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October 16, 2008

Rep. Bette Grande, Chairman
Employee Benefit Programs Committee
c/o Jeff Nelson
ND Legislative Council
State Capitol
600 East Boulevard
Bismarck, ND 58505-0360

Re: Actuarial Analysis: Bill No 109 (90109.0200 – 13th Check)

Dear Rep. Grande:

As requested, we have reviewed and analyzed the revised version of Bill 109 (90109.0200), which provides for two special payments for certain annuitants of the Teachers' Fund for Retirement (TFFR).

Provisions

Each annuitant—retiree, disabled retiree, or beneficiary receiving a benefit—who retired before January 1, 2009 and who is still receiving benefits as of December 1, 2009 would receive a special one-time payment equal to the sum of:

- $24.00 times the member's years of service, and
- $18.00 times the number of years the member has been retired

However, the payment would be limited to no more than the larger of 10% of the member's annual retirement benefit or $750.00. This payment would be made in December 2009.

The bill also provides for a second payment, determined under the same formula and with the same maximum, to be made in December 2010 to the members who retired before January 1, 2009 and who are still receiving payments as of December 1, 2010. The payment made in 2010 will usually be slightly larger than the one made in 2009 because the member will have been retired for one more year. Note that the eligibility requirement to receive one of these special payments (retired before Jan. 1, 2009) is the same for both payments.

The bill also provides for a transfer from the general fund of up to $11 million to TFFR, intended to pay for these two special payments. We presume this transfer will be made in two pieces, one in conjunction with the December 2009 payment and one in conjunction with the December 2010 payment.

Analysis

As of June 30, 2008, the date of the last actuarial valuation, there were 6,317 annuitants in TFFR. The average annuitant's benefit was $1,477/month, and the average annuitant had 27.63 years of service. As of 2009, these annuitants will have been retired on average for 12.9 years.

Based on the bill's formula, the average payment in 2009 would be about $846, and the average payment in 2010 would be about $861. The payments would be limited to the maximum ($750 or 10% of the annual annuity) for about 1,000-1,100 annuitants in each of the years.

TFFR would pay about $5.4 million in December 2009 and about $5.5 million in December 2010. This is an approximation that takes into account our estimate of the impact of new retirees between June 30, 2008 and Dec. 31, 2008. Therefore, payments should be no more than about $10.9 million for the two years combined, making the $11 million appropriation sufficient. These estimates are slightly conservative, since they do not reflect any reduction for annuitants who die before the payments are made.

Therefore, there would be no effect on the unfunded actuarial accrued liability (UAAL) for TFFR, and no effect on the funded ratio or margin, since the special payments would be covered by the appropriation.

Technical Comments

Based on past precedent with other cost-of-living legislation, we assumed that for annuitants who are beneficiaries, the years of service will be based on the service of the deceased member, and for annuitants who are survivors of deceased retirees, the years retired will be based on the number of years since the member's retirement. In the case of members whose benefits are divided by a qualified domestic relations order (QDRO), the one-time payment would likewise be divided in accordance with the language of the QDRO. We assumed that the Retirement and Investment Office would use exact decimal service in the formula, and that the number of years retired would be determined by subtracting the year of retirement from 2009 (first payment) or 2010 (second payment).

The Rollover Issue

Under Internal Revenue Service regulations, a payment that is supplemental to the regular annuity is treated as eligible for rollover to an IRA or another qualified plan, unless it meets an exception under the regulation. Under IRS Regulation 1.402(c)-2, Q&A 6, there is an exception for supplemental payments, if they meet these four requirements:

1. The supplement is a benefit increase for annuitants;
2. The amount of the supplement is determined in a consistent manner for all similarly situated annuitants;
3. The supplement is paid to annuitants who are otherwise receiving payments that would constitute substantially equal periodic payments; and

4. The aggregate supplement is less than or equal to the greater of 10% of the annual rate of payment for the annuity, or $750 or any higher amount prescribed by the Commissioner in revenue rulings, notices, and other guidance published in the Federal Register.

Because the maximum payment in each year is limited as required in the fourth condition above, and because the other three requirements are met, it will not be necessary for these payments to be treated as eligible for rollover. TFFR will be able to use the member's regular withholding election to determine federal income tax withholding on the special payments.

Data and Assumptions

Our calculations were based on the member data used in preparing the June 30, 2008 actuarial valuation, and on the actuarial assumptions and methods used in that valuation.

If you have any questions about our analysis or comments, please do not hesitate to call or write.

Sincerely,

J. Christian Conradi

J. Christian Conradi
Senior Consultant

cc: Ms. Fay Kopp, Deputy Executive Director, North Dakota Retirement & Investment Office

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