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Montana Legislative Services Division

Office of Research and Policy Analysis

August 27, 2012

TO: Sen. Ron Arthun

FROM: Sheri Scurr, Research Analyst

RE: Cash Balance Retirement Plan - Information Request No. 3597

This memorandum responds to your recent request for information concerning the Kansas, Nebraska, and other state cash balance retirement plans for their public employees. You specifically asked about how these plans handled any increases in the costs of their current plan liabilities, the contribution and interest rate credits, and the payout or portability options.

To answer your information request, I conducted individual interviews with representatives of the Kansas and Louisiana retirement systems; a representative of the Kansas retirement systems emailed additional documents for reference; and I researched information in documents available at various websites. A digest of the information I was able to collect is provided in a table on the following pages.

In summary, according to an NCSL report, three states recently adopted cash balance plans for future employees: Kansas, Nebraska, and Louisiana.[1] These cash balance plans cover general classified employees and/or teachers. None cover public safety employees. Both Kansas' and Louisiana's cash balance plans established a new tier within their current defined benefit (DB) plans. Thus, Kansas and Louisiana are still able to use employer contributions to continue to pay the DB plan's overall liabilities. Nebraska's old plan was a DC plan, which does not have unfunded liabilities.

Among these three plans, employee contribution amounts range from a low of 4% of salary in Kansas for employees with less than 5 years of service, to a high of 8% in Louisiana. Employer contribution amounts range from a low of 3% of salary in Kansas for employees with less than 5 years of service to a high of 9.37% in Kansas. Each state has a different way of calculating how additional interest or dividends are to be credited. Payout options are similar in all three plans. However, Kansas limits the amount that can be taken in a lump sum to 30%. Eligibility for retirement varies in each plan, ranging from age 55 and 3 years of service (i.e., vested) in Nebraska, to age 65 regardless of service in Kansas.

With respect to funding its liabilities, Kansas is funding its unfunded liabilities by increasing employer contributions incrementally to 10.57% by FY 2017 and by adopting a cash balance plan that will lower employer contributions for new hires based on years of service. This allows more of the employer contributions to be used to fund the previously unfunded liabilities. Furthermore, the contribution for current employees was increased, but only for future service. This could have been an attempt to avoid contract impairment issues with respect to increasing employee contributions to benefits already earned. Increased employee contributions means that more of the employer contribution is free to be used to pay for the unfunded liabilities.

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[1] Texas has had cash balance plans for municipal, county, and district employees for many decades.

As mentioned earlier, Nebraska was moving from a pure DC plan, so did not have past service liabilities.

Finally, Louisiana seems to have set only a 1% cushion in paying investment interest to employees. In other words, any investment earnings above the actuarially assumed rate, minus 1%, is credited to employee cash balance accounts rather than used to pay down unfunded liabilities.

It was difficult (and prohibitive given time constraints) for me to gather more actuarial data about how enactment of the cash balance plans in Kansas and Louisiana affected their plans' total unfunded liabilities. However, general comments from available from bill summaries suggested that in Kansas no new liabilities were created and that the employer's overall risk was reduced. But, in Louisiana, the cash balance plan was expected to cost more than the traditional DB plan in the long-term due to unspecified plan design variables, generous additional dividends, and the need to invest more and more conservatively as the plan matures and funds available to generate investment income decreases.

I hope this information is responsive to your request. If you need additional information or have followup questions, please do not hesitate to contact me at 444-3596 or sscurr@mt.gov.

State	How implemented and how old unfunded liability (UAAL) handled	Employee contributions	Employer contributions	Minimum Interest Rate	Payment of additional dividends	Benefit eligibility, amount, and payout options
Kansas PERS	> After July 1, 2015, all new hires must join new Cash Balance (CB) plan, old plan was traditional DB with 2 Tiers (no option for Tier 1 or Tier 2 members to joint new CB plan) > Employee and employer contributions increased - EE increase coupled with higher multiplier for ***future*** service or option to take lower multiplier (subject to IRS ruling) - Employers pay one rate for all employees regardless of tier, which is used to cover UAAL for all > Other revenue streams tapped to help fund UAAL (e.g., lottery, state land sales, etc.)	6% CB Tier 3 6% DB Tier 1 4% DB Tier 2	For CB Tier 3: 3%, 4%, 5%, or 6% depending on years of service Tier 1 - 9.37% Tier 2 - 9.37% *Employers pay one rate, but amounts are to CB accounts as shown above, remainder goes to UAAL for all **KPERS board is authorized to increase ER contribution incrementally by up to 1.2% by FY 2017	5.24% in new CB plan	When all plans reach 80% funded ratio: > KPERS board may pay additional dividends of up to 4%, but may not grant a dividend unless investment returns are at least 10%. > Any dividends paid may only be for interest earned above 8%.	> 5-yr vesting > Eligible at age 65 or age 60 with 30 yrs service > Payout options: - Rollover - Annuity options - Lump sum of up to 30% > Actuarial analysis estimated income replacement of about 43.7%

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Nebraska PERS,	> All new hires must join Cash Balance (CB) plan, old plan was DC > Current members may elect to stay in DC plan or convert to CB **(No UAAL,old plan was DC, but additional funding was needed to administer the new CB plan)*	4.8%	7.488%	The greater of the federal mid-term rate plus 1.5% or 5%	Paid if plan is more than 110% funded. Dividends may not exceed 8.0% unless a majority of the PERB agrees.	> 3-yr vesting > Eligible at age 55 > Payout options: - Rollover - Annuity options - Lump sum - Combination of annuity, lump sum and/or rollover
Louisiana (equivalent of PERS, TRS)	> Mandatory for new hires > Optional for others > Legislature's Actuary produced an "actuarial note" that estimated cost of CB plan was going to be higher than the DB plan in the long-term. The actuary used an 8.25% investment rate of return assumption.	8%	4%	Actuarial rate of return on investments set by actuarial committee, minus 1%, but no less than 0% - no interest credited after termination of employment	None	> 5-yr vesting > Eligible at age 60 > Payout options: - Rollover - Annuity - Lump sum

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