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**On the Record Statement
Regarding the Legal and Practical Considerations of Closing
the New Hampshire Retirement System (NHRS)**

by Hank Kim, Esq.

Executive Director and Counsel

National Conference on Public Employee Retirement Systems (NCPERS)

Before the New Hampshire House Special Committee on

Public Employee Pension Reform

Submitted January, 27 2012

Introduction

Thank you for allowing my organization, the National Conference on Public Employee Retirement Systems (NCPERS), to submit this on-the-record testimony for your review.

The growing national debate over public pension funds has raised a wide range of concerns. Some of those concerns are justified, but many are not. In many instances, the current debate has generated much more heat than light. It is our hope that our testimony will shed much-needed light on the status of public pension plans and provide the Committee with up-to-date information on the legal and practical implications of closing NHRS. Given the contentious political climate that has put NHRS plans under unfair attacks, it is crucial that the New Hampshire legislature operate with full and accurate information and that they are evaluating that information in the proper context.

NCPERS is the largest trade association for public sector pension funds, representing more than 550 funds throughout the United States and Canada. It is a unique non-profit network of public trustees, administrators, public officials and investment professionals who collectively manage nearly \$3 trillion in pension assets. Founded in 1941, NCPERS is the principal trade association working to promote and protect pensions by focusing on advocacy, research and education for the benefit of public sector pension stakeholders. Further, NCPERS promotes retirement security for *all* workers through access to defined benefit pension plans.

In addition to serving as Executive Director and Counsel for NCPERS, I currently serve as a Trustee on the Fairfax County Uniform Retirement System, \$1 billion public employee retirement system providing pension coverage for the Fire & Rescue Department, Sheriff's Department, and certain other sworn employees of Fairfax, Virginia. I also served on the Morningstar Pension Endowments and Foundations Steering Committee and City of Virginia Beach Mayor's Committee on Employee Pensions. I have served on several Federal Advisory Committee Act (FACA) committees and working groups. I began my

career in the office of former Sen. Bill Bradley of New Jersey, where I worked on the Newborns' and Mothers' Health Protection Act (PL 104-204).

The Lessons Learned from Other States & Jurisdictions

Retaining a DB plan is likely to cost state and local governments less over the short term. The long-term cost savings of switching to a DC plan are uncertain at best. Pension benefits currently promised to state and local employees and retirees are protected by law. In New Hampshire, the courts have provided protection based on impairment of contract principles. Switching to a DC plan does not reduce the accrued DB plan benefits already earned by current employees.

When given the option to transfer from a DB plan to a DC plan, most employees remain in the DB plan. In some cases when new DC plans are established, current employees are given the option to transfer from the DB plan to the new DC plan. For current DB plan members who elect the DC plan, the value of the member's accrued DB benefit is often transferred to the DC plan. However, the vast majority of public employees remain within the DB plan.¹

Even when newly hired employees are required to join the DC plan, long-term cost savings for employers are uncertain and may take many years to be realized. To increase the number of employees who enter the DC plan, some governments have restricted the DB plan to current employees and have required newly hired employees to join the DC plan.² However, when a DB plan is closed to new hires, benefits continue to accrue to employees in the DB plan as a result of their service. To the extent that DB plan assets are lower than the accrued liabilities, unfunded liabilities remain. Because new hires are not entering the plan, the cost of funding the liabilities is spread over a declining number of active members.³ As a result, the employer's contribution rate is likely to increase as a percentage of covered payroll. In addition, since a growing portion of plan assets must be used to pay benefits, a larger share of the assets would likely be held in short-term securities, thereby reducing investment returns.

- For example, the Los Angeles County Employees Retirement Association estimated that the county's DB plan contribution rate would increase by 3.66 percent if new employees were required to join a DC plan. This scenario would have increased county

¹ Mark Olleman, "Public Plan DB/DC Choices," *PERiScope*, January 2009.

² National Association of State Retirement Administrators, "Overview of Plan Types," <http://www.nasra.org>. Of the 14 state retirement systems discussed in this paper, only two (those of Michigan and West Virginia) required newly hired employees to join the DC plan. The remaining systems offered DC plans as a voluntary alternative to the DB plan or offered a new plan that combined DB and DC plan features.

³ Governmental Accounting Standards Board, Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* (Norwalk, Conn. : Governmental Accounting Standards Board, 1994), 7. In situations where a DB plan is closed to new members and unfunded liabilities are amortized as a level percentage of projected payroll, the payroll growth rate should include projected decreases in the number of active plan members.

contributions to the closed DB plan by \$206 million in 2008. Although the contributions would have gradually declined over time, the county would have had to wait a dozen years to see any savings in DB plan costs as a result of the change.⁴

DC plans are costly to establish and maintain. Overall, a DC plan must be designed, vendors must be selected, the plan's operation must be monitored, and employees must be informed about plan features and available investments. Staff time is spent throughout this process, and the sponsoring government must pay legal and consulting fees. If a third-party administrator is not hired to operate the plan, the government must do this task as well. Even if a third-party administrator is hired, the government will still have operating costs related to the DC plan, possibly ranging in the millions of dollars.

- For example, the budget for the State of Florida's DC plan, established in 2000, totaled \$89 million from FY 2001 through FY 2004. This total included \$55 million to educate Florida's 650,000 government employees about the new plan.⁵

In several cases, states have replaced DC plans with DB plans because of the inadequacy of plan benefits or increased costs.

- The North Dakota Public Employees Retirement System was originally established as a DC plan in 1966. In 1977, it was changed to a DB plan to provide adequate retirement benefits and to assist the state in attracting and retaining quality employees.⁶
- In 2000, the State of Nebraska reviewed its two DC retirement plans for state and county workers. It found that between 1983 and 1999, the DC plans' investment returns averaged only 6 percent, compared with 11 percent for the state's DB plans. Recognizing that these returns were inadequate to sustain retirement benefits, the state responded by creating a new hybrid DB plan for state and county workers.⁷
- In 2005, the West Virginia legislature passed a law allowing teachers in the Teacher's Defined Contribution (TDC) Plan (created in 1991) to transfer into the State Teachers' Retirement System, a DB plan, effective upon approval by TDC plan members. According to the West Virginia Consolidated Public Retirement Board's actuary, the change would save the state \$1.8 billion over 30 years, because lower employer contributions would

⁴ Los Angeles County Employees Retirement Association, "Proposals to Close Public Defined Benefit Plans," <http://www.lacera.com/archives/archivesHome/ProposalstoClosePublicDefinedBenefitPlans.html>.

⁵ Information provided by the Pension Protection Coalition, based on an analysis of the Florida Public Employee Optional Retirement Program's approved budgets and revenue collections. The analysis was done for the Coalition by the law firm of Olson, Hagel & Fishburn, LLP, January 18, 2005. The budgeted amounts exclude investment management fees paid by plan participants. Used with permission.

⁶ North Dakota Legislative Council Employee Benefits Program Committee, "Public Employees Retirement Programs – History," October 1998.

⁷ Anya Sostek, "Pension Pendulum," *Governing Magazine*, March 2004, 28.

be required for the DB plan (4.34 percent of payroll) than for the DC plan (7.5 percent of payroll).⁸ State teacher representatives also indicated that the change would help prevent teachers from leaving their jobs.⁹ In 2008, more than 78 percent of the TDC members voted to transfer to the DB plan.¹⁰

Tax Qualification Issues

Except for certain grandfathered plans, a governmental plan is not generally permitted to adopt a 401(k) feature (i.e., a cash or deferred election with respect to contributions, accruals or other benefits). Treas. Reg. section 1.401(k)1(e)(4)(i). However, a one-time irrevocable election by an employee to participate or not to participate in the plan is not a cash or deferred election, so long as such election is made when the employee first becomes eligible to participate in a plan of the employer. Treas. Reg. section 1.401(k)-1(a)(3)(v). Accordingly, the portion of LSR 12-2876.1, proposed RSA 100-E:3, that makes membership in the DC Plan "optional in the case of elected officials, unclassified state employees appointed for fixed terms, or full-time employees of the general court" raises concerns. A "one-time irrevocable election" must be made upon an employee's becoming eligible under any plan of the employer. Therefore, an employee who is currently, or was previously, a member of the retirement system would not be eligible to make a one-time irrevocable election to be covered under the proposed defined contribution plan.

America's Retirement Crisis

While budget and revenue shortfalls have prompted officials at all levels of government to take a close look at public pensions systems, we believe that their focus is too narrow. The fact is that while the vast majority of public pension plans are healthy and sustainable, they provide retirement benefits to only a fraction of American workers.

The U.S. is facing an overall retirement crisis. Our ability as a nation to sustain our economy at a time when a record number of workers are entering their retirement years should be an important part of our national debate. Retirement security for *all* Americans – whether the work in the public or private sector – must become a national priority.

The truth is that for more than 100 years, public pension plans have been the most economically efficient means of delivering retirement benefits. Another inescapable truth is that until the 1980s benefit pensions were common in the private sector. Workers knew that with their pensions, Social Security and their own savings like a 401(k), they could retire with dignity.

⁸ Justin D. Anderson, "State: Reviving Teacher Benefit Plan Will Save Money," *Wheeling News Register*, June 21, 2005.

⁹ Jim Wallace, "Teacher Pension Bill Has Hurdles," *Charleston Daily Mail*, March 31, 2005.

¹⁰ Walt Williams, "Teachers Rack Up Enough Votes to Switch Systems," *State Journal*, June 5, 2008.

Today, there's an \$8.5 trillion retirement savings deficit and the 75 million baby-boomers who are nearing retirement are unlikely to have enough retirement assets. It is our hope that as the New Hampshire legislature looks at the functioning of NHRS, they and other policymakers will see that public pension plans provide ample evidence of how effective retirement systems can and do work – and that they provide a strong model for addressing America's retirement crisis and providing retirement security for all.

NCPERS stands ready to assist New Hampshire policymakers with facts, research, and expertise as they delve into policy discussions on retirement security. We invite this committee to contact us should you need additional information.

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