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October 17, 2014

Mr. Sparb Collins
Executive Director
State of North Dakota Public Employees' Retirement System
400 East Broadway, Suite 505
P.O. Box 1657
Bismarck, ND 58502

Re: **Technical Comments – Bill Draft No. 15.0043.02000**

Dear Sparb:

The following presents our analysis of the proposed changes found in draft Bill No. 15.0043.02000:

***Systems Affected:*** North Dakota Public Employees Retirement System (PERS) Hybrid Plan

***Summary:*** The proposed legislation would allow current active Defined Contribution (DC) participants the option to participate in the PERS Hybrid Plan. This election would take place during a three-calendar-month period beginning no later than February 1, 2016. Participants' Defined Contribution accumulated fund balances (less rollovers) would be transferred to the PERS Hybrid plan, and the participant would be credited with benefits as if they had always participated in the PERS Hybrid plan. The opportunity for DC Plan participants to participate in the Hybrid Plan is limited only to currently active employees with a participating employer whose DC Plan account balances are not subject to any court order, such as a qualified domestic relations order.

***Actuarial Cost Analysis:*** This bill will have an actuarial cost impact on the Hybrid Plan. Due to the transfer of funds and the crediting of service, both the assets and the liabilities would increase as a result of the transfer.

It is difficult to predict which participants will elect to participate in the Hybrid Plan. However, previous analysis has concluded that for nearly all DC plan members, the account balance is less than the actuarial present value of comparable service under the Hybrid Plan. For this reason, we have previously assumed that 100% of DC participants will elect to transfer in this analysis.

Based upon analysis, the Unfunded Actuarial Accrued Liability (UAAL) for members as of July 1, 2014 would be $40,506,274 offset by assets from the existing DC Plan of $27,952,921. If this were to be amortized using the current 20 year policy of the PERS Plan for Main members, the required annual contribution would be $876,102. In addition to this amortization amount, the annual employer Normal Cost (total Normal Cost less member contributions) would be $625,374. This would result in an annual required employer contribution of $1,501,476 on behalf of the DC Plan participants, which is approximately 8.5% of DC Plan participant payroll (a total of 15.5% of payroll including employee contributions). This is based on the projected annual payroll of $17,575,003 for DC Plan members.

If these participants were allowed to enter the PERS plan and were subject to the same contributions as current PERS Main members, the resulting 14.12% of pay contribution would be approximately 1.38% of payroll less than actuarially required for these participants. Under the recommended 16.12% of contribution, the addition of these members would result in an actuarial gain to the System.

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

**General**

Allowing participants to choose their type of benefit exposes the Hybrid Plan to antiselection risk. This is the risk that participants will behave in ways that will have the greatest cost impact to the Plan. Any analysis of provisions involving choice should consider this effect.

**Benefits Policy Issues**

- Adequacy of Retirement Benefits

  To the extent that Defined Contribution members elect a Hybrid Plan benefit that has a greater value than their current account balance, the bill will improve benefit adequacy for this group of employees.

- Benefits Equity and Group Integrity

  To the extent that Defined Contribution members elect a Hybrid Plan benefit and receive a similar benefit to similarly situated Hybrid Plan participants, the bill will improve benefit equity and group integrity.

- Competitiveness

  No impact.

- Purchasing Power Retention

  To the extent that Defined Contribution members elect a Hybrid Plan benefit that has a greater value than their current account balance, the bill will improve purchasing power for this group of employees.

- Preservation of Benefits

  No impact.

- Portability

  No impact.

- Ancillary Benefits

  - *Death and Disability Benefits:* The DC plan does not provide additional death and disability benefits outside of payment of the participant's account balance. To the extent that Defined Contribution members elect to participant in the Hybrid Plan, these employees will receive additional death and disability benefits.

  - *Social Security:* No impact.

**Funding Policy Issues**

- Actuarial Impacts

  This bill would have an actuarial impact on the Hybrid Plan as discussed above.

- Investment Impacts

  - *Cash Flow*: The Hybrid Plan will receive increased funds as a result of the bill. These will come from the initial transfer of DC account balances and the ongoing contributions for transfers. Additional benefit payments will also be expected to be paid as a result of the granting benefits to former Defined Contribution participants.

  - *Asset Allocation:* Because the bill would affect a relatively small portion of the Hybrid Plan's employees, the bill is not expected to create new investment asset allocation issues.

**Administration Issues**

- Implementation Issues

  This bill would present implementation issues for the PERS. The bill specifies that the Board shall determine the method by which a participating member may make a written election. System staff would be responsible for notifying the affected members and processing the forms in accordance with the bill. The provision that the spousal signature requirement may be waived in extenuating circumstances will require that the Board or System staff make determinations in those cases.

In addition, for employees who purchased service in the Hybrid Plan, then transferred to the Defined Contribution Plan and now transfer back to the Hybrid Plan under this bill, it is unclear how future service purchases would be handled. It may be necessary for PERS to verify that any requests for future service purchases by such employees do not violate permissive service credit purchasing limits under Internal Revenue Code section 415(n) or the Hybrid Plan's own rules limiting service credit purchases.

- Administrative Costs

  The bill would have an impact on the administrative resources of the PERS in addressing the implementation issues discussed above.

- Needed Authority

  The bill appears to provide appropriate levels of administrative and governance authority to the PERS Board to implement the mandated changes.

- Integration

  No impact.

- Employee Communications

  The PERS would need to notify the affected participants of their option to elect under the bill. It may also be appropriate for the PERS to assist participants in making this election by estimating the value of benefits under the Hybrid Plan on an individual basis. It may be necessary to create a system to perform these calculations.

- Compliance Issues

  Pursuant to Internal Revenue Code section 415 and the regulations thereunder, annuity benefits attributable to a plan-to-plan transfer are not subject to annual benefit dollar limitations. However, it is our understanding that this exception only applies to the extent that the actuarial value of the service credited from the transfer is not greater than the amount of the asset transfer. Thus, it appears that actuarial value of the service credited which exceeds the value of the assets transferred for any individual will be subject to the Code section 415(b) annual benefit limit. For DC Plan participants who transfer to the Hybrid Plan and then retire with less than ten years of participation in the Hybrid Plan, their annual benefit may be limited to the extent that this excess annuity value (when added to subsequently earned Hybrid Plan benefit) is greater than the prorated annual benefit limitation. Thus, it may be advisable for PERS to test the Code section 415(b) limit applicable to individual participants who retire from the Hybrid Plan within 10 years of transferring from the DC Plan under this bill.

- Miscellaneous and Drafting Issues

  The language in this bill indicates that DC Plan participants who elect to transfer to the Hybrid Plan waive all rights to the DC Plan account balance. It is unclear whether this includes the right to the value of mandatory employee contributions, since employee contributions under the Hybrid Plan are immediately vested. Thus, you may wish to consider communicating that transferring participants retain their rights to receive mandatory employee contribution amounts after the transfer, regardless of vesting status under the Hybrid Plan, in the notice to participants of the option to transfer.

The information contained in this letter is provided within our role as the plan's actuary and benefits consultant and is not intended to provide tax or legal advice. We recommend that you address all issues described herein with your legal counsel. The calculations summarized were prepared under the supervision of Tammy F. Dixon, FSA, EA, MAAA. Please call if you have any questions or comments.

Sincerely,

Brad Ramirez, FSA, MAAA, FCA, EA
Vice President and Consulting Actuary

Sincerely,

Melanie Walker, JD
Vice President

/csw

cc: Tammy Dixon
Laura Mitchell

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