the defined contribution plan would be meaningful enough to provide significant savings for a large number of participants.

- <u>Miscellaneous and Drafting Issues</u>

The bill does not specify the type of plan to be established, but presumably the PERS Board will have the discretion to establish the plan as a tax-qualified plan under Internal Revenue Code section 401(a). If the new plan is established under Code section 401(a), it must be designated as a profit sharing or money purchase defined contribution plan.

It appears that under the provisions of the bill eligible employees may change their election to participate in and contribute to the plan or cease participation in and contributions to the plan at any time. If eligible employees may change their elections under the plan at any time, employee contributions cannot be made to Code section 401(a) plan because this would constitute an impermissible cash or deferred arrangement for a governmental plan under Code section 401(k). However, employee contributions under this plan design could be made to an eligible governmental deferred compensation plan under Code section 457(b), while the employer contributions could be made to a Code section 401(a) plan. In such case, all eligible employees who elect to participate in the plan would be required to make the employee contributions to a section 457(b) plan. To the extent those contributions were made to the North Dakota 457 Deferred Compensation Plan, the employees would vest in PEP contributions to the Hybrid Plan.

In addition, it is unclear under the provisions of the bill whether a participating member must terminate employment to be eligible for a distribution from the plan or can receive a distribution when the member changes from an eligible position to an ineligible position with the employer.

Please call if you have any questions or comments.

Sincerely,

Brad Ramirez, FSA, MAAA, EA
Consulting Actuary

Melanie Walker, JD
Vice President

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1575

Page 10, after line 3, replace the remainder of the bill with:

Agency	General Fund	Special Funds	Total
Attorney general	$118,437	$9,658	$128,096
Total	$118,437	$9,658	$128,096

Renumber accordingly