URS Fiscal Analysis of 2016 3rd 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, 3rd Substitute H.B. 86, Postretirement Employment Restrictions, has the following fiscal impact on URS:

<table>
<tr><th>Increase in unfunded actuarial accrued liability:</th><th colspan="2">Increase in annual cost for all participating employers:</th><th>Increase in contribution rates:</th></tr>
<tr><td rowspan="2">$196.3 million</td><td colspan="2">Total: $22.3 million</td><td rowspan="2">See Exhibit 1 for detailed information about the net contribution rate increases, but some examples are:
• Tier I Public Employees Noncontributory Retirement System, State and School Fund: 0.28% increase
• Tier I Public Safety Noncontributory Funds: increases ranging from .55% to 1.17%
• Tier I Firefighters' Retirement System:
o Division A: .86% increase
o Division B: 1.09% increase</td></tr>
<tr><td>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:
$7.1 million</td><td>Amount of the annual cost increase financed by increases to the employer contribution rates:
$15.2 million</td></tr>
</table>

If this legislation becomes enacted, there would be a $22.3 million 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 $196.3 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 normal cost rate portion and 80% of the amortization rate portion of the 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 $7.1 million of the total $22.3 million in increased annual cost. Exhibit 1 provides additional information by fund.

If enacted, this legislation would increase the actuarially determined contribution rate for the Noncontributory State and School fund, Fund 16, would increase by 0.28% to 22.47%. The contribution rate for the Tier II Public Employee Hybrid Plan would increase by 0.03%, 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. 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 particular bill 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 not be reemployed for at least 60 days from their retirement date and be reemployed by a different employer. 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 normal cost rate plus 80% of the amortization rate of the certified contribution rate to the Retirement System 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 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.

The proposed legislation would require the employers who hire retirees that utilize this exemption to contribute the normal cost plus 80% of the amortization rate. 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 would experience some increase in their contribution rates; even those employers that do not rehire retirees.

Because of the numerous funds and different employee types, URS maintains and communicates many different contribution rates to the participating employers. Specifying another contribution requirement that is just slightly different than the full contribution rate that is applied to the pay for this type of working retiree seems like an unnecessary administrative burden for URS. The different contribution rates will also create some confusion for the participating employers. Therefore, the actuary recommends that the proposed legislation would require employers to contribute the full contribution rate on these rehired retirees. This change would not have a fiscal impact, but shifts some of the cost to those employers who employ these types of working 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.

To model the anticipated change in retirement behavior, we have assumed that the normal retirement rates for state and local government employees would increase by 2% (i.e. add 2%) at each age below age 57 and increase by 4% at each age from 57 through 64. On the other hand, since historical return to work behavior was found to be more prevalent for public educators, normal retirement rates for this employee group were increased by 4% at each age below age 57 and increased by 6% at each age from 57 through 64.

Similarly, the retirement rates for public safety members were increased by 4% at each age under age 50 and increased by 6% at each age from 50 through 59. Finally, the retirement rates for firefighters were increased by increased by 1% at each age under age 50 and increased by 2% at each age from 50 through 59.

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. Due to Utah's high urbanization rate, the requirement for retirees to seek reemployment at a different agency in order to continue receiving their retirement allowance, will be a relatively low hurdle for most employee groups. Since there are numerous State agencies, often with several agencies operating within a single building or complex, retired State employees will have opportunity to find an employment position that satisfies this requirement. In application, retired city and county employees, including public safety officers and firefighters, will need to seek employment at a different municipality or county. The different agency provision could be slightly more problematic for school teachers since they will have to seek employment at a different school district. However, we also expect a majority of the retired school teachers can seek suitable employment that is within a 30 to 45 minute commute from their current residence.

Note, the different agency provision could be problematic for some employers because of the inability to utilize these retirees in the workforce to provide valuable services for certain essential tasks or projects. For instance, under these provisions, school districts would be unable to utilize recently retired teachers from their school districts as substitute teachers during the school year following the member's retirement.

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 3rd 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

Impact on Actuarially Determined and Board Certified Contribution Rates

Fund/Division	Actuarially Determined Contribution Rates: Current	Proposed Legislation	Total Increase	Offset from Contributions on Working Retiree Pay	Net Increase in Employer Actuarially Determined Rate	Applicable Board Certified Contribution Rate if Legislation is Enacted
(1)	(2)	(3)	(4)	(5)	(6)	(7)
I. Public Employees Contributory						
A. Local Government	11.49%	11.76%	0.27%	-0.05%	0.22%	**14.68%**
B. State and School	14.37%	14.73%	0.36%	-0.09%	0.27%	**17.97%**
II. Public Employees Noncontributory						
A. Local Government	15.50%	15.77%	0.27%	-0.05%	0.22%	**18.69%**
B. State and School	18.86%	19.22%	0.36%	-0.08%	0.28%	**22.47%**
III. Public Safety Contributory						
A. State	23.50%	25.29%	1.79%	-0.77%	1.02%	**30.72%**
B. Other Division A (2.5% COLA)	16.75%	18.45%	1.70%	-0.79%	0.91%	**23.66%**
C. Other Division A (4% COLA)	19.00%	21.05%	2.05%	-0.88%	1.17%	**25.50%**
D. Other Division B (2.5% COLA)	17.22%	18.74%	1.52%	-0.90%	0.62%	**22.91%**
E. Other Division B (4% COLA)	19.62%	21.35%	1.73%	-0.83%	0.90%	**29.85%**
IV. Public Safety Noncontributory						
A. State	35.12%	36.84%	1.72%	-0.77%	0.95%	**42.30%**
B. Other Division A (2.5% COLA)	28.12%	29.80%	1.68%	-0.79%	0.89%	**34.93%**
C. Other Division A (4% COLA)	30.42%	32.32%	1.90%	-0.88%	1.02%	**36.73%**
D. Salt Lake City	41.40%	43.32%	1.92%	-0.88%	1.04%	**47.71%**
E. Ogden	42.24%	44.02%	1.78%	-0.82%	0.96%	**49.64%**
F. Provo	37.18%	39.12%	1.94%	-0.87%	1.07%	**43.23%**
G. Logan	37.83%	39.90%	2.07%	-0.90%	1.17%	**43.09%**
H. Bountiful	45.84%	47.30%	1.46%	-0.75%	0.71%	**48.04%**
I. Other Division B (2.5% COLA)	27.73%	29.18%	1.45%	-0.90%	0.55%	**32.75%**
J. Other Division B (4% COLA)	30.18%	31.91%	1.73%	-0.83%	0.90%	**39.84%**
V. Firefighters[1]						
A. Division A	9.34%	10.42%	1.08%	-0.22%	0.86%	**16.39%**
B. Division B	9.06%	10.36%	1.30%	-0.21%	1.09%	**19.39%**
VI. Judges[1]	48.48%	48.48%	0.00%	0.00%	0.00%	**51.91%**
VII. Tier II - Hybrid Plans[2]						
A. Public Employees	7.99%	8.03%	0.04%	-0.01%	0.03%	**8.25%**
B. Public Safety and Firefighter	10.16%	10.56%	0.40%	-0.21%	0.19%	**10.86%**
VIII. Grand Total						

[1] These contribution rates are before reflecting offsets for insurance premiums and court fees.

[2] These rates for the Tier II Hybrid Funds exclude the Tier I amortization payment.

Exhibit 2

Increase in Annual Cost by Fund
($ in thousands)

			Impact on Annual Cost	
Fund/Division		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	$ 137	$ 31	$ 106
	B. State and School	110	37	73
II.	Public Employees Noncontributory			
	A. Local Government	2,515	513	2,002
	B. State and School	10,565	2,616	7,949
III.	Public Safety Contributory			
	A. State	3	1	2
	B. Other Division A (2.5% COLA)	47	12	35
	C. Other Division A (4% COLA)	6	3	3
	D. Other Division B (2.5% COLA)	1	0	1
	E. Other Division B (4% COLA)	4	2	2
IV.	Public Safety Noncontributory			
	A. State	1,876	992	884
	B. Other Division A (2.5% COLA)	1,881	1,022	859
	C. Other Division A (4% COLA)	628	328	300
	D. Salt Lake City	543	285	258
	E. Ogden	101	54	47
	F. Provo	101	53	48
	G. Logan	50	26	24
	H. Bountiful	27	15	12
	I. Other Division B (2.5% COLA)	789	574	215
	J. Other Division B (4% COLA)	81	43	38
V.	Firefighters			
	A. Division A	308	69	239
	B. Division B	1,156	200	956
VI.	Judges	0	0	0
VII.	Tier II - Hybrid Plans			
	A. Public Employees	790	93	697
	B. Public Safety and Firefighter	568	178	390
VIII.	Grand Total	$ 22,287	$ 7,147	$ 15,140

Exhibit 3

Impact on Unfunded Actuarial Accrued Liability and Funded Ratio by Fund Determined on an Actuarial Value of Asset Basis

($ in thousands)

		Unfunded Actuarial Accrued Liability			Funded Ratio		
	Fund/Division	Current	Proposed Legislation	Increase	Current	Proposed Legislation	Decrease
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
I.	Public Employees Contributory						
	A. Local Government	$ 48,655	$ 49,966	$ 1,311	89.8%	89.6%	-0.2%
	B. State and School	48,064	49,224	1,161	94.1%	94.0%	-0.1%
II.	Public Employees Noncontributory						
	A. Local Government	572,485	598,454	25,969	87.0%	86.5%	-0.5%
	B. State and School	2,750,262	2,856,872	106,609	85.5%	85.0%	-0.5%
III.	Public Safety Contributory						
	A. State	250	269	19	99.5%	99.4%	-0.1%
	B. Other Division A (2.5% COLA)	2,949	3,331	382	97.7%	97.4%	-0.3%
	C. Other Division A (4% COLA)	394	444	50	98.5%	98.3%	-0.2%
	D. Other Division B (2.5% COLA)	63	69	7	99.8%	99.8%	0.0%
	E. Other Division B (4% COLA)	282	314	32	96.6%	96.2%	-0.4%
IV.	Public Safety Noncontributory						
	A. State	213,206	229,468	16,262	81.0%	79.8%	-1.2%
	B. Other Division A (2.5% COLA)	117,224	132,492	15,268	87.0%	85.5%	-1.5%
	C. Other Division A (4% COLA)	42,560	47,924	5,364	83.9%	82.2%	-1.7%
	D. Salt Lake City	84,679	89,347	4,667	73.1%	72.0%	-1.1%
	E. Ogden	17,879	18,706	827	75.1%	74.3%	-0.8%
	F. Provo	12,469	13,357	888	76.7%	75.5%	-1.2%
	G. Logan	6,258	6,720	462	79.2%	78.0%	-1.2%
	H. Bountiful	6,323	6,511	187	73.1%	72.5%	-0.6%
	I. Other Division B (2.5% COLA)	52,569	58,117	5,548	81.7%	80.1%	-1.6%
	J. Other Division B (4% COLA)	5,578	6,214	636	85.5%	84.1%	-1.4%
V.	Firefighters						
	A. Division A	(195)	1,750	1,944	100.1%	98.9%	-1.2%
	B. Division B	18,035	26,095	8,060	97.9%	96.9%	-1.0%
VI.	Judges	35,489	35,489	0	81.6%	81.6%	0.0%
VII.	Tier II - Hyrbid Plans[2]						
	A. Public Employees	(7,119)	(6,756)	363	108.7%	108.2%	-0.5%
	B. Public Safety and Firefighter	(1,234)	(956)	278	116.6%	112.4%	-4.2%
VIII.	Grand Total	$ 4,027,125	$ 4,223,419	$ 196,294	85.5%	84.9%	-0.6%