House BILL NO. 458

INTRODUCED BY [signature]

A BILL FOR AN ACT ENTITLED: "AN ACT FREEZING THE CURRENT PUBLIC EMPLOYEES' RETIREMENT SYSTEM; CREATING A DEFINED CONTRIBUTION RETIREMENT PLAN FOR NEW EMPLOYEES; PROVIDING CURRENT MEMBERS WITH AN OPTION; ESTABLISHING CONTRIBUTION RATES; ALLOWING THE PUBLIC EMPLOYEES' RETIREMENT BOARD TO ADOPT RULES; SUPERSEDING THE UNFUNDED MANDATE LAWS; AMENDING SECTION 19-3-103, MCA; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE."

STATEMENT OF INTENT

A statement of intent is required for this bill because the bill gives the public employees' retirement board authority to adopt administrative rules.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

NEW SECTION. **Section 1. Short title.** [Sections 1 through 12] may be cited as "The Public Employees' Defined Contribution Act".

NEW SECTION. **Section 2. Definitions.** Unless the context requires otherwise, as used in [sections 1 through 12], the following definitions apply:

(1) "Board" means the public employees' retirement board established in 2-15-1009.

(2) "Compensation" means compensation as defined in 19-3-108.

(3) "Division" means the public employees' retirement division of the department of administration.

(4) "Employee" means an employee as defined in 19-2-303.

(5) "Employer" means an employer as defined in 19-3-108.

(6) "Member" means an employee who elects to become a member of Plan II under [section 5(2)] or who is an employee hired on or after July 1, 1997.

(7) "Plan II" means the defined contribution retirement plan provided for under the provisions of [sections 1 through 12].

(8) "Public employees' retirement system" means the public employees' retirement system

established in 19-3-103.

NEW SECTION. **Section 3. Establishment of plan.** (1) There is a defined contribution retirement plan to become effective July 1, 1997. This plan may be referred to as "Plan II".

(2) Subject to the provisions of [sections 1 through 12], Plan II must be a defined contribution retirement plan.

(a) Plan II may be an independent plan or part of a larger plan with respect to some or all of the benefits provided.

(b) The benefits under Plan II must be provided through individual annuity contracts, either fixed or variable, or a combination of contracts, issued to and owned by the members.

NEW SECTION. **Section 4. Administration -- duties of board.** The board shall:

(1) provide for the administration of Plan II;

(2) designate the company or companies from which the contracts are to be purchased and approve the form and content of the contracts, taking into consideration the:

(a) nature and extent of the rights and benefits to be provided by the contracts for members and their beneficiaries;

(b) relationship of these rights and benefits to the amount of contributions to be made;

(c) suitability of these rights and benefits to the needs of the members and the interests of the employers; and

(d) ability of the designated company or companies to provide these rights and benefits.

NEW SECTION. **Section 5. Membership.** (1) All employees hired on or after July 1, 1997, are required to become members of Plan II on the first day of employment by an employer and shall file with the division in a manner prescribed by the board information affecting the employee's status as a member.

(2) A member of the public employees' retirement system may elect to join Plan II by submitting a written election to the division. This election must be made before December 31, 1997, and in a manner prescribed by the board.

NEW SECTION. **Section 6. Member contributions.** Each member shall contribute to Plan II a minimum of 6%, up to a maximum of 8%, of the member's compensation, notwithstanding federally established maximum limits.

<u>NEW SECTION.</u> **Section 7. Employer contributions.** (1) Each employer shall contribute to Plan II 5% of each member's compensation.

(2) Subject to [section 8], each employer shall contribute to the public employees' retirement system 2.7% of each member's compensation for the unfunded liabilities of the system.

<u>NEW SECTION.</u> **Section 8. Actuarial valuation -- rulemaking authority to change contributions.** (1) The board, through its regular biennial actuarial valuation of the public employees' retirement system, shall determine the dollar value of the past service liability of active, inactive, and retired public employees' retirement system members as compared to contributions required to be made by the employer pursuant to [section 7(2)].

(2) If the board determines that the contribution established in [section 7(2)] does not amortize the public employees' retirement system unfunded liabilities over a 40-year period, then the board may increase, through administrative rule, the contribution rate established in [section 7(2)] to an amount that provides that the liabilities are paid off over a 40-year amortization schedule.

<u>NEW SECTION.</u> **Section 9. Unfunded mandate law superseded.** The provisions of [sections 1 through 12] expressly supersede and modify the unfunded mandate requirements of 1-2-112 through 1-2-116.

<u>NEW SECTION.</u> **Section 10. Payment of benefits.** Retirement, death, or other benefits may not be paid under Plan II. Benefits are payable to a member and the member's beneficiaries only by the designated company or companies in accordance with the terms of the contracts.

<u>NEW SECTION.</u> **Section 11. Exemption from taxation, legal process, and assessments.** All contracts, benefits, and contributions under Plan II and the earnings under Plan II are:

(1) except for a retirement allowance received in excess of $3,600 or adjusted by an amount determined pursuant to 15-30-111(2)(c)(ii), exempt from any state, county, or municipal tax;

(2) not subject to execution, garnishment, attachment, or other process;

(3) not covered or assessable by an insurance guaranty association; and

(4) unassignable except as specifically provided in the contracts.

NEW SECTION. **Section 12. Rulemaking authority.** The board may adopt rules to implement [sections 1 through 12].

**Section 13.** Section 19-3-103, MCA, is amended to read:

"**19-3-103. Retirement system created -- system frozen**. (1) A retirement system is created and established to become effective July 1, 1945, and to be known as the public employees' retirement system. The system is governed by the provisions of chapter 2 and this chapter.

(2) On and after July 1, 1997, an employee of an employer may not become a member of the public employees' retirement system."

NEW SECTION. **Section 14. Codification instruction.** [Sections 1 through 12] are intended to be codified as an integral part of Title 19, and the provisions of Title 19 apply to [sections 1 through 12].

NEW SECTION. **Section 15. Effective date.** [This act] is effective on passage and approval.

-END-

STATE OF MONTANA - FISCAL NOTE

Fiscal Note for HB0458, as introduced

DESCRIPTION OF PROPOSED LEGISLATION:
The bill closes the Public Employees' Retirement System (PERS) to new members after July 1, 1997, establishes a defined contribution retirement plan called "Plan II" for employees hired on and after July 1, 1997, and those PERS members who wish to transfer to Plan II, provides for continuing employer contributions to the PERS to amortize unfunded liabilities, sets employer and employee contribution rates to Plan II, and gives the Public Employees' Retirement Board responsibility for administering both Plan II and setting employer contributions to PERS to amortize unfunded liabilities of PERS.

ASSUMPTIONS:

1. The actuarial cost of funding current unfunded liabilities of PERS over its current amortization schedule of 11 years is 3.19% of active members salaries. The cost required to amortize the new unfunded liabilities created by implementation of this proposal will be determined after current PERS members have exercised their option of whether to remain in PERS or convert to Plan II. Unfunded liabilities generally occur when an employer funds a plan more slowly than plan assets accrue or are attributable to past service credits or net actuarial losses. The bill requires employer contributions of 2.7% of the Plan II member salaries to PERS during the next biennium to amortize the new unfunded liabilities. Total contributions for Plan II covered payroll is 7.7% (5.0% to Plan II and 2.7% to PERS).
2. The fiscal year 1996 PERS covered payroll totaled $608,592,099. Of the total covered payroll, 44.5% are state employees, 8.7% are university employees, 30% are local government employees, and 16.8% are school district employees. Covered payrolls are estimated to increase by 3.5% per year. The general fund pays approximately 40% of the costs of PERS for state payroll, approximately 60% of costs for university classified employee payroll funded by current unrestricted funds, and approximately 30% of the costs for school payrolls through guaranteed tax base (GTB) payments. It is assumed that increased costs for contributions attributable to school payrolls will not be paid from the general fund because the GTB payments will not be increased.
3. It is assumed that 15% of the PERS membership will elect to convert to Plan II on July 1, 1997, and that additional new hires will account for another 5% of Plan II membership in fiscal year 1998. The 5% for additional new hires is based upon average annual turnover in the PERS--primarily persons employed for less than one year. These two assumptions result in a total of 20% of the fiscal year 1998 covered payroll applicable to Plan II and 80% applicable to PERS. After fiscal year 1998, it is assumed that PERS membership will decline by 2.5% per year for another 29 years (PERS members leaving service and retiring) and the Plan II members will increase by 2.5% per year.
4. Implementation of the bill will require programming changes to the computerized accounting systems, design and implementation of educational programs for PERS members across the state regarding the options for conversion, adoption of emergency rules, and interviewing and contracting for investment firms to provide investment options for the DC (Plan II) participants. The consultant cost to develop a similar education program for the state of Washington in a similar conversion was in excess of $1.2 million. The Public Employees Retirement Division estimates supplemental costs of up to $500,000 in fiscal year 1997 to design an educational program for PERS members (funded by the PERS pension trust funds) and up to $450,000 in fiscal year 1997 for contracts for Plan II investment managers and third party administrators (funded by the general fund or general fund loans to PERS).
5. The Public Employees Retirement Division estimates that the costs of 3.00 FTE temporary (Grade 11), travel and presentation for the educational program developed by consultants will be $100,000 in fiscal year 1998. Funding may be provided by the PERS pension trust fund.

(Continued)

Dave Lewis 2-12-97

DAVE LEWIS, BUDGET DIRECTOR DATE
Office of Budget and Program Planning

BETTY LOU KASTEN, PRIMARY SPONSOR DATE

Fiscal Note for HB0458, as introduced

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6. Section 4 of the bill requires the Public Employees Retirement Board to administer Plan II but does not identify the specific source of funding. It is assumed that the estimated administrative costs for fiscal year 1997 and the following biennium will be funded from the PERS pension trust fund and the general fund.

FISCAL IMPACT:

| Expenditures: | FY98 Difference | FY99 Difference |
|---|---|---|
| PERD: | | |
| FTE | 3.00 | 0.00 |
| Personal services | 76,110 | 0 |
| Operating expenses | 23,890 | 0 |
| Total | 100,000 | 0 |
| **Funding:** | | |
| PERS pension trust (09) | 100,000 | 0 |
| **Increased retirement contributions:** | | |
| State agencies | 579,000 | 674,500 |
| University system | 113,000 | 132,000 |
| Local govt/school districts | 390,500 | 455,000 |
| School districts | 219,000 | 254,500 |
| Total | 1,301,500 | 1,516,000 |
| **Funding:** | | |
| General fund (01) | 299,500 | 349,000 |
| Other funds | 393,000 | 457,500 |
| Local govt/school districts | 609,000 | 709,500 |
| Total | 1,301,500 | 1,516,000 |
| **Revenues:** | | |
| PERS pension trust (09) | (637,850) | (742,697) |
| **Net impact on pension trust fund balance:** | | |
| PERS pension trust (09) | (737,850) | (742,697) |

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:
The bill creates substantial, unfunded fiscal impacts to local governments during the 2001 biennium totaling approximately $1.18 million and increasing annually for 40 years. While this bill requires local governments to spend additional sums for which no specific means of financing are provided, language in Section 9 of the bill supersedes and modifies the unfunded mandate requirements of Section 1-2-112 through 1-2-116, MCA.

LONG-RANGE EFFECTS OF PROPOSED LEGISLATION:
Costs to state and local government employers will increase annually through fiscal year 2038 at approximately the rate of increase in covered payrolls as adjusted for future changes in the contribution percentage to amortize the PERS unfunded liabilities. No additional unfunded liabilities for current or future members are allowed to be projected in defined benefit plan. The Plan II defined contribution plan has no risk of unfunded liabilities and may provide an inestimable amount of long-term cost avoidance.

TECHNICAL NOTES:
1. The staff of the PERS believe that HB 458, as drafted, may be unconstitutional because of the unfunded liability issue. OBPP, however, believes that the issue is unclear and that a conclusion cannot be drawn since the period needed to amortize the unfunded liability can be extended as proposed in this bill.
2. As noted in assumption 6, the bill does not provide a specific funding mechanism for the ongoing administrative expenses for Plan II. The bill defines Plan II as a defined contribution plan distinct from the PERS but does not establish a Plan II pension trust fund.