

## Retirement Board

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September 4, 2008

Mike Alastuey  
Director, Public Policy and Analysis  
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10100 West Charleston Blvd., Suite 200  
Las Vegas, Nevada 89135

*Delivered as PDF via email*

Dear Mike:

This letter is in response to your request for my review of the draft study prepared by Applied Analysis for the Las Vegas Chamber of Commerce regarding Nevada PERS. I have had only a short period of time (approximately 24 hours) to review the report given the timeline you indicated to me on the telephone. I will restrict my comments to the most significant areas for comment, given the limited time available.

### Employer Pay

First and foremost—the continued characterization of the Employer Pay contribution plan as a plan where the cost of funding a public employee's retirement benefit is born 100% by the employer is incorrect, based upon statute and implementation. This mischaracterization is seen throughout the report and in the comparative charts supplementing the report as well (Pages 1, 7, 8, 9, 10, 11, 12, 13, 15, Exhibit III, Exhibit III-A, Exhibit IV, Exhibit IV-A, Exhibit V, Exhibit VI, Exhibit VII). If the employee's portion of the cost was recognized in these exhibits, Nevada's contribution rate would rank near the bottom (10.25%)—instead of the report's characterization as one of the highest contribution rates (20.5%).

NRS 286.421(3)(a) states quite clearly:

*Payment of the **employee's portion** of the contributions pursuant to subsection 1 must be:*

- (1) Made in lieu of equivalent basic salary increases or cost-of-living increases, or both or*
- (2) Counterbalanced by equivalent reductions in employees' salaries.*

I understand that this cost sharing mechanism is acknowledged in passing within the report (pages 7, 11, 14) but then appears to be abandoned when national comparisons are

made and in the body of report to indicate that the “Employer Pay” contribution plan is one of the highest in the nation.

The introduction of “Employer-Pay” in the 1970s was done for one reason: removing refundability of contributions to the employee made financing the program **less expensive** (the cost of refundability varies but typically falls between .75% and 1% of covered payroll). It was never designed nor has it been implemented as employer “pick up” (a term which has specific meaning under the Internal Revenue Code) or to require the employer to shoulder 100% of the burden of financing retirement for public employees.

The offsetting advantage for the employee to the removal of refund for the employee was the tax deferred status of the employee’s part of the contributions. (*As an aside: it was not an argument that was easily won—since litigation has prevented mandatory imposition of employer-pay, See SNEA vs. Keating, 903 F.2d 1227 9<sup>th</sup> cir. (1990)*). Reduction in taxable wage often results in slightly higher take-home pay to the employee, because of the tax advantage—not unlike what you see today with respect to an employer’s use of IRC section 125 cafeteria plans to finance health care premiums. True “employer pay” (with no cost sharing to the employee) is only available for local government elected officials and members of the judiciary. *See NRS 286.421 (3)*.

Every employer, from the beginning of the program, has certified that the cost sharing mechanism has been implemented, with every rate change. Over 1900 employer certifications for employees to bear **half** the cost of financing their retirement benefits attest to the direct cost sharing mechanism. Local government employers, over time, have used both salary reduction and the lieu of salary increase method for cost sharing to the employees. The trend for our largest public employers in the most recent period has been use of the salary reduction method.

The State as a participating employer is perhaps the easiest illustration of the **equal sharing** nature of the contribution cost. Since inception of the program for the State (implementation dates vary due to litigation and other issues), the State used the second method for contribution rate cost sharing for its employees (*counterbalanced by equivalent reductions in employees’ salaries*). With original implementation and with each subsequent contribution rate increase (and for that matter-sharing back to the employee when rates decrease), employees of the State, participating in employer pay, have seen a direct salary reduction (or increase) equivalent to half the change in the contribution rate. The State maintains two salary schedules that reflect the lower salary for employees under employer pay (the *tax deferred* contribution plan) and a higher salary for those participating under the employee/employer plan (the *after tax* contribution plan). Regardless of the contribution plan, employees shoulder their responsibility quite clearly.

The cost sharing mechanism also translates into investment risk sharing, as well. The report indicates that the employer solely bears the risk of investment losses (Pages 2, 4, 12). While this statement is incorrect, the report correctly describes the mechanism for which investment losses are absorbed in the contribution rate. Since losses are paid for through payment on the unfunded liability (as a level percent of payroll--part of the contribution rate) employees are equally exposed to investment volatility. This risk sharing to the employee is one of the reasons that the Retirement Board is quite diligent in managing investment risk within given market constraints.

**The only time** the investment risk would be born solely by the employer—is if the plan were to be terminated (voluntarily by the Sponsor) and payment on the unfunded liability accelerated to lump sum. Closing the funding gap immediately (in contrast to the level percent of payroll that is shared by the employee under the current contribution process) would be required to fully pay the contractual nature of the benefit.

Every national comparison of the Nevada “Employer Pay contribution plan” in the report which uses 100% of the rate as solely paid for by the employer is open to clear criticism that it does not acknowledge the employee’s participation. Employee participation has been intended-**and implemented**-since the passage of “Employer Pay” as a contribution plan alternative.

I will conclude my comments on the mischaracterization of “Employer Pay” by reviewing history from the inception of the program. It is interesting to note that one of the arguments against the move to “Employer Pay” in 1979 was that ‘...*it would create the impression that the employee has made no contribution when in fact the employee will have taken a 7.5% reduction in salary.*’ From 1979, until today, this argument seems almost prophetic in nature.

**Other commentary:**

**Page 2:** The discussion related to the ratio of active members to retirees implies a weakening of the financing of the retirement system over time. While this ratio is very important to a system such as Social Security where today’s generation of active taxpayers pays today’s generation of retirees, it is less significant in a funded program such as Nevada PERS where contributions are invested today to pay for the benefits of current active employees. Funded systems use the power of investments to finance benefits and contributions are the foundation of those investments.

**Page 14:** The report makes no analysis of the cost of conversion to a defined contribution plan yet broadly concludes (without citation) that it is difficult to conceive a scenario in which the State would be placed in a worse financial situation prospectively as a result of such a

change. Does this analysis include plan termination? Closing the current plan to new hires (which will immediately affect costs of the closed plan)? I disagree with the conclusion based upon clear monetary implications for members left in any closed plan or for the potential for accelerated payment on the unfunded liability. There is significant cost to such a conversion to the employers, employees and taxpayers. The State of Alaska saw significant increases in contribution percentages in the closed plan after new hires were defaulted into the new defined contribution plan. The State of Nebraska recently moved to modify their defined contribution plan to look more like a defined benefit plan due to a study of adequacy of retirement preparedness that showed significant numbers of public employees without any retirement security.

**References to Social Security-** The GPO and WEP offsets only occur in non Social Security pension plans (such as Nevada). Although only seven states do not participate in Social Security, numerous local teacher and public safety plans also do not participate. The number of employees not covered by Social Security is high-8 to 9 million.

- The chart on page 10 of the average benefit for a Social Security state does not include the average Social Security benefit which would be available (with no offset). Combining benefits with Social Security is how these states make a suitable replacement ratio for their employees in retirement.
- The reference to risk sharing with the Social Security Administration is unclear on page 12—Social Security for public employees carries a significant cost to the employer and employee. The report appears to conclude that movement to Social Security for public employees would somehow save money. I disagree and the point is made clearly on Exhibit VII where you show the combined total contributions necessary to pay for retirement. Virtually every state that participates in Social Security has a higher percentage total combined contribution to fund retirement benefits than Nevada.

**Chart of benefit calculation** (page 6). This chart is very misleading as it assumes 30 years of accumulation of service credit at 2.67%. Since this multiplier has only been in place since July 1, 2001, any person with service credit calculated solely at 2.67 % for 30 year is necessarily capped by the 75% limit on replacement income.

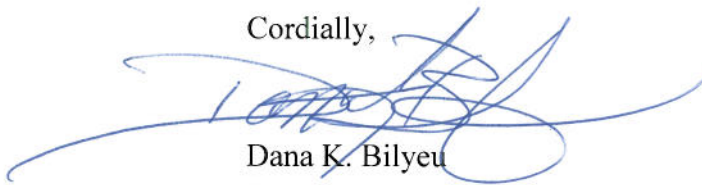
**Reported return number** (Page 7) Please insert the word “actuarial” before “return on investments.” This figure (9.6%) differs from market return for the same period due to the application of actuarial methodology.

**Payment on the Unfunded Accrued Actuarial Liability (UAAL)-** (Page 13) Your discussion of the payment of the UAAL seemed to conclude that the Board “manages” but will not entirely pay off the UAAL. That is not correct. The most significant piece of the UAAL is in year 27 (approximately \$4 billion) and will be paid off in 27 years. The purpose of the layer closed amortization schedule is to insure that each generation of **employees and employers** pay for unfunded liabilities caused during their active employment period. For example, if a market

event that causes an investment loss happens in 2023, it is assigned its own financing period so that employees, then working, will share in the cost. This approach provides much greater predictability to employees and employers in the cost of the retirement plan over the course of the employment period. Once the initial UAAL is paid, gains and losses are expected to be offsetting in later years (in some years they will be positive and in other years they might be negative). The goal is to move towards 100% financing, with the least amount of volatility in the contribution rates as possible.

I understand your time constraints, and hope these comments are helpful.

Cordially,



Dana K. Bilyeu  
Executive Officer  
NVPERS

C: Retirement Board