

LC 90118.03 will establish a new, supplemental defined contribution plan only for peace officers and correctional officers employed by the State of North Dakota

Proposal	Section	Actuarial Comment	PERS Comment & Recommendation
Eligible employees must make an irrevocable election to participate in the plan.	Section 2		
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.	Section 2		No appropriation is contained in the bill be the effected agencies to pay the required contribution. PERS would recommend that this bill be funded to support the required program.
Employer contributions become 100% vested upon completion of four years of service, or upon attainment of age 60 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. This language is problematic, as will be explained.	Section 2	1. The Age Discrimination in Employment Act (ADEA) generally prohibits cessation 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	PERS is concerned this provision may violate the age discrimination act. An Attorney General's opinion should be sought to insure this provision does not violate federal law

Proposal	Section	Actuarial Comment	PERS Comment & Recommendation
		<p>under the new plan are subject to a mandatory retirement age rule from their employers</p> <p>2. The bill does not require the employer contributions be forfeited until after the bill stipulates they are 100% vested, after which point contributions cannot, by definition, be forfeited.</p> <p>3. The defined contribution plan proposed in this bill has shortcomings in this regard. Since the provisions for payment in the proposed plan do not match the provisions for payment in the current plan, participants are not always able to receive benefits from both plans. In fact, in many cases, the participant must make a decision between receiving benefits from the defined contribution plan or a reduced benefit from the defined benefit plan.</p>	<p>PERS would recommend this provision be addressed in the final bill</p> <p>PERS is concerned that the provisions of this plan do not coordinate with the primary retirement plan. Consideration should be given to dropping the "60" provision to provide the necessary coordination. However if this is done then this supplemental savings program could be argued that it should be available to all employees.</p>
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	Section 2		

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Proposal	Section	Actuarial Comment	PERS Comment & Recommendation
by the PERS Board including a lump sum, rollover and periodic payments			
The new plan will be administered and governed by the PERS Board.	Section 2		
Participating members will direct the investment of their accounts among choices made available by the PERS Board	Section 2		

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PROPOSED AMENDMENTS TO BILL NO. 90018.0100

Page 1, line 4, remove "and"

Page 1, line 5, after "appropriation" insert "; and to provide for an appropriation"

Page 9, after line 22, insert:

Section 3. APPROPRIATION. The funds provided in this section, or so much of the funds as may be necessary, are appropriated out of any moneys in the general fund in the state treasury, not otherwise appropriated, and from special funds derived from federal funds and other income, to the agencies listed below for the purpose of funding benefit increases contained within this bill, for the period beginning July 1, 2009, and ending June 30, 2011:

Department	General Fund	Other Funds
125 - Attorney General	\$77,995	\$24,630
504 - Highway Patrol	\$2,725	\$861
223 - Youth Corrections	\$109,076	\$19,249
502 - Parole	\$263,971	\$5,387
518 - Jamestown Penitentiary	\$296,014	\$0
519 - Bismarck Penitentiary	\$412,645	\$8,421
520 - Roughrider	\$0	\$46,198
530 - Corrections	\$66,693	\$1,361
720 - Game & Fish	\$0	\$115,909
TOTAL	\$1,229,119	\$222,016

Renumber accordingly



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October 17, 2008

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

Re: **Technical Comments – Bill Draft No. 90118.0300**

The following presents our analysis of the proposed changes found in Bill Draft No. 90118.0300:

Systems Affected: North Dakota Public Employees Retirement System

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

- Eligible employees must make an irrevocable election to participate 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 60 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. This language is problematic, as will be explained.
- 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.

Benefits, Compensation and HR Consulting ATLANTA BOSTON CALGARY CHICAGO CLEVELAND DENVER HARTFORD HOUSTON LOS ANGELES
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- 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

Actuarial Cost Analysis: The bill will not have an actuarial impact on 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 60 or has a combined total of years of service credit and years of age equal to 85, and that participating members who continue to be employed in an eligible position beyond either such date will forfeit all employer contributions. Forfeitures will revert to the State's general fund. These provisions of the bill are problematic for two reasons.

First, the Age Discrimination in Employment Act (ADEA) generally prohibits cessation 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.

Also, the bill does not require the employer contributions be forfeited until after the bill stipulates they are 100% vested, after which point contributions cannot, by definition, be forfeited. Even if the vesting provision is removed, and the forfeiture provision is not found to be discriminatory on the basis of age, the provision is also problematic from a practical standpoint. A participant who does not leave eligible service upon reaching age 60 or attainment of age plus service equal to 85 will immediately forfeit all employer contributions. This would have the effect of a participant's accumulated balance being reduced by 60% in a single day.

A participant facing this forfeiture must make the decision between continuing work or losing a substantial portion of his or her retirement savings. This would likely affect employee behavior, causing more retirements at or before age 60. It would also likely affect the initial elections of employees of whether or not to participate in the plan.

Second, since some of the salaries of peace officers and correctional officers who are eligible employees under the new plan may be paid by federal agencies, it may not be permissible to forfeit employer contributions paid by those federal agencies to the State's general fund.

Benefits Policy Issues

➤ Adequacy of Retirement Benefits

The bill will enhance retirement benefits for those peace officers and correctional officers employed by the State that elect to participate in the new plan. However, since this new

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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, peace officers and corrections 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 and correctional 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. However, for certain short service employees (e.g., those with less than four years of service), benefits under the new defined contribution plan are less portable than similar benefits provided under the Hybrid Plan. This is because benefits under the Hybrid Plan are 100% vested after three years of service, while benefits under the new defined contribution plan would not be 100% vested until after four years of service.

➤ 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.

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- ♦ Social Security: No impact.

Funding Policy Issues

➤ Actuarial Impacts

As previously noted, the bill will not have 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 does not create new cash flow needs for the Hybrid Plan.

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

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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 defined contribution plan proposed in this bill has shortcomings in this regard. Since the provisions for payment in the proposed plan do not match the provisions for payment in the current plan, participants are not always able to receive benefits from both plans. In fact, in many cases, the participant must make a decision between receiving benefits from the defined contribution plan or a reduced benefit from the defined benefit plan.

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 forfeiture of benefits at age 60 or attainment of age plus service equal to 85.

Based upon data provided by the System, we analyzed employee data for eligibilities under both the current defined benefit plan and the proposed defined contribution plan. The gap between the two provisions causes integration problems as shown below.

Current Age	Age at Rule of 85 Eligibility			
	51-55		56-59	>=60
<=25	31		0	0
25-29	55		8	0
30-34	56		34	0
35-39	33		54	13
40-44	17		29	26
45-49	29		24	30
50-54	21	3	22	21
55-59		8	9	4
>=60		1	10	26

Eligible for employer contribution balance until DB NRA	422
Ineligible for employer contribution balance at DB NRA	120
Ineligible Immediately	52
Total	594

From the data above, 422 participants will be eligible for defined contribution benefits until reaching normal retirement under the defined benefit plan. For these employees, the plans will integrate without the problems mentioned above.

However, 120 participants (highlighted in yellow above) will be required to forfeit the employer contribution portion of their defined contribution balances before being able to receive unreduced benefits from the defined benefit plan. These participants will be faced with choosing between the plans as they approach retirement.

Furthermore, 52 participants (highlighted in blue above) will not qualify for the defined contribution benefits at all based upon their current age and service. These participants would receive no benefit in the proposed plan, and would not be motivated to elect to participate.

➤ Employee Communications

The bill will require employee communications to the peace officers and correctional 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.

➤ Goals

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 before age 60, 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.

The 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 for a portion of employees. However, as shown above, a substantial portion of current employees will not be able to receive unreduced benefits from both plans. 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.

➤ Miscellaneous and Drafting Issues

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 is unclear under the provisions of the bill whether employee contributions will be paid on an after-tax basis or may be picked up by the employer on a pre-tax basis in accordance with

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Internal Revenue Code section 414(h). If the employee contributions will be picked up by the employer, the plan must include language describing the pick up and tax treatment of contributions and should provide for a specific window period within which eligible employees can elect to participate in the new 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

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Senate Bill 118

Department	Monthly Salary	Estimated Biennium Salary	3% of Payroll Increase	Funding Source Gen, Fed, Other	General Increase	Other Increase
125 - Attorney General	\$131,781	\$3,420,824	\$102,625	76%, 22%, 03%	\$77,995	\$24,630
504 - Highway Patrol	\$4,605	\$119,538	\$3,586	76%, 00%, 24%	\$2,725	\$861
223 - Youth Corrections	\$164,782	\$4,277,477	\$128,324	85%, 10%, 05%	\$109,076	\$19,249
502 - Parole	\$345,884	\$8,978,595	\$269,358	98%, 02%, 00%	\$263,971	\$5,387
518 - Jamestown Penitentiary	\$380,113	\$9,867,125	\$296,014	100%, 00%, 00%	\$296,014	\$0
519 - Bismarck Penitentiary	\$540,694	\$14,035,551	\$421,067	98%, 02%, 00%	\$412,645	\$8,421
520 - Roughrider	\$59,323	\$1,539,930	\$46,198	00%, 00%, 100%	\$0	\$46,198
530 - Corrections	\$87,389	\$2,268,479	\$68,054	98%, 02%, 00%	\$66,693	\$1,361
720 - Game & Fish	\$148,840	\$3,863,648	\$115,909	00%, 00%, 100%	\$0	\$115,909
Higher Education	\$101,035	\$2,622,707	\$78,681	00%, 00%, 100%	\$0	\$78,681
TOTAL	\$1,964,446	\$50,993,875	\$1,529,816	85%, 03%, 12%	\$1,229,119	\$300,697
W/O Higher Education		\$48,371,168	\$1,451,135		\$1,229,119	\$222,016