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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 Comments on Bill 56 (Administrative Changes)

Dear Rep. Grande:

As requested, we have reviewed Bill 56 (Bill 10056.0100). This bill makes a number of technical and administrative changes to the Teachers' Fund for Retirement (TFFR).

None of the changes made by the bill impact the actuarial position of the fund. The change to the death benefits, discussed below, has no material impact on the liabilities or costs, and none of the other changes affect either the contributions or benefit structure of TFFR.

We will discuss each of the changes made by the bill, describing the change and providing technical comments.

Section 1 – "Beneficiary" Definition

The "Beneficiary" definition in NDCC (North Dakota Century Code) Section 15-39.1-04(2) was revised, in part because some of the provisions were moved to the death benefit section. See the discussion of Section 4 below.

In addition, the definition as modified by Bill 56 says that a member may name an organization or estate as Beneficiary; the member does not have to name a person as Beneficiary. The naming of an organization or estate as Beneficiary implies that the death benefit would be a lump-sum refund of the member's contribution account; only if the Beneficiary is one "person" can the death benefit take the form of an annuity. This change codifies existing practice, and it conforms the North Dakota Century Code to the North Dakota Administrative Code, where this language already is in place. This change was recommended by the plan's legal advisor.

In addition to allowing members to name a person, organization or estate as their beneficiary, we recommend that consideration be given to explicitly allowing a trust to be named as the member's beneficiary. We understand that current practice allows this already.

Our last comment about this section touches on the material in Section 4. Under the current plan, if an unmarried member dies before retirement, and no Beneficiary has been named, then the member's children are automatically the Beneficiaries. This provision was removed in the revisions made to the death benefit section. Under Bill 56, the death benefits in a case like this would be paid to the estate, and then distributed according to the member's will, or in the absence of a will, as required by state law. It is our understanding that this change was made at the recommendation of the plan's legal advisor, because it has proved difficult in some cases to identify all of the decedent's children. (With multiple marriages and divorces, and the birth of many children out of wedlock, it may be difficult to identify all of the decedent's children, and there are also issues about whether step-children and/or adopted children should share in the benefits.) The bill would put these issues before the courts, which are better prepared to decide such matters. The legal advisor does not believe that this makes the member's children less likely to receive the benefits if there is no surviving spouse, because: (a) the member may always name his children as beneficiary or contingent beneficiary, (b) the member may make his children his heirs in a will, and (c) even if the member dies intestate, North Dakota law would make them next to inherit in the absence of a spouse.

Section 1 – "Salary" Definition

Section 1 of Bill 56 also revises the definition of "Salary" in NDCC Section 15-39.1-04(9). Three kinds of changes are being made to this definition.

First, some wording was changed to improve clarity. For example, the term "recruitment bonuses" was replaced by "signing bonuses" in Section 15-39.1-04(9)(g), because State law provides a definition of "signing bonus".

Second, the definition is being amended to update references to various sections of the Internal Revenue Code (IRC). For example, under the bill, Section 15-39.1-04(9) refers to IRC Section 401(a)(17) as in effect on August 1, 2011, rather than as in effect on August 1, 2009. Section 401(a)(17) limits the compensation that can be used in a qualified retirement plan. None of the active TFFR members has a salary large enough to be affected by this limit, currently $245,000 per year. No material changes have been made to Section 401(a)(17) since July 1, 2009. The change is being made at the request of the plan's legal advisor.

Third, the bill modifies whether certain payments are includable as salary. The prior language allowed any performance, retention, experience, or service-related bonus to be included, unless it was conditioned on or in anticipation of the member's retirement. Bill 56 modifies this language, and allows performance payments to be included at the discretion of the Board. While we know that this language is intended to give the Board the flexibility to deal with potential abusive cases, such as salary spiking, we are concerned that this may give overly broad authority or discretion to the Board, violating the general requirement on all qualified retirement plans that benefits be definitely determinable. We are not attorneys, and this is a legal question, so our recommendation is that a legal review of this point be conducted by a knowledgeable attorney with experience in retirement law.

Section 2 – Minimum Required Distributions

This section amends NDCC Section 15-39.1-10(4) to change references from August 1, 2009 to August 1, 2011 in connection with the minimum distribution requirements under IRC Section

401(a)(9). These rules have not changed since August 1, 2009. The change is being made at the request of the plan's legal advisor.

Section 3 – Maximum Benefit Limits

This section changes references from August 1, 2009 to August 1, 2011 in connection with the maximum benefits payable from a qualified retirement plan under IRC Section 415. The Section 415 limit is currently $195,000 for a straight life annuity commencing at age 62-65 in 2010. The limit is reduced for earlier retirement or for other forms of payment. The limit increases each year with changes in the Consumer Price Index. To the best of our knowledge, no retiree's benefit has ever exceeded the limit under Section 415, nor do we expect any future retiree's benefit to be limited. There have been no changes to Section 415 since August 1, 2009. The change is being made at the request of the plan's legal advisor.

Section 4 – Death Benefits

Section 4 amends NDCC Section 15-39.1-17 in its entirety.

New paragraph 1 incorporates various provisions relating to the naming of beneficiaries which were previously contained in the Beneficiary definition, as noted earlier. These include:

- Members may designate a beneficiary
- If the member is married, the spouse is the beneficiary, unless the spouse consents in writing to the naming of another beneficiary.
- The member may name a contingent beneficiary to receive the member's benefits if the primary beneficiary dies before receiving all benefits due.
- If the member dies without having named a contingent beneficiary, the primary beneficiary may name one.

Although relocated, all of these provisions are present in current law.

New paragraphs 2 and 3 describe the death benefits available. All beneficiaries may elect—or in some cases are required to receive—a lump-sum distribution of the member's contribution account. If the member's beneficiary is one person, the beneficiary may elect to receive an annuity in lieu of the refund. The annuity is equal to the benefit the member would have received if he/she had retired immediately prior to the death and elected the Joint & 100% Survivor option. If the member was not eligible for an unreduced retirement benefit at the time of death, any early retirement reduction is waived, and the reduction for the Joint & 100% Survivor option is made using the actuarial factor for disabled lives.

The only change here, other than clarifying current practice, is the elimination of the 60-month optional death benefit. The current plan permits the beneficiary to choose to receive an amount equal to the member's earned benefit (2.00% x Final Average Salary x Service), without regard to early retirement reductions or option reductions, for a period of 60 months (5 years). This option was used very rarely—on average less than once per year. In almost all cases, this option is less valuable than the refund or life annuity. We understand this option is being removed in order to simplify administration, because rollover rights attach to this option. Removing this option does not produce material savings to the fund.

The Committee should be aware that one could argue that removing this option is an impermissible cut-back, since it eliminates an option for current active members, including some who are vested and some who are eligible for retirement. There is a school of thought that holds that reducing <u>any</u> benefit for current active members, without providing another benefit of similar value, would violate the State's contract clause. On the other hand, this change is very minor.

Finally, as under current law, the Bill provides that, if a married annuitant (and if applicable, any joint annuitant or Beneficiary) dies before the plan has paid benefits equal to the member's account balance at the time of retirement, then the plan will pay the difference in a lump-sum to the beneficiary or contingent beneficiary.

Section 5 – Rollovers by Beneficiaries

Section 5 amends NDCC Section 15-39.1-20 in order to permit beneficiaries to elect to have death benefit proceeds rolled over to an IRA or other qualified plan, as now required by federal law. The Pension Protection Act of 2006 permitted qualified retirement plans to make direct trustee-to-trustee transfers (rollovers) to inherited IRAs on behalf of beneficiaries. The Worker, Retiree, and Employer Recovery Act of 2008 made it mandatory that qualified plans permit such rollovers, effective for distributions after Dec. 31, 2009. This section of the bill codifies current practice, since TFFR already has been allowing beneficiaries to elect a direct trustee-to-trustee transfer. This section was added on the advice of outside tax counsel, as part of the IRS determination letter review.

General Comments

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.

The undersigned is not an attorney, and this communication should not be construed to provide legal or tax 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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