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September 17, 2010

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

Re: Technical Analysis of Bill 54 (TFFR Bill with No Appropriation)

Dear Rep. Grande:

As requested, we have reviewed Bill 54 (Bill 10054.0100). This bill would modify benefits for most current and future members of the Teachers' Fund for Retirement (TFFR), principally by increasing the eligibility requirements for unreduced (normal) retirement. It would also increase required contributions for both employers and members. This bill is identical to Bill 55, except that Bill 55 requires a $75 million appropriation to TFFR from the General Fund.

Provisions of Bill

Contribution Rates: The current employer contribution rate for TFFR members in 8.75% of salary, and members pay 7.75% of salary. Section 2 of this bill increases both of these rates a total of 4.00 percentage points in two steps of 2.00 percentage points each, as shown below:

Period	Employer	Member	Total
Current rates (FY 2010 – FY 2012)	8.75%	7.75%	16.50%
Effective July 1, 2012 (FY 2013, FY 2014)	10.75%	9.75%	20.50%
Effective July 1, 2014 (FY 2015 & later)	12.75%	11.75%	24.50%

As under present law, these higher contributions are not intended to be permanent. Both the member and employer rates would revert to 7.75% once the plan reaches a 90% funded ratio, i.e., once the actuarial value of assets ÷ the actuarial accrued liability is at least 0.90.

Unreduced Retirement Eligibility: Section 3 of the bill make changes to the eligibility requirements for normal (unreduced) retirement. These changes are applied to current as well as future members of TFFR. However, these changes would not apply to certain "grandfathered" members. Section 1 adds a new definition for a Tier One Grandfathered Member. A Tier One Grandfathered Member is a Tier 1 member who, on June 30, 2013, is vested (has three years of service) and meets either of these conditions:

- Is at least age 55; or
- The sum of the member's age and years of service is at least 65

Therefore, all Tier 1 members who are eligible for retirement are grandfathered, as are all active Tier 1 members who are within ten years of eligibility for an unreduced retirement benefit. Tier One Grandfathered Members are exempt from the changes made by Section 3. They retain the current retirement eligibility provisions.

As a reminder, Tier 1 members are those who joined TFFR on or before June 30, 2008, and Tier 2 members are those who joined after that date.

For all other members—both nongrandfathered Tier 1 members and all Tier 2 members, including all future members—Section 3 of the bill increases the eligibility requirements for unreduced retirement. Currently, members in Tier 1 are eligible for an unreduced benefit if they meet the Rule of 85 (the sum of age plus years of service is at least 85), while Tier 2 members must meet the Rule of 90. Members of both tiers who do not meet the appropriate Rule of 85 or 90 can still retire at age 65 if they are vested. Vesting requires three years of service for members in Tier 1 and five years of service for Tier 2 members. Under the bill, nongrandfathered members would have to be at least age 60 and would have to meet the Rule of 90 to be eligible to retire with an unreduced benefit. Members who did not meet the Rule of 90 would still be permitted to retire at age 65 if they were vested.

For example, a Tier 1 member who is age 45 with 20 years of service on June 30, 2013 would be grandfathered, because she is vested and the sum of her age and service is at least 65. Therefore, she would see no change to the age at which she could retire with an unreduced benefit. If she continues in full-time service, she would be eligible to retire at age 55, when she would have 30 years of service and would meet the Rule of 85.

If she had been age 44 with 19 years of service on June 30, 2013, she would not be grandfathered, since she would be less than 55 and the sum of her age and service would be less than 65. In her case, rather than being able to retire at age 55, she would have to wait until age 60.

A Tier 2 member who is age 30 with 4 years of service would see her earliest unreduced retirement age increased from age 58, when she would have 32 years of service and meet the Rule of 90, to age 60, since this would be the earliest unreduced retirement age for any nongrandfathered member.

Early Retirement: Section 4 of the bill modifies the reduced (early) retirement benefits. At present, a member who is not eligible for unreduced retirement but who is vested and at least age 55 can retire with an early retirement benefit. The benefit is reduced 6% per year that the member is retiring early. The reduction is applied from age 65, or if earlier, from the age at which the member would qualify under the applicable Rule of 85 or 90, using just the member's current service.

One change made by the bill just conforms the computation of the early retirement reduction to the new requirements for unreduced retirement. That is, the reduction is applied from the age 65, or if earlier, from the point the member would both reach age 60 and satisfy the Rule of 90 based on current service. The other change made by this section increases the reduction per year from 6% to 8%. Neither of these changes would affect a Tier One Grandfathered Member.

So, for example, a nongrandfathered member who wishes to take early retirement at age 60 with 15 years of service would have her formula benefit reduced 30% under current law (5 years early x 6%/year), but this reduction would be increased to 40% under the bill (5 years early x 8%/year).

Disability: Section 5 of the bill makes two changes to the disability benefit. The first change is to the eligibility requirements. Currently, members are eligible for this benefit if they have at least one year of service. The bill would change this to require five years of service. Members who become disabled prior to earning five years of service would only be entitled to a refund (or in the case of vested members, a deferred retirement benefit payable at 65). Second, the current benefit is based on the regular retirement benefit with no reduction for age—2.00% x Final Average Salary x Service—but there is a minimum of 20 years of service for the disability calculation. Therefore, the minimum benefit at present is 40% (2.00% x 20 years) of the member's Final Average Salary. The bill would eliminate this minimum, and the disability benefit would reflect the member's actual service. These changes would apply to all members, including Tier One Grandfathered Members.

Member Contributions for Reemployed Retirees: Sections 6 and 7of the bill require that reemployed retired teachers pay the member contribution to TFFR. Currently reemployed retirees do not contribute to the Fund, although their employers make the employer contribution. This change would apply to all retirees, regardless of when they retired or when they returned to work, if they perform TFFR covered services after July 1, 2012. Therefore, even retirees who returned to teach before this date would be required to contribute if they continued working after this date.

Effective Dates: Section 8 of the bill sets the effective dates for the changes described above. As already noted, the provision requiring reemployed retirees to make the member contributions would be effective July 1, 2012. The contribution rate changes would be effective on July 1, 2012 and July 1, 2014, as shown above. All of the other provisions—the changes to the retirement and disability provisions—would become effective July 1, 2013.

Actuarial Analysis

The actuarial analysis will be prepared following completion of the July 1, 2010 actuarial valuation, and will be provided to the committee before its October meeting.

Technical Comments

It is possible that this bill, if enacted, would face a court challenge, since it changes the benefit provisions applicable to members already in the plan. There is a legal theory under which it would be impermissible, because it would be a violation of the State's contract clause, to reduce benefits for current members, unless an offsetting improvement were made at the same time.

We are not attorneys, and we cannot provide a legal opinion about this. We can provide a bit of history about this issue. Several years ago, Scott Miller, who was the Assistant Attorney General assigned to assist and advise the TFFR Board, provided his opinion that, if a bill like this were proposed, the bill would likely be found unconstitutional. Last year, the TFFR Board asked Aaron

Webb, the Assistant Attorney General who is now assigned as their advisor, to re-review Mr. Miller's opinion and the relevant law. In his view, the outcome of a court challenge was more uncertain.

We recommend that the committee hear from Mr. Webb about this issue.

Before endorsing a bill that made changes to retirement eligibility for current vested Tier 1 members, the TFFR Board looked at several other alternatives. These included: (a) changing benefits only for future members, and (b) changing benefits for future members and current nonvested members. However, these produced very small savings. There will be more discussion of this when the actuarial analysis is provided.

This legislation, by grandfathering members eligible for or near eligibility for retirement attempts to minimize the impact on members who are making active plans for their retirement, while still producing meaningful savings. (The TFFR Board also looked at other possible ways to determine the group of grandfathered members before settling on the approach in the bill.)

It should be noted that this bill would reduce the differences between the nongrandfathered Tier 1 members and Tier 2 members. They will generally be subject to the same provisions, except that (a) the Final Average Salary for Tier 1 members is a three-year average, while it is a five-year average for Tier 2 members, and (b) vesting requires five years for Tier 2 members but just three years for Tier 1 members.

The provision requiring reemployed retirees to contribute has been criticized because it requires members who are no longer earning benefit service to continue contributing. Contributions are required although they will not receive a larger benefit due to those contributions. On the other hand, some school districts pick up the member contribution, and as a result, the district may favor hiring a retiree over a brand new teacher. This may make it more attractive for members to retire immediately upon becoming eligible for an unreduced retirement benefit, which has a cost for the fund.

The proposed changes to the disability benefit will reduce the disability benefits paid by the fund, and will mean that some shorter-service teachers will not be eligible for this benefit. However, it is difficult to determine the actual impact on the members, since some school districts also provide a separate long-term disability benefit.

The provision requiring an 8.00%/year reduction for early retirement will approximate a full actuarial reduction while retaining a simplified formula which is easy to communicate to members. The following chart compares an actuarially calculated factor for a member with an age 65 normal retirement age with the 6% factors used currently and the proposed factors based on an 8%/year reduction.

Comparison of Early Retirement Factors (NRA = 65)			
Age	Actuarial	Current Plan (6%/Year)	Proposed (8%/Year)
65	100%	100%	100%
64	91%	94%	92%
63	83%	88%	84%
62	75%	82%	76%
61	69%	76%	68%
60	63%	70%	60%
59	57%	64%	52%
58	52%	58%	44%
57	48%	52%	36%
56	44%	46%	28%
55	40%	40%	20%

As you can see, the 8%/year reduction more closely approximates a true actuarial reduction for the first five years of reduction. Keep in mind, though, that not all employees under the current plan or under this bill will have an age 65 normal retirement age, because of the Rules. A member retiring at age 55 with 30 years of service would be eligible for normal retirement at age 60 under the bill. For this person, the reduction would be applied from age 60, not age 65, and the factor would be 60% (40% reduction), compared to an actuarial factor of 64%.

We have not identified any other legal, regulatory or compliance issues raised by the bill. We are not aware of any conflicts between federal pension law and the bill.

Administration and Timing

The bill will require the Retirement and Investment Office to revise member communications materials and to have some programming redone. Members and employers will need to be notified of the changes, and the grandfathered members will need to be identified. While there will be some implementation costs associated with enactment of the bill, it is unlikely that these would require additional permanent staffing.

We believe the bill's delayed effective dates give the Retirement and Investment Office sufficient time to make and communicate these changes prior to implementation.

Basis of Calculations

The actuarial reductions for early retirement discussed above were based on the actuarial assumptions we use for the TFFR actuarial valuation. In particular, they are based on (a) an 8.00% interest rate, and (b) a unisex mortality table composed by weighting the male valuation table for post-retirement mortality by 35% and weighting the female table by 65%.

General Comments

No statement in this letter is intended to be interpreted as a recommendation in favor of the change or in opposition to it.

In the event that more than one plan change is being considered, it is very important to remember that the results of separate actuarial valuations cannot generally be added together to produce a correct estimate of the combined effect of all of the changes. The total can be considerably greater than the sum of the parts due to the interaction of various plan provisions with each other, and with the assumptions that must be used.

The undersigned is a member of the American Academy of Actuaries and meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

This communication shall not be construed to provide tax advice, legal advice or investment advice.

Sincerely,

J. Christian Conradi

J. Christian Conradi
Senior Consultant

cc: Ms. Fay Kopp, Deputy Executive Director, ND Retirement and Investment Office

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