

## URS Fiscal Analysis of 2016 5th Substitute H.B. 86

*This document has been prepared by the Utah Retirement Systems (URS) based on information and analysis received from its consulting actuary, Gabriel Roeder Smith & Company.*

### Summary of Fiscal Impact

If enacted, 5th Substitute H.B. 86, Postretirement Employment Restrictions, has the following fiscal impact on URS:

Increase in unfunded actuarial accrued liability:	Increase in annual cost for all participating employers:		Increase in contribution rates:
\$10.7 million	Total: \$1,147,000		See Exhibit 1 for detailed information about the net contribution rate increases, but some examples are: <ul style="list-style-type: none"> <li>• Tier I Public Employees Noncontributory Retirement System, State and School Fund: 0.03% increase</li> <li>• Public Safety and Firefighter Funds: No increases</li> <li>• Tier II Public Employee Hybrid Plan: 0.01% increase</li> </ul>
	Amount of the annual cost increase financed by requiring employers to pay the full normal cost rate portion and 80% of the amortization rate portion of the certified contribution rate (rather than just the amortization rate) on the salary of reemployed retirees: \$147,000	Amount of the annual cost increase financed by increases to the employer contribution rates: \$1,000,000	

If this legislation becomes enacted, there would be a \$1,147,000 increase in the annual cost for the participating employers in URS. Also, the collective unfunded actuarial accrued liability of the participating employers will increase by \$10.7 million due to this legislation. Please refer to Exhibit 3 for the impact on the unfunded actuarial accrued liability and funded ratio for each fund.

The actuary also separately analyzed the financial effect of the provision that requires employers of working retirees to contribute the full certified contribution rate, rather than the amortization rate that is currently contributed on the payroll of working retirees. The increased contributions on the payroll of the working retirees would finance a portion, but not all, of the fiscal impact of the benefit improvement. Specifically, the actuary determined that this modification would finance \$147,000 of the total \$1,147,000 in increased annual cost. Exhibits 1 and 2 provide additional information by fund.

If enacted, this legislation would increase the actuarially determined contribution rate for the Noncontributory State and School fund, Fund 16, by 0.03% to 22.22%. The contribution rate for the Tier II Public Employee Hybrid Plan would increase by 0.01%, but would remain noncontributory. Since the employer's cost is fixed at 10% of pay, the increased cost of the defined benefit plan would decrease the

allocation to the members' defined contribution account by 0.01%. Please refer to Exhibits 1 and 2 for the impact on the actuarially determined contribution rates and annual cost impact for each fund.

While the actuarially determined contribution rates remain below the contribution rates certified by the Utah State Retirement Board (Board), even after reflecting the cost of the benefit enhancement, this version of H.B. 86 would require the current Board certified contribution rates to increase to reflect the increased cost of the benefit enhancement. Increasing the contribution rates to reflect the cost of the benefit improvement will avoid extending the date the funds will attain a 100% funded status. Column 7 on Exhibit 1 provides the applicable Board Certified contribution rate for each fund.

### **Proposed Legislative Provisions**

This version of H.B. 86 would increase the earnings limit that applies to retirees who become reemployed between 60 days and one year of their initial retirement date. Currently URS will suspend the retirement allowance for members who become reemployed after 60 days but within one year of their initial date of retirement if the member's compensation during any calendar year exceeds the lesser of \$15,000 or 50% of the member's final average salary (FAS). The proposed legislation would increase the earnings limit to be the lesser of \$17,500 or 50% of the member's FAS. The limit would be adjusted in the future by the annual change in the Consumer Price Index.

This particular bill also provides another exemption to the reemployment of retiree restrictions to allow a retiree to continue receiving their retirement allowance. These changes become effective on July 1, 2016. To utilize this additional exemption, the retiree must: 1.) not be reemployed for at least 60 days from their retirement date; 2.) be reemployed by a different employer; 3.) be reemployed by a participating employer with a principal place of employment for the retiree in a county with a population of less than 45,000; and 4.) be reemployed as an educator. The proposed legislation also includes a restriction that the retiree may only be reemployed by a participating employer for a total of five years (service is not required to be consecutive and may be with multiple participating employers) before their retirement benefits become suspended during reemployment. Also, the reemployed retiree will not receive any employer provided retirement benefits, including additional service credit. Employers of retirees who return to the workforce under this new exemption will be required to contribute the certified contribution rate to URS on the pay of the working retiree.

Finally, this proposed legislation would require the Board's certified contribution rate to be increased to reflect the cost of any benefit improvement enacted by the Legislature, even if the Board certified contribution rate is greater than the actuarially determined contribution rate determined by the Board's actuary. This provision would also apply to any future legislation that enhanced retirement benefits.

### **Discussion and Actuarial Analysis**

For more background information, general discussion, and analysis of postretirement reemployment restrictions and the fiscal impact of potential changes to the working after retirement provisions, please see the letter from Gabriel Roeder Smith & Company to URS Executive Director Daniel Andersen dated September 23, 2015, including the exhibits. This letter titled, "Actuarial Analysis: Potential Changes to Working After Retirement Provisions" was presented at the Legislature's Retirement Working Group meeting on September 24, 2015 and is available online at <http://le.utah.gov/interim/2015/pdf/00004225.pdf>. This Working Retiree Analysis reflects the actuary's 2015 study of historical experience as well as the most recent actuarial valuation of URS.

The provision changes modeled herein provide members opportunity to increase their personal financial resources late in their career by encouraging certain members to commence their retirement benefit and continue to participate in the workforce. As a result, we must anticipate the change in the retirement behavior and the age members commence their retirement allowance to identify the financial impact of the modifications to the working after retirement provisions.

This legislation provides increased opportunity for members to enhance their income in the last few years prior to exiting the workforce. It has been demonstrated in prior analysis that providing this opportunity to members has a fiscal cost to URS (and participating employers in the URS). This effect has been studied and documented several times for stakeholders in URS.

This bill does not prohibit retirees from remaining employed beyond five years under this new exemption. Rather, the legislation only requires URS to suspend the retirement allowance after the five year period. The five-year limitation will require members to carefully plan when to commence their retirement benefit if they intend to return to the workforce. The five-year limit could be problematic for some members who commence their retirement benefit at an early age, return to the workforce utilizing this new exemption, and later realize they want to remain in the workforce more than five years. The fiscal cost would increase if the five-year limitation period was removed.

This legislation requires employers to pay the full contribution rate (rather than just the amortization rate) on the salary of the eligible exempt retirees, which would finance a portion, but not all, of the fiscal impact of the benefit improvement. There are a couple of characteristics to note about this financing mechanism. First, this financing arrangement places a larger portion of the financial cost on those employers who utilize working retirees in their workforce. In other words, rather than applying the cost increase proportionately to all employers as a percentage of payroll, this “user fee” requires those employers who utilize working retirees in their workforce to pay a slightly higher portion of the benefit enhancement. However, this surcharge does not cover all of the cost of the changes to the provisions. All employers in certain funds would experience some increase in their contribution rates; even those employers that do not rehire retirees.

Another characteristic of this financing arrangement is the working retiree’s benefit is no longer fully funded at the time they commence their retirement benefit and the retirement system has increased reliance on those anticipated contributions as a working retiree to avoid an actuarial loss due to their retirement. As a result, it will become even more important for URS to have appropriate employer reporting processes in place for working retirees to ensure the employers are not under reporting their working retiree payroll in order for URS to collect the appropriate employer contributions on the payroll of their working retirees.

### **Data and Assumptions**

This modeled analysis is based on the member and financial data that were used to prepare the January 1, 2015 actuarial valuation which was presented and adopted by the Board in August 2015.

If enacted, the annual cost will increase by \$1,147,000 per year. The cost increase can be looked at as two mutually exclusive components; increasing the earnings limit to \$17.5k and providing a special exemption to the working retiree rules for rural educators.

Increasing the earnings limit to \$17.5k will increase the annual cost by \$601,000. This is approximately half the cost of increasing the earnings limit from \$15k to \$20k that was determined for H.B. 50.

As of January 1, 2015, there are approximately 3,000 members employed in positions that qualify for the rural educator exemption. For comparison purposes, there are approximately 12,700 total rural positions that are covered by URS (including educators, public employees, public safety members, and firefighters). Using the same methodology for determining the fiscal impact of H.B. 47 and H.B. 117, we have determined this exemption would increase the annual cost by \$546,000. Of this cost increase, \$147,000 would be financed as a surcharge on these working retirees and the difference, or \$399,000, would be financed as an increase in the contribution rate for employers participating the Funds 12, 16, and the Tier II Hybrid plan. The increase in the cost of the Tier II Hybrid plan would be offset by a decrease in the contribution to the member's defined contribution account.

#### **Other Actuarial Comments**

In our opinion, removing the earnings limit for retirees who seek reemployment between 60 and 365 days of their initial retirement date provides significant flexibility for members to commence their retirement benefit and shortly thereafter reenter the workforce. The different agency provision could be problematic for school teachers since they will have to seek employment at a different school district.

Our calculations are based upon assumptions regarding future events, which may or may not materialize. Please bear in mind that actual results could deviate significantly from our projections, depending on actual plan experience. This information is intended to describe the financial and actuarial effect of the proposed plan changes on URS only. Changes in reemployment provisions could impact the cost of other benefit programs, such as post-retirement health benefits. Our analysis does not include this possible effect.

It should be noted that we are neither for nor against the proposed changes. Return to work rules for retirees is a policy decision for the Legislature and employers. Our goal is to inform the stakeholders of the impact on URS of changes to these rules.

#### **Administrative Cost Analysis**

As with all bills that alter benefit design or make substantive benefit modifications, implementation of 5th Substitute H.B. 86 will likely result in some administrative costs. However, such costs will be handled within existing budgets, will not result in direct, measurable costs for URS, and will not result in an increase to actuarially determined contribution rates in addition to those discussed above resulting from the benefit modifications.

## Exhibit 1

### 5th Substitute to HB 86 Impact on Actuarially Determined and Board Certified Contribution Rates

Fund/Division	Actuarially Determined Contribution Rates					Applicable Board Certified Contribution Rate if Legislation is Enacted
	Current	Proposed Legislation	Total Increase	Offset from Contributions on Working Retiree Pay	Net Increase in Employer Actuarially Determined Rate	
(1)	(2)	(3)	(4)	(5)	(6)	(7)
I. Public Employees Contributory						
A. Local Government	11.49%	11.50%	0.01%	0.00%	0.01%	<b>14.47%</b>
B. State and School	14.37%	14.41%	0.04%	-0.01%	0.03%	<b>17.73%</b>
II. Public Employees Noncontributory						
A. Local Government	15.50%	15.51%	0.01%	0.00%	0.01%	<b>18.48%</b>
B. State and School	18.86%	18.90%	0.04%	-0.01%	0.03%	<b>22.22%</b>
III. Public Safety Contributory						
A. State	23.50%	23.50%	0.00%	0.00%	0.00%	<b>29.70%</b>
B. Other Division A (2.5% COLA)	16.75%	16.75%	0.00%	0.00%	0.00%	<b>22.75%</b>
C. Other Division A (4% COLA)	19.00%	19.00%	0.00%	0.00%	0.00%	<b>24.33%</b>
D. Other Division B (2.5% COLA)	17.22%	17.22%	0.00%	0.00%	0.00%	<b>22.29%</b>
E. Other Division B (4% COLA)	19.62%	19.62%	0.00%	0.00%	0.00%	<b>28.95%</b>
IV. Public Safety Noncontributory						
A. State	35.12%	35.12%	0.00%	0.00%	0.00%	<b>41.35%</b>
B. Other Division A (2.5% COLA)	28.12%	28.12%	0.00%	0.00%	0.00%	<b>34.04%</b>
C. Other Division A (4% COLA)	30.42%	30.42%	0.00%	0.00%	0.00%	<b>35.71%</b>
D. Salt Lake City	41.40%	41.40%	0.00%	0.00%	0.00%	<b>46.67%</b>
E. Ogden	42.24%	42.24%	0.00%	0.00%	0.00%	<b>48.68%</b>
F. Provo	37.18%	37.18%	0.00%	0.00%	0.00%	<b>42.16%</b>
G. Logan	37.83%	37.83%	0.00%	0.00%	0.00%	<b>41.92%</b>
H. Bountiful	45.84%	45.84%	0.00%	0.00%	0.00%	<b>47.33%</b>
I. Other Division B (2.5% COLA)	27.73%	27.73%	0.00%	0.00%	0.00%	<b>32.20%</b>
J. Other Division B (4% COLA)	30.18%	30.18%	0.00%	0.00%	0.00%	<b>38.94%</b>
V. Firefighters <sup>1</sup>						
A. Division A	9.34%	9.34%	0.00%	0.00%	0.00%	<b>15.53%</b>
B. Division B	9.06%	9.06%	0.00%	0.00%	0.00%	<b>18.30%</b>
VI. Judges <sup>1</sup>	48.48%	48.48%	0.00%	0.00%	0.00%	<b>51.91%</b>
VII. Tier II - Hybrid Plans <sup>2</sup>						
A. Public Employees	7.99%	8.01%	0.02%	-0.01%	0.01%	<b>8.23%</b>
B. Public Safety and Firefighter	10.16%	10.16%	0.00%	0.00%	0.00%	<b>10.67%</b>
VIII. Grand Total						

<sup>1</sup> These contribution rates are before reflecting offsets for insurance premiums and court fees.

<sup>2</sup> These rates for the Tier II Hybrid Funds exclude the Tier I amortization payment.

#### Summary of Proposed Provisions:

- Increase the Board certified contribution rate due to legislative enhancements.
- Rural educators are permitted to return to work after 60 day separation by a different agency for a maximum of 5 years. Employers contribute the full contribution rate on the payroll of these working retirees.
- Earnings limit for all working retirees who return to employment after 60 days and before 1 year following their retirement date from \$15k to \$17.5k.

# Exhibit 2

## 5th Substitute to HB 86 Increase in Annual Cost by Fund (\$ in thousands)

Fund/Division	Impact on Annual Cost		
	Total Cost Increase	Cost Increase Financed by Contributions on Working Retiree Pay	Cost Increase Financed by the Employer Certified Rates
(1)	(2)	(3)	(4)
I. Public Employees Contributory			
A. Local Government	\$ 3	\$ 0	\$ 3
B. State and School	9	2	7
II. Public Employees Noncontributory			
A. Local Government	49	0	49
B. State and School	952	140	812
III. Public Safety Contributory			
A. State	0	0	0
B. Other Division A (2.5% COLA)	0	0	0
C. Other Division A (4% COLA)	0	0	0
D. Other Division B (2.5% COLA)	0	0	0
E. Other Division B (4% COLA)	0	0	0
IV. Public Safety Noncontributory			
A. State	0	0	0
B. Other Division A (2.5% COLA)	0	0	0
C. Other Division A (4% COLA)	0	0	0
D. Salt Lake City	0	0	0
E. Ogden	0	0	0
F. Provo	0	0	0
G. Logan	0	0	0
H. Bountiful	0	0	0
I. Other Division B (2.5% COLA)	0	0	0
J. Other Division B (4% COLA)	0	0	0
V. Firefighters			
A. Division A	0	0	0
B. Division B	0	0	0
VI. Judges	0	0	0
VII. Tier II - Hybrid Plans			
A. Public Employees	136	5	131
B. Public Safety and Firefighter	0	0	0
VIII. Grand Total	\$ 1,147	\$ 147	\$ 1,000

### Summary of Proposed Provisions:

- Increase the Board certified contribution rate due to legislative enhancements.
- Rural educators are permitted to return to work after 60 day separation by a different agency for a maximum of 5 years.  
Employers will contribute the full contribution rate on the payroll of these working retirees.
- Earnings limit for all working retirees who return to employment after 60 days and before 1 year following their retirement date from \$15k to \$17.5k.

## Exhibit 3

### 5th Substitute to HB 86 Impact on Unfunded Actuarial Accrued Liability and Funded Ratio by Fund Determined on an Actuarial Value of Asset Basis (\$ in thousands)

Fund/Division (1)	Unfunded Actuarial Accrued Liability			Funded Ratio		
	Current (2)	Proposed Legislation (3)	Increase (4)	Current (5)	Proposed Legislation (6)	Decrease (7)
I. Public Employees Contributory						
A. Local Government	\$ 48,655	\$ 48,685	\$ 30	89.8%	89.8%	0.0%
B. State and School	48,064	48,120	56	94.1%	94.1%	0.0%
II. Public Employees Noncontributory						
A. Local Government	572,485	573,199	715	87.0%	87.0%	0.0%
B. State and School	2,750,262	2,760,126	9,864	85.5%	85.4%	-0.1%
III. Public Safety Contributory						
A. State	250	250	0	99.5%	99.5%	0.0%
B. Other Division A (2.5% COLA)	2,949	2,949	0	97.7%	97.7%	0.0%
C. Other Division A (4% COLA)	394	394	0	98.5%	98.5%	0.0%
D. Other Division B (2.5% COLA)	63	63	0	99.8%	99.8%	0.0%
E. Other Division B (4% COLA)	282	282	0	96.6%	96.6%	0.0%
IV. Public Safety Noncontributory						
A. State	213,206	213,206	0	81.0%	81.0%	0.0%
B. Other Division A (2.5% COLA)	117,224	117,224	0	87.0%	87.0%	0.0%
C. Other Division A (4% COLA)	42,560	42,560	0	83.9%	83.9%	0.0%
D. Salt Lake City	84,679	84,679	0	73.1%	73.1%	0.0%
E. Ogden	17,879	17,879	0	75.1%	75.1%	0.0%
F. Provo	12,469	12,469	0	76.7%	76.7%	0.0%
G. Logan	6,258	6,258	0	79.2%	79.2%	0.0%
H. Bountiful	6,323	6,323	0	73.1%	73.1%	0.0%
I. Other Division B (2.5% COLA)	52,569	52,569	0	81.7%	81.7%	0.0%
J. Other Division B (4% COLA)	5,578	5,578	0	85.5%	85.5%	0.0%
V. Firefighters						
A. Division A	(195)	(195)	0	100.1%	100.1%	0.0%
B. Division B	18,035	18,035	0	97.9%	97.9%	0.0%
VI. Judges	35,489	35,489	0	81.6%	81.6%	0.0%
VII. Tier II - Hybrid Plans <sup>2</sup>						
A. Public Employees	(7,119)	(7,085)	34	108.7%	108.7%	0.0%
B. Public Safety and Firefighter	(1,234)	(1,234)	0	116.6%	116.6%	0.0%
VIII. Grand Total	\$ 4,027,125	\$ 4,037,824	\$ 10,699	85.5%	85.4%	-0.1%

#### Summary of Proposed Provisions:

1. Increase the Board certified contribution rate due to legislative enhancements.
2. Rural educators are permitted to return to work after 60 day separation by a different agency for a maximum of 5 years. Employers will contribute the full contribution rate on the payroll of these working retirees.
3. Earnings limit for all working retirees who return to employment after 60 days and before 1 year following their retirement date from \$15k to \$17.5k.