[LR210]

The Committee on Nebraska Retirement Systems met at 10:00 a.m. on Tuesday, November 22, 2011, in Room 1525 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on LR210. Senators present: Jeremy Nordquist, Chairperson; LeRoy Louden, Vice Chairperson; Lavon Heidemann; Russ Karpisek; R. Paul Lambert; and Heath Mello. Senators absent: None.

SENATOR NORDQUIST: (Recorder malfunction)...Kate Allen is our legal counsel. To my far right is Laurie Vollertsen, our committee clerk. Emily and Ben our pages today and I'll let each senator go around and introduced themselves, starting to my far right.

SENATOR MELLO: Heath Mello, state senator, District 5.

SENATOR KARPISEK: Russ Karpisek, District 32.

SENATOR LAMBERT: Paul Lambert, District 2.

SENATOR NORDQUIST: Great. Thank you, gentlemen. Thank you for showing up. Just a reminder for the audience, please silence your cell phones. We have three kind of topics we're going to push through here. First will be our annual actuarial study and a discussion of the 30-year modeling projections that we have with the actuary, then we will have Sue Alt from the Social Security Administration come and talk about 218 Agreements and the referendum process for opting into Social Security, and then finally Kerry Eagan with Lancaster County to discuss some proposed legislation that they would like to approach the Legislature on. If you would like to...well, probably after we have the folks open, it will kind of be open comments. We won't really have a positive or a...or proponents, opponents. It will just be open discussion at that point. So with that, I will invite up Dave Slishinsky with Buck Consultants to walk us through this year's annual report and the 30-year model. Thank you.

DAVE SLISHINSKY: Thank you, Mr. Chairman, members of the committee. My name is Dave Slishinsky and I'm a consulting actuary with Buck Consultants. We perform the actuarial valuation work and study work for the Nebraska employees retirement...Public Employees Retirement Systems, and each year we do an actuarial valuation. And just a brief description of what that is, it's a snapshot of the calculation of the benefit obligation. Sometimes we call that the value of the benefits, the pension liability, or the present value of benefits. We collect a lot of information in order to do these calculations. We collect information on all members of the system, all active members, all members that have terminated and have not yet begun receiving benefits, and also all retirees and beneficiaries. We take that information, and using the information on the benefit structures defined in state statutes, the contributions in state statutes, and the amount of the pension plan assets, we project forward the amount of the benefits that are expected to be paid, discount those back to the valuation date, and then compare that to the assets, as well as the statutory contributions, and determine whether or not those contributions are sound or whether or not there need to be additional contributions made in order to meet the funding requirements also defined in statutes. So that's basically the process. So these results are a snapshot in time. We do that at the beginning of each fiscal year, as of July 1, so these results that we're going to be discussing with you today are measurements as of July 1, 2011. We'll look at what changes have been made since the last actuarial valuation was performed in 2010, provide some information on historical information, also go through those actuarial results, and we'll look at some projections as well. And at any time that I'm going through this information, please feel free to ask questions. If there's something that you don't understand as we're talking about it, just go ahead and raise the question. Okay, with regards to changes, there were changes in the contribution rates for the school retirement system and the State Patrol Retirement System. LB382 increased the member contribution rate from 8.28 percent of pay to 8.88 percent of pay for those contributions made from September 1, 2011, to August 31, 2012. And then those contribution rates increase further to 9.78 percent from September 1, 2012, through

August 31, 2017. The member contribution rate at that point in time then drops back down to 7.28 percent, the level that it was before a series of increases that were made to that rate. It should be noted that the employer contribution rates remain at 101 percent of the member contribution rate, so as these member contribution rates are increasing so are the contributions of the employers, the school districts for which the members are employed. There's also a state contribution that has been .7 percent of pay each year. That was increased a while back to 1 percent. Another change that was made during the last legislative session was to extend that 1 percent from 2014 to 2017. On the State Patrol Retirement System, contributions of the members and the employer, thereby the state, were increased from 16 percent to 19 percent. Now these are matching contributions so the members currently are contributing 19 percent and the matching employer contribution is 19 percent, for a total of 38 percent; and that those contributions are for the period of July 1, 2011, through June 30, 2013, at which point in time they drop back from 19 down to 16 percent matching contributions. So those are the changes that were made in this year's valuation versus last year's valuation. There were no other changes made to the benefit structures of the plans. Now a little information on the investment and return, would like to show you is that the return on the assets of the trust funds for the year ending June 30, 2011, were very strong. The market value return was 23.3 percent and you can see that with looking at the end of the red line. That last dot is for 2011; that previously it shows the rates of return for each year from 1998 through 2011. What I like to do is I like to show this graph that shows the history of what the investment returns have been on the pension fund and compare the returns on the actual assets at market value with what we're assuming, the assumed valuation rate in the actuarial valuations, as well as the actuarial value of assets. Now when we perform the actuarial valuations and we determine whether or not there's an unfunded liability, we determine that based upon the actuarial value of assets, not the market value. What we do with the actuarial value of assets is we smooth any market returns above or below our assumption over a five-year period. We do this to smooth out the peaks and valleys of the returns that you find in the market value, so that when you look at this chart and you look at the red line you see how jagged it is. It jumps up and it jumps down. There's a lot of volatility in the investments of pension funds so we use a smooth basis whereby each year we determine the amount of returns that are either above or below our assumed rate of 8 percent. That amount is identified and it's recognized over a five-year period beginning with the valuation date. So 20 percent of those gains from 2011 are recognized this year in this valuation and 80 percent of those gains are deferred for the next four years so that each year 20 percent more of that will be recognized. That's important to note because of the size of the investment gains this year of 23.3 percent. Just to give you a sense of the dollars involved, for the school system that was a gain above the 8 percent that resulted in $905 million added to the pension fund, so that's a significant increase versus last year and we'll see the impact that that has on funding over the five-year period in our projections. You look at the...the next graph shows the actual history of the amount of the assets for both market value of assets and the actuarial value of assets. Here again what I like to do is I like to look at each of these lines separately. Looking at the red line, which is the market value of assets, you see the value of those assets have grown from 1996, when it was about $2.5 billion, to the amount that it is today, a little over $7 billion, about $7.3 billion. When you look at that red line you see that it jumps around a little bit. There was a period of time from 1996 through 2000 where the red line was above the blue line. The blue line is the amount of the actuarial value of assets that's used for funding. We use that value to determine the amount of unfunded liability. We amortize that unfunded liability. It becomes part of the annual contribution rate. So in the late '90s the markets were doing well and the value of the market value was above the actuarial value. Then from 2000 to 2002 there were losses experienced during that period of time because the market was performing poorly and the value of the market value was below the actuarial value. And then the market value increased above the actuarial value because during the period 2003 through 2007 was a good period for the markets, and then the economic crisis in 2008 and 2009 seriously impacted the value of the pension fund assets. And the extent to which there are gains or losses has an impact on the direction of the growth in the actuarial value of assets, but it's still being smoothed. So for instance, if you look at the blue line from 2008 through 2011, it's fairly flat and the losses that were experienced during the 2008 and 2009 economic crisis, those losses are being recognized slowly in the actuarial value of assets, pulling those gains on the actuarial value down. So that's why you see that those amounts are fairly level. But the values now of market and actuarial value are fairly equal. And the next page shows the amount of the deferred asset gains and losses. These are the amounts that have been recognized immediately in the market value of assets but have not yet been recognized in the actuarial value of assets. So we can kind of see the transition from a period where there are deferred gains to periods where there are deferred losses. In the late '90s there were deferred gains; the early 2000s there were deferred losses; mid-2000s, deferred gains; and now what we've been doing is we've been deferring losses. It's interesting to note that 2011, it's not that we forgot to put that one in, it's just that it is so small it's virtually zero. Okay, now I'll go through the actuarial valuation results, first starting with the school system. What I would like to do on the school system is I would like to just run through the development of the actuarial value of assets and how that's calculated. The other two systems are very similar to this, the judges and the State Patrol system, so I'll just go through the school system assets and you'll get the sense of how we do this. And there's a comparison with last year's development, but I'm going to focus on this year's development. For June 30, 2011, we start with the amount of the actuarial value of assets at the beginning of the fiscal year. So as of July 1, 2010, the value was $7,041,000,000 and we roll that forward with cash flow. So we add to it the contributions that were received for the year of $296 million. We deduct the amount of the disbursements that are being made, these are the pension payments that are being made to retirees and beneficiaries as well as refunds of contributions, of $351 million. And then we add in an expected return on the market value. Our expected return rate is 8 percent, and this on the market value, and that's $474 million. So we come up with a preliminary actuarial value that rolls forward the beginning of the year amount to the end of the year with cash flow and expected return to get $7,460,000,000 as our preliminary value. And then we recognize the amounts of the deferred gains and losses for the year to make an adjustment to that preliminary value, recognizing the smoothing amounts which was a net loss amount of $193 million, to arrive at our final actuarial value of $7,267,000,000. That compares to a market value at the end of the year of $7,264,000,000 or only $3 million. [LR210]

SENATOR NORDQUIST: Just the prior year we were looking at a, on the five-year smoothing, a negative $347 million, so even though we included an additional year, the losses, the gains of the last year is the reason for that being significantly smaller? [LR210]

DAVE SLISHINSKY: Yeah. Correct. [LR210]

SENATOR NORDQUIST: Okay. [LR210]

DAVE SLISHINSKY: There's a previous year that drops off and then we add in the current year. So you'll see that the five-year smoothing adjustment for this year is less than last year. A lot of that is because of the gain that was experienced this year being recognized in this value. [LR210]

SENATOR NORDQUIST: Okay. All right. Thank you. [LR210]

DAVE SLISHINSKY: Yeah. And also you look at the future smoothing amount. Last year that amount was $1.1 billion of losses last year. You think about the 2008-2009 economic crisis and the impact on the pension fund, the amount of the loss that was experienced in 2009 in the school retirement system was almost $1.8 billion, and that $1.8 billion is recognized over five years and that's...that means that at least over $300 million each year is still being recognized and there's two more years to go on that. There's two more years to recognize that amount and there was a previous...the year before that also was a loss and there's one more year there. And what we see in the projections, and we'll get to that, is that there are...with those gain...with those losses being recognized over the next two years, there's still an expectation that the actuarial value of assets will not meet the 8 percent return, causing additional losses that increase the unfunded liability. And when the unfunded liability increases, the amortization payment to pay that off increases, so the contribution rate increases. But once those losses are fully absorbed then there's two years of gains, which will act to reduce the unfunded liability. So right now there's almost a wash but there's an expectation that the next two years there's still going to be an increase in the unfunded, basically, and then two years after that will decrease. All right? Now to get to the development of the actuarial calculations and the amount of the actuarial contribution. We use the entry age actuarial cost method, and that's a method that determines what we call a normal cost, which is the cost of the accruing benefits, and it's calculated in such a way that it's intended to be level as a percentage of pay. So each year we'll calculate the normal cost and it will remain relatively level from one year to the next. We start with, as I said before, the calculation of the present value of all of the future benefits for all the actives, inactive vested members, and retirees and beneficiaries. Those projected benefits, discounted back to the valuation to get the value, is about $10.6 billion. Amount of that expected to be paid in the future from the normal cost amount from the cost of the accruing benefits going forward based on future service is a little less than $1.6 billion. So we have an accrued actuarial liability, as of the valuation date, of about $9 billion. The amount of the assets developed for actuarial purposes is $7,267,000,000, so that difference is an unfunded liability of $1,773,000,000. Now that amount is amortized over a 30-year period. The funded ratio is the ratio of the assets to the accrued liability. If that ratio is less than 100 percent, it means you're behind in funding and have an unfunded liability. If that amount is over 100 percent, then you're ahead in funding and actually have a reserve or negative unfunded. Now obviously over the past few years, because of those losses that have been experienced, the amounts are unfunded and lead to an additional contribution required to amortize the unfunded liability. So in developing the annual actuarial contribution, we take the amount of the normal cost, which is calculated to be $187 million, and that's the cost of the accruing benefit for active members, and we amortize the unfunded liability over 30 years, and the process that we use is we develop the unfunded each year. The amounts of the changes each year are set up separately and amortized over 30 years. All previous years' amounts are amortized over the 30-year period from the time in which those amounts were determined. And this year those amounts are $156 million of amortization payments to pay off the unfunded for a total actuarial contribution amount of $343 million or 20.45 percent of pay. That amount is an increase over last year of about 1.24 percent of pay with the increase in the unfunded liability. The expected contribution coming in from member contributions, employer contributions, and state appropriations is $319 million. Because that amount, which is 19.05 percent of pay, is less than the annual actuarial contribution, the additional amount is shown as an additional state contribution of $24 million or 1.4 percent of pay. Our calculations also include state funding required for the Omaha service annuity that is funded through the Nebraska Retirement System of about $1 million. Now for the State Patrol Retirement System, same process. On all three of these systems we use the same methodology and the same amortization policy. So we start with about $400 million in benefits for the State Patrol system, the future normal cost payments are about $60 million, so we have an actuarial accrued liability of about $340 million. The actuarial value of assets is up slightly from last year, up from $273 million to $279 million. So the unfunded liability this year is just a little bit over $60 million and that's up almost $12 million from last year due to the asset losses that are being recognized in coming to the actuarial value. The annual actuarial contribution amount, the amount of the normal cost was $7.3 million this year versus $7.4 million last year. There are a few less active members this year so that's why the normal cost rate is down a little bit. The amortization payment is $5.3 million this year for a total annual actuarial contribution of $12.6 million or 47.81 percent of pay. Actual contributions coming in, and this includes the increase to 19 percent matching from the employees and the state, is $10 million with some additional appropriations of $300,000, for a total contribution coming in of $10.3 million or 39.2 percent of pay. That is less than the calculated actuarial annual contribution, with an additional amount required of $2.3 million or 8.61 percent of pay. On the Judges Retirement System, the calculation of the present value of future benefits is about $153.7 million, the value of future normal cost payments will be about $25.4 million, so the actuarial accrued liability for the year is $128.3 million. By subtracting the actuarial value of assets of $125.2 million, we arrive at an unfunded liability this year of a little over $3 million. That compares to a reserve that we had last year of $97,000. Funded ratio is 98 percent. It's the ratio of the assets to the accrued liability. Last year it was virtually 100 percent, so a little bit of a drop also in the funded ratio of the judges' plan. The annual actuarial contribution amount, the normal cost is about $3.8 million, amortization of that $3 million unfunded is $267 million...$267,000, excuse me, for a total contribution of $4.1 million or 22.56 percent of pay. The expected contribution coming in from the rate-of-pay contributions from the members and court fees that are collected, the member contribution is about $1.3 million and the court fees are about $3.5 million, and some appropriations of $72,000 coming in to arrive at a total contribution of $4.9 million. So since that contribution is in excess of the actuarial contribution, there's no additional contributions required for the judges' system this year. Now just to review calculations that were presented to the PERB in April of this year on the state and county cash balance funds, just to update you, those valuations are performed January 1 each year and these are the results of those valuations. For the state cash balance plan, the present value of benefits was about $1.1 billion with future normal cost payments of $374 million, so there's an actuarial accrued liability of about $763 million with a value of assets of $714 million. So there was an unfunded liability of $48.6 million in the state cash balance plan and it's 94 percent funded. The normal cost payments are $46.3 million, and an amortization of that unfunded if $4.4 million. So the total contribution, actuarial contribution, was $50.7 million or 11.28 percent of pay. The amount that's coming in, the statutory contribution rates for employees of 4.8 percent and matching employer contributions at 156 percent of the member contribution of 7.49 percent means that there's total contributions coming in of 12.29 percent of pay. Since that exceeds the amount of the actuarial requirement, there's no additional contributions required for the state cash balance plan. For the county cash balance plan, the benefits are roughly $405 million, value of future normal costs of $184 million, so there's an accrued liability of $221 million. The actuarial value of assets is $206 million, so there's an unfunded of $15 million. The funded ratio was 93 percent, down 2 percent from last year. The annual actuarial contribution then on the normal cost is $17.9 million, and the amortization of the unfunded is $1.4 million, for a total contribution of $19.3 million or 10.47 percent of pay. Now the contribution rates are slightly different than the state cash balance. The employees are contributing on a weighted basis 4.67 percent and the employer is contributing 150 percent of the member contributions, or 6.92 percent. That total is 11.59 percent, and since that amount is greater than the actuarial requirement there are no additional state contributions required for that plan either. Now what I'd like to do is just make a few concluding remarks on these valuations and what we've just seen. The rate of return on the market value of assets this year was very strong. It was about 23 percent or 15 percent greater than what we're assuming. So as a result, there is a significant gain on investments recorded for this year; 20 percent have been recognized in this year's valuation, which means 80 percent will be recognized over the next four years at 20 percent per year. However, the recognition of the losses from 2008-2009 are still being recognized and, as a result, the increase and the rate of return on our actuarial value of assets was only 4 percent. And since the 4 percent was less than the 8 percent, it's still creating a loss for the actuarial purposes this year. For the school, State Patrol, and the judges' system, the actuarial value is about 100 percent of the market value, so that means that the net future deferred gains and losses is zero. The amount...the percentage of actuarial value to market value last year was 84 percent, so actuarial value was 16 percent greater than market value. There's only small net losses of $4.9 million on all three of these systems to be recognized in the future. The funded ratios have decreased. You know, because of the losses still being recognized from 2008 and 2009, a school system's funded ratio is down 2 percent, from 82 down to 80 percent. I think I should comment that when you compare Nebraska's system with other systems around the country, this average is probably anywhere between 65 and 75 percent around the country. So to be even 80 percent funded right now, you're funded better than average of the average state systems out there. State Patrol system decreased from 85 down to 82. We've seen generally about a 2 percent reduction in the funded ratios, with the exception of the state cash balance plan, which remained at 94 percent. The contributions in court fees were sufficient to meet the actuarial requirement for the judges' plan for this plan year. Additional contributions were calculated for the State Patrol and for the school retirement system. The recognition of investment losses experienced during the economic crisis are really the reasons why there's still an increase in the unfunded liabilities this year and an increase in those contribution rates. And our net deferral over the next four years is zero, so what that really means is that there's an expectation that long term the contribution rates will still remain at this relatively high level until the unfunded liability is amortized. Now there is an experience analysis that is scheduled for early next year that we'll be performing, so what we'll do in that analysis is we'll look at all of the assumptions that we're using right now, the economic assumptions that include inflation and the expected long-term rate of return on assets, that 8 percent that we're using now. We'll also review all of the demographic assumptions, including the mortality tables and the expected...the life expectancy amounts that are used in determining the values of the benefits being paid. Now what I'd like to do is run through some projections that we've run on all of these systems just very briefly. On some of these systems we do a five-year projection. We have developed a 30-year projection model for both the school and the State Patrol systems and we'll look at some of those results as well. But just real briefly, in the state cash balance plan during the next five years we're still projecting that there will be no additional state contributions through 2016 required. Now this is based, and I have to preface this, this is based on all of our actuarial assumptions being met. So this includes recognition of any prior losses but assumes that there are going to be no gains or losses experienced from the valuation date, which was January 1, 2011, through this projection period. Obviously, if there's any significant investment losses that occur on any of these plans, those would be additional losses that would increase unfunded liabilities and increase contribution requirements. The same is true for the county cash balance plan. If the expected return on the assets is earned over the projection period, then we're projecting no additional state contributions be required in the county cash balance plan either. On the Judges Retirement System there's no additional state contributions projected through 2013, and then 2014 there's a reduction in the amount of the court fees collected. The court fee amount from...reduces or is reduced from $6 per case to $5 per case in 2014, so that's the reason why the expected court fees are being reduced from $3.5 million down to $2.9 million from 2013 to 2014. Now since the annual requirement is above that amount then there's projected to be some additional state contributions in the Judges Retirement System because of the decrease in the contribution rates expected with the court fees. On the State Patrol Retirement System there's projected to be an increase in the additional amount of the state contribution required because of the continued recognition of the losses from 2008 and 2009, as well as a decrease in 2013 of the matching member and employer contribution rates from 19 down to 16 percent. So in 2013 the amount of the annual...the additional state contribution increases, and then once all of the losses are fully recognized from 2009 there's some gains that come in that further reduce the amount of the state contribution in 2014 through 2016. Now that's if those contributions are made. We ran some additional contributions if those additional state contributions weren't made to give you a sense of what the impact that has on the additional contribution in future years. So the best way to compare this is to look at 2016. So by making the contributions in each year, going back to looking at the amounts required if the additional state contribution is made, the additional state contribution in 2016 would be $3,745,000. If contributions during the period were not made, the additional requirement in 2016 would be $5,734,000, so roughly a $2 million increase in the required. Part of what happens when the actuarial requirement isn't made, we like to use the term saying that paying for the pension system and accumulating the assets necessary to meet the fixed payments, it's a pay me now or pay me more later. The extent to which you don't pay them today, that deficit increases the unfunded liability and it grows over time with interest, so that's the reason why you have that kind of impact on the future payments if the payments...earlier payments aren't being made. Now the 30-year amortization amount is determined to be an amount that will pay off that unfunded liability. The extent to which it's not paid off, then that unfunded liability grows. [LR210]

SENATOR NORDQUIST: And on this chart, what...is it '13 that the...would it be in the year '13 on this chart that the contribution rates would go back to 16 percent? [LR210]

DAVE SLISHINSKY: Correct. [LR210]

SENATOR NORDQUIST: Okay. [LR210]

DAVE SLISHINSKY: Yeah, on both of these charts you'll see that the employer contribution from 2012 to 2013 drops from about $5.1 million down to $4.3 million and that drop is a result of the contribution rates at 19 percent basically sunsetting... [LR210]

SENATOR NORDQUIST: Uh-huh. [LR210]

DAVE SLISHINSKY: ...so that in 2013 they drop that down to 16 percent. So there's an additional 6 percent of pay contribution then that moves up to the additional state contribution. [LR210]

SENATOR NORDQUIST: Okay. [LR210]

DAVE SLISHINSKY: So one way of looking at all of these charts is looking at the bars and saying this is what the total requirement is,... [LR210]

SENATOR NORDQUIST: Uh-huh. [LR210]

DAVE SLISHINSKY: ...and then by looking at the different colors in the bars... [LR210]

SENATOR NORDQUIST: Sure. Sure. [LR210]

DAVE SLISHINSKY: ...shows this is the allocation of who's paying what or what the anticipation is for who's paying what. Okay, now to the school retirement system. This is a projection over five years of the actuarial contributions if the additional state contributions are made. This year's amount was $23.5 million, roughly. The anticipated contributions going forward for the additional state contribution would be about $19.5 million next year, $26.4 million in 2013, and $1.2 million in 2014. Now the way to read this chart, these years are for fiscal years beginning July 1, so these years coincide with the valuation date, so 2011 is the valuation date in 2011. When appropriations are made, the appropriations are made to be paid in the fiscal year...the next fiscal year following the current fiscal year. So for instance, the $23.5 million would be an amount payable in FY '13 because the beginning of the fiscal year is in 2011, the end of that fiscal year is 2012, and the end of the next fiscal year is 2013. So the way the accounting works on appropriations, and this is true of all appropriations, is those appropriations are made in the next fiscal year. They're paid at the beginning of the fiscal year, typically in July, and they're accounted for in the value of the assets of the pension fund as of June 30 of that year. So basically those contributions, even though they're being made...in this case would be made in FY '13, they're really for the FY '12 year and actually get recognized and counted as assets in the accounting statements for FY '12, for the fiscal year ending June 30, 2012, any appropriations that are made in FY '13. Now when it comes to the contribution rates of members and the employers, those rates are applied in the year in which they're made, so any contribution rates for the period July 1, 2012, through June 30, 2013, those years' rates are applied to FY '13. [LR210]

SENATOR NORDQUIST: Uh-huh. [LR210]

DAVE SLISHINSKY: So that's the way the accounting of the contributions work. [LR210]

SENATOR NORDQUIST: Just looking, I was looking at last year's projections and in 2014 we were looking at an additional state contribution of $99 million; 2015, $116 million; and 2015, $116 million; and in 2016, $112 million. And now we're down to $1.2 million, zero, and zero. Is that a combination of the rate increase and the market returns? [LR210]

DAVE SLISHINSKY: Correct. [LR210]

SENATOR NORDQUIST: Okay. [LR210]

DAVE SLISHINSKY: Yeah. [LR210]

SENATOR NORDQUIST: Okay. [LR210]

DAVE SLISHINSKY: When you compare last year's projections with this year's projections, there is a marked improvement on the amount of the additional state contribution due to the increases in the contribution rates that were made under LB382, as well as the $905 million gain that the pension fund earned for FY '11. [LR210]

SENATOR NORDQUIST: Uh-huh. Okay. [LR210]

DAVE SLISHINSKY: So those are operating to reduce the additional state contribution from 2000...really from 2011 through 2016 in this chart. [LR210]

SENATOR NORDQUIST: Uh-huh. Uh-huh. And then can you walk through also--I guess the time line still isn't clear for me--on how the increased contributions...when they phase in here between '11 and '12? I guess I'm not... [LR210]

DAVE SLISHINSKY: Okay. So we're calculating an additional state contribution of $23.5 million for 2011. Now that would be paid in the next fiscal year so this is...the calculation is for the FY '12 year and the appropriation to be paid is for the FY '13 year, and that would mean that it would be appropriated and paid in July of 2012, which is the beginning of FY '13, and would be accounted for in the assets as of June 30, 2012, as if the contribution...because it's being made for the FY '12 year. [LR210]

SENATOR NORDQUIST: Okay. Okay. So that rate increase went into effect September

'11 and that will accumulate through the payment on '12,... [LR210]

DAVE SLISHINSKY: So...so that it would be... [LR210]

SENATOR NORDQUIST: ...on July 1, '12? [LR210]

DAVE SLISHINSKY: The contribution rate increases that went into effect September 1 of 2011, those are being included in the employer contribution of $148.7 million,... [LR210]

SENATOR NORDQUIST: Okay. Okay. [LR210]

DAVE SLISHINSKY: ...and then the increases that are being made again next year for September 1, 2012, that really run through 2017, are applied in increasing the employer contribution rate for FY '12 and then through 2016 in this chart. [LR210]

SENATOR NORDQUIST: Okay. [LR210]

DAVE SLISHINSKY: So you'll see that the employer contributions increase from $148.7 million up to $166.6 million because of the increase in those rates for the FY '12 and the FY '13 years, and then increase again for FY '13. And then the increases from FY '13 to...or from '13 to '16 are due to expected increases in salary. [LR210]

SENATOR NORDQUIST: Sure. Sure. Great. Thank you. [LR210]

DAVE SLISHINSKY: Uh-huh. Now this is a five-year view. Now currently the increased contributions are scheduled to sunset in 2017, so what future projections show is that when the sunset happens, you know, the requirement is still the same but if the member and employer contributions are reduced then that amount would be picked up by additional state contributions. [LR210]

SENATOR NORDQUIST: Uh-huh. Okay. [LR210]

DAVE SLISHINSKY: Okay, now this page assumes that the additional state contributions are made from, let's say, FY '13 through FY '16 because those additional state contributions are paid in the next fiscal year. And then the next chart shows, well, what if the state didn't make those payments, what would the impact be going forward? And the amount of the additional...for each year that those contributions aren't made it increases the additional state contribution, but once those additional gains are recognized...and when you're talking about recognizing $905 million worth of gains over a five-year period, that's $140 million a year. So that has the impact of reducing the unfunded liability by $140 million a year for four more years. And then by 2015, once all of that is recognized, the additional state contributions go to zero for 2015 and 2016 even if those contributions in those earlier years wasn't made. Okay? And then we've also got some additional contributions from the 30-year model and this one shows the rate sunsetting in 2017 and you'll see that top...the top of the bars in that blue color are the additional state contributions. So even though it's showing that there's no contributions, no additional state contributions, in 2015 or '16 with the drop in the rates, then there's additional state contributions are picked up that run from 2017 all the way out to 2037. Now they reduce as a percentage of pay because as pay increases, when you're amortizing at a level dollar payment, that level payment amount becomes smaller and smaller as a percentage of pay. And then here's the backup. There's some people that like to look at charts, there's some people who like to look at the numbers, so we've got both of them here for you in case you wanted to look at the detail. And then we also ran this as if the amounts don't sunset, so if the 9.78 percent member contribution, and of course 101 percent of that being paid by the employers, if those remain then there's no additional state contributions that would be required. Here again it's the requirement is being paid; it just depends on how it's allocated between the members, the employers, and the state. And the numbers, for the numbers people. And then we did the same thing on State Patrol's, based on the current sunset, back down to 16 percent;

in 2013 shows the amount of the additional state contribution. From, you know, 2014 through 2016 that amount is reducing and, as a matter of fact, throughout the entire period through 2037 that amount reduces here again because the amount of the contributions that they...percentage of pay contributions are increasing and the amount of the amortization is decreasing. And then here are the numbers. And then here are the amounts if the contribution rates remain at 19 percent matching member and state contributions; there remains an additional state contribution amount through about 2031. I think we can see that: 2030 on this chart shows an additional state contribution of $219,000 and then thereafter no additional state contribution. Here again, when we do all of these projections, this is based on all of the actuarial assumptions being met, including the 8 percent return. So with that, that concludes the presentation on the actuarial valuation and projections. [LR210]

SENATOR NORDQUIST: Well, thank you for a thorough walkthrough. And since we did introductions earlier, Senator Louden, the Vice Chair of the committee from District 49, Senator Lavon Heidemann from District 1 have joined us as well. Any additional questions from the committee on this? Well, seeing none right now but we'll go forward then and were you going to do an additional highlight on the 30-year modeling? [LR210]

DAVE SLISHINSKY: I will leave that up to you to decide. [LR210]

SENATOR NORDQUIST: Yeah. Okay. [LR210]

DAVE SLISHINSKY: I am prepared to walk through some information... [LR210]

SENATOR NORDQUIST: Sure. [LR210]

DAVE SLISHINSKY: ...that I discussed with the legislative staff back in October on the 30-year model... [LR210]

SENATOR NORDQUIST: Yeah. [LR210]

DAVE SLISHINSKY: ...that looks at what happens if some changes are made to the retirement benefits applied to new hires. [LR210]

SENATOR NORDQUIST: Uh-huh. Sure. [LR210]

DAVE SLISHINSKY: And that information was on the school system and the proposed change to a cash balance plan. [LR210]

SENATOR NORDQUIST: Uh-huh. We can for, I don't know how long you think it will take, for maybe a brief, brief summary of it. [LR210]

DAVE SLISHINSKY: Well, I...okay. [LR210]

SENATOR NORDQUIST: Do you have it on the computer as well? [LR210]

DAVE SLISHINSKY: I do not have... [LR210]

SENATOR NORDQUIST: Okay. [LR210]

DAVE SLISHINSKY: ...unfortunately, I don't have it on the computer but there's a handout I think each of the senators received that shows the information that was discussed at that meeting back in October. (Exhibit 1) It was held on October 19 here again with legislative staff, and it's from the model that we developed and is available to legislative staff and the retirement system really over the Internet. They have passwords and they can get into this and they can actually play around with it and do some "what-if" scenarios on their own. But this shows, if you turn to the first page, this is on the school system and shows the total employer contribution rates for the current plan, as well as four other scenarios and those four scenarios are cash balance plans that would be applied only to new hires, and the only change in each of those scenarios is a change in the interest crediting rate. The way that the cash balance plans currently work for state and county employees is that the interest crediting rate is defined as the greater of 5 percent or the federal midterm rate plus 1.5 percent. Now most recently interest rates have been fairly low. That federal midterm rate is running below 3.5 percent. So when you add 1.5 percent to it, it's less than the 5 percent. So there's a 5 percent interest credit that has been earned recently by members of the state and county cash balance plans. Long term, however, our expectation is that over time that federal midterm rate will average about 5.5 percent. So when you add 1.5 percent to it, we're expecting long term those interest credits to be on average 7 percent. But there are different ways of defining that interest crediting rate in the cash balance plan and oftentimes when...as long as you have an opportunity to pay additional dividends when the markets are doing well, the amount of the interest crediting rate is a minimum guarantee. It's not the total guarantee of the interest credit that can be provided in the cash balance plan, provided that the investments do well and the plan is able to pay dividends. And dividends have been paid in the state cash balance plans I believe through 2006, but since then there have been no dividends paid. But it just gives you the idea that the way that the plan works is there's a minimum level of guaranteed benefit with the opportunity for increased benefits with excess returns. So depending upon how that minimum level is defined, we have anywhere from 3, 5, 6, and 7 percent for Scenarios 2, 3, 4, and 5. So it gives you a sense when you look at this graph, it shows that there is some reduction amount in the total employer contribution rate with the lower guaranteed level. Now in these projections we're assuming that there's no dividend paid, so any gains during the year are just accumulated, which is the reason why the lower interest crediting rates would create long term a lower employer contribution rate. [LR210]

SENATOR NORDQUIST: So our current plan, you were saying though, is essentially Scenario 5 with the interest crediting rate be... [LR210]

DAVE SLISHINSKY: Yeah, now the... [LR210]

SENATOR NORDQUIST: ...long... [LR210]

DAVE SLISHINSKY: ...the state and county cash balance plans, the current interest crediting rate defined long term is 7 percent, which is Scenario 5. [LR210]

SENATOR NORDQUIST: Uh-huh. [LR210]

DAVE SLISHINSKY: And what we've done for these is we've used the long-term employee contribution rate for the schools of 7.28 percent instead of the contribution rates in the state and county plans. Those plans, the state employees are contributing 4.8 percent and county employees are contributing 4.5 percent, and there's some additional contributions made on the part of public safety members in the county plans. But this ties back to the original rates of the state, of the school, excuse me, the school retirement system, which are 7.28 percent employee and 7.35 percent employer. And those would be the rates that are accounted in the cash balance accounts for each member. And this applies only to new hires, so whenever you do projections like this and apply a new tier of benefits, whether it's a cash balance plan or it's a revised traditional defined benefit plan possibly with lower multipliers or lower retirement...or higher retirement ages, lower COLA benefits, any kind of adjustment to the benefit, long term there's a reduction in costs but there's a transition from current members to future members that occurs over a 30-year period in order to get the full impact of the reduction in the cost as a result of the reduction in the benefits. [LR210]

SENATOR NORDQUIST: Uh-huh. On the graph, the two lines between the current plan and Scenario 5, they kind of correlate to each other here with a certain space between them as far as total employer contribution percentage. Do you know what that percentage is? Is it... [LR210]

DAVE SLISHINSKY: Yeah, if you just... [LR210]

SENATOR NORDQUIST: ...a couple tenths of a percent? [LR210]

DAVE SLISHINSKY: ...if you just turn the page now,... [LR210]

SENATOR NORDQUIST: Okay. [LR210]

DAVE SLISHINSKY: ...these are just rounded to the nearest percent,... [LR210]

SENATOR NORDQUIST: Okay. [LR210]

DAVE SLISHINSKY: ...but you get a sense, from looking at the next page, of those percentages. [LR210]

SENATOR NORDQUIST: Uh-huh. [LR210]

DAVE SLISHINSKY: So going from the current plan to Scenario 5, it looks like there is a reduction of anywhere from .5 to 1 percent... [LR210]

SENATOR NORDQUIST: Uh-huh. [LR210]

DAVE SLISHINSKY: ...or .5 to 1.5 percent of pay in that contribution rate, especially as you go out further. [LR210]

SENATOR NORDQUIST: Uh-huh. Could you do a...maybe this is on the 30-year projection. Does it have...does it go beyond full percentages on the... [LR210]

DAVE SLISHINSKY: I think what you can do on the projection model is you can point to any of these points on the graph and it will tell you what it is... [LR210]

SENATOR NORDQUIST: Okay, and it will show the...okay. Great. [LR210]

DAVE SLISHINSKY: ...so you can get a sense by just looking at it. You'd almost have to get into the software to find out what that is, but those rates should be shown to the nearest one-hundredth percent... [LR210]

SENATOR NORDQUIST: Okay. [LR210]

DAVE SLISHINSKY: ...instead of just to the nearest percent. [LR210]

SENATOR NORDQUIST: Sure. [LR210]

DAVE SLISHINSKY: So that's the first set of results that are shown. And then if you turn the next couple of pages, it shows the amount of the employer contributions in dollars so you get a sense of the difference in the dollar amounts of the employer contributions. And if you turn the page, it lists the amounts here that are shown to the nearest dollar. So you're getting that detail right here on the change in the amounts. So for instance, if you look out...let's look at year 2035. The amount under the current plan, the employer contribution would be about $300 million under the current plan; under Scenario 5 would be $282 million. So there's a savings of $18 million going out to 2035 by transitioning from the current plan to this cash balance plan that has a 7 percent long-term interest crediting rate. And then further reductions, if you look at Scenario 4, 3, and 2, shows some of the reductions based upon the other contribution rate. And then in addition to that, shows the additional state contributions if you go to the next one. It shows the amounts of the contributions dropping to zero in 2015 and 2016 but then bouncing back up in 2017 and beyond with a reduction in the member and employer contribution rates. And then the next one shows the dollars of the additional contributions. And then beyond that are the funded ratios. Now the methodology is set up to meet 100 percent funding by the end of the amortization period. So no matter what happens, no matter what changes are made, the methodology gets you to 100 percent. And then there's also a graph at the end of the normal cost rates; gives you a sense of the reduction in the costs of the accruing benefits for each of these proposals. Okay? [LR210]

SENATOR NORDQUIST: Great. Thank you for going through that quickly. [LR210]

DAVE SLISHINSKY: Uh-huh. [LR210]

SENATOR NORDQUIST: Any questions from the committee regarding this? Then the Appropriations Committee and Kate, the Appropriations Committee staff and Kate in my office have access to it, so if any committee members would like to pursue that in further detail please let us know and we can always follow up with Mr. Slishinsky if we have questions on that, but... [LR210]

DAVE SLISHINSKY: Okay. [LR210]

SENATOR NORDQUIST: Thank you. [LR210]

DAVE SLISHINSKY: All right. Thank you. [LR210]

SENATOR NORDQUIST: Yeah. All right. At this time we'll take any additional comments regarding the actuary reports. [LR210]

ROGER REA: Senator Nordquist and members of the committee, for the record, I am Roger Rea. I live in Omaha. My name is spelled R-e-a. I live in Omaha and am currently the president of NSEA-Retired, an organization comprised of approximately 5,000 retired school employees. I have served for five years as a member of the public...public member of the PERB, the Public Employees Retirement Board. That's the board that provides oversight over the five retirement systems that are governed by state law. I am currently serving on the executive committee of the National Council on Teacher

Retirement, which is an organization representing more than 60 retirement plans across the country in which school employees are enrolled. Retirement plans are long-term entities. Retirement funds are invested for the long term and retirement benefits are paid over the long term. In fact, it's often said that retirement plans have a 50-year time horizon. Retirement plans expect an employee to be with a system as an active member for a 30-year career and a retirement plan is expected to pay benefits to that member for an additional 20 years in retirement. There is nothing short term about the contributions that were coming in and nothing short term about the stream of benefit payments to be paid. Money in our retirement system is managed by professional money managers for that long term. While short-term market returns may fluctuate above and below the target rate of 8 percent, the historical long-term investment return for a diversified portfolio has been above 8 percent for every rolling 30-year period of investments since records were kept back in 1930. Hewitt EnnisKnupp, the firm that provides oversight for the investments for the defined benefit money for Nebraska, reports the total return of the defined benefit plans for Nebraska has been an annualized return of about 9.4 percent since 1983, when the money began to be managed...being invested in a broadly diversified portfolio managed by outside investment professionals. The recent actuarial report for the school plans shows that the strong market returns of almost 23 percent for this last fiscal year brought the actuarial value of the plan roughly equal to the market value of the plan. One year ago that market value was only 84 percent of the actuarial value. Investment returns tend to regress to the mean. That means that the short-term investment returns may be higher or lower than the long-term average, over time investment returns will average what the long-term investment mix should bring. In our case that's about 8 percent. In the past 12 months, market returns have begun to regress to the mean even if the long-term rate of return is beginning to return to the more normal rate of 8 percent. Prudent management of retirement investments coupled with contributions that exceed the normal cost of providing (inaudible) benefits have made...have the net effect of bringing the funding ratios for the school retirement plan to more normal historical levels. I would encourage all the parties who are responsible for managing the retirement plan for school employees, that includes the legislative Retirement Committee, the Investment Council, and the Public Employees Retirement Board, to keep that long-term perspective. It's good to remember the old parable of the tortoise and the hare. It was the slow and steady runner who won that race. And with the long-term steady investment returns of monies that will eventually provide money are funding for the (inaudible) retirement benefits for school employees. One more point: Long-term retirement plans tend to attract long-term employees. School employees typically retire with a 20- or 30-year work record, a stability in the classroom that provides superior education experience and superior student learning for Nebraska students. Nebraska students and Nebraska schools are well-served by the current defined benefit retirement plan and the superior nature of our student learning in Nebraska is proof positive. I encourage you to maintain the course regarding the current defined benefit plan for school employees. The winners of that action will be Nebraska schools and Nebraska students. Be glad to respond to any questions. [LR210]

SENATOR NORDQUIST: Thank you, Mr. Rea. Any questions from the committee? Seeing none, thank you for your testimony. [LR210]

ROGER REA: Thank you. [LR210]

SENATOR NORDQUIST: Any additional comments regarding the actuary studies? Thank you. [LR210]

MARY SPURGEON: (Exhibit 3) Good day. Chairman Nordquist and members of the Nebraska School Employees Retirement System, my name is Mary Spurgeon and I am speaking for the BEARs, that is members of the Bellevue Education Association-Retired members. BEARs need a sound retirement system for themselves and for their families and for the 1,611 active members of the system who went to work this morning for the Bellevue Public Schools. These members teach, coach, sponsor clubs, clean and maintain school buildings, shovel snow, cook, answer phones, keep records, and do the many other tasks that provide a quality education for Nebraska's children. All active and retired Bellevue School Employees thank you and former legislators for our sound retirement system. Legislative Resolution 210 calls on you to report on the funding needs, benefits, contributions, and administration of each retirement system, which includes our School Employees Retirement System. Our system passes with high honors. The Public Employees Retirement Board, and the Nebraska Investment Council, and the employees under their direction should get A's. Retirees receive their checks on time. Retirement applications go smoothly. Retirement benefits are clear. The beneficiary change process is good. Investment returns over the past 30 years have exceeded the actuarial assumptions. Reports to active and retired members are clear, accurate, and timely. We hear no complaints about administration, which is an excellent sign. We no longer come to the Legislature seeking funds for teachers who retired into poverty. Forty years ago the maximum system benefit, $52.50 per month, was completely paid for by the state. Today's larger contributions from active members and boards of education, which you've just heard about so extensively, have stopped that poverty cycle. Today's School Employees Retirement System provides common-sense retirement planning. Active members can choose a retirement date without being influenced by the ups and downs of the stock market. In some plans, people retire early when the stock market is up and delay retirement when the stock market is down. This is not in the best interest of either schools or students. Our formula system provides excellent financial planning and predictability at a lower cost than other types of plans. Benefits for system members also include disability, death-spousal benefits, mobility, buy-in provisions, veterans' benefits, and a modest cost-of-living plan. Some other types of plans cannot provide these benefits. BEARs appreciate and support the state's contribution to the system, as well as the major contributions to the system from active members and boards of education. Rather than taking all the funds in current salaries, active members and school boards choose to invest in our retirement system plan so school employees can retire with dignity. Contribution rates set by the Legislature make our plan one of the most fiscally sound systems in the United States, even during this "Great Recession." As you write your report, we would ask that you include contributions made by retirees of our system to communities in every corner of Nebraska. It's kind of like state aid in an informal way. As you examine any group of retirees, like the BEARs, you will discover two benefits to Nebraska communities: financial benefits and cultural benefits. BEARs and other Nebraska system retirees own their own homes. They pay property taxes. Actually, I'm an exception to the rule. I do know a few other people who rent. As far as I know...well, nobody has told me that I am actually paying property tax through my rent but somehow I expect it to be so. Retirees shop and pay taxes in Nebraska. They pay Nebraska state income taxes on all income received through our Nebraska School Employees Retirement System. Their monthly incomes are spent in their communities where their money recirculates and helps to ensure prosperous Nebraska communities. Cultural contributions of BEARs seem not to end. BEARs volunteer in Bellevue and the metropolitan area. BEARs tutor. They help at museums. They build homes with Habitat for Humanity, serve on civic boards from the drug council to the bridge commission, help at the zoo, serve with the Bellevue Garden Club and Lauritzen Botanical Gardens, sponsor clubs, do Meals on Wheels, serve churches, etcetera, etcetera. All Nebraska school retirees give their time and talents to their communities, making for better communities, a better state, and a better quality of life for all Nebraskans. Give the Nebraska School Employees Retirement System good grades for funding needs, benefits, contributions, and administration. The system needs no major changes. By working together, the School Employees Retirement System plan keeps active and retired school employees out of poverty, keeps them in Nebraska, and keeps them active in the communities that they love. Thank you for your time and support of Nebraska's students, public schools, and public school employees. This concludes my testimony but I want to note that these remarks were prepared by Philip Caudill (phonetic), a BEAR member who has a wealth of history and experience regarding our retirement system. Thank you. [LR210]

SENATOR NORDQUIST: Great. Thank you for being here and thank all the BEARs for their commitment to our communities, so thank you. Any questions? Seeing none, thank you. Any additional comments? Seeing none, that will conclude that portion of our hearing today. Next...well, this summer our committee joined with the Business and Labor Committee to look at defined benefit pensions of political subdivisions around the state. That was under LR215 and LR216. As a portion of that there was some discussion about largely public safety pensions and those that aren't participating in Social Security and how that process would happen if there was a change in their plan and they needed to move back into Social Security. So we have Sue Alt with us this morning from the Social Security Administration in Kansas City who's going to talk to us about that process, the Social Security 218 Agreements and the referendum process for opting into Social Security. [LR210]

SUE ALT: Good morning. [LR210]

SENATOR NORDQUIST: Morning. [LR210]

SUE ALT: (Exhibit 4) I'm Sue Alt from Social Security. Thank you for inviting us today. With me here is Christy Schmidt (phonetic). She is our chief counsel from our Office of General Counsel. And first of all, we want to really thank you for inviting us so we have the opportunity to talk with you beforehand and as issues come up. Now we're obviously from the Social Security Administration but we have, you know, no role in trying to sway your decision one way or the other. Our job is to provide you with the background and the facts, and the decisions, of course, are up to you folks. Unfortunately, Social Security coverage for state and local employees is not a simple thing. The point that we're at right now for all of you and everybody in every other state did not get there by any simple straight line and there isn't a simple formula for making changes. There's no easy...there's no way to say you just do this and this and it's all taken care of. But we are willing to assist with anything that you're considering doing or want to look at more information on. We, the folks at the Social Security Administration, our legal folks are certainly willing to work with you, evaluate proposals you might be considering, and try to help in any way that we can so we make sure that the point that we end up at is the point that everybody wants to be at. And we certainly appreciate the opportunity to look at those things beforehand, before the decisions are made, because it's very difficult when there's some unintended consequences there. I'd like to spend a couple minutes talking about the legislative history on both the federal side and your state side that maybe paints a little bit better picture of how and why we are where we are with state and local coverage. When the Social Security Act was debated back in 1935, there was a lot of decision about who should be covered by Social Security and how that was going to be decided. What the final decision was, there was a real question at that time whether the federal government had the authority to tax the states. That was something the Supreme Court hadn't decided that yet and so that original Social Security Act that passed in 1935 did not cover state and local workers. There were many groups that were excluded from coverage--professionals, doctors, lawyers, self-employed individuals. Many groups were excluded so that original Social Security Act did not include any state and local employees. It was the amendments that became effective with January 1 of 1951 and it was Section 218 of the act, that's why you hear a lot of reference to 218, some of them not really very nice, but that's why, it's Section 218, and that allowed the states and its political subdivisions to voluntarily elect Social Security coverage and that "voluntarily" is very important. Now the only people in 1951 that could be covered by Social Security that were state and local employees were those that were not covered by an existing retirement system. Now Nebraska, like all states, have 218 Agreements and your 218 Agreement was effective January 1 of 1951, back at the very beginning, and on a state level pretty much covered state workers except those covered by a retirement system, and that's your State Patrol. Now in 1955 Social Security Act was changed again--I mean it's changed many, many times--and that extended the 218 coverage, Social Security coverage, to state and local workers, of course on the voluntary basis, to those that were covered by a retirement system if the members of the retirement system wished coverage, and that's the referendum process that you're probably going to hear more about than you ever wanted to, but that referendum process is the process by which those people in a retirement system can voluntarily elect to have Social Security coverage. Another big issue in Social Security legislative history that makes a difference for you are the 1983 amendments. For those of us that were around then and remember those well, which I certainly do, that was the Greenspan Commission. Alan Greenspan and Bob Dole and Daniel Patrick Moynihan were kind of the leaders of that movement. But at that time the Social Security didn't have enough money on hand to pay all benefits due right then and they looked at and they made some major comprehensive changes to Social Security that included how the system is financed and also its benefit structure. That was the point in time that Social Security coverage was extended to all federal workers, so all federal workers are now covered by Social Security. In the past they were not. Another thing that it did that I'm sure that you have probably heard about through the course of time with your State Patrol is it eliminated the windfall Social Security benefits that workers who receive pensions from work not covered by Social Security got when they receive their Social Security benefits, WEP, the windfall elimination provision. We say it makes you weep if you're affected by it. And it also had the government pension offset provision that applied to benefits that an individual would get from a spouse's record, and so that was part of those 1983 amendments. It also did things like started the taxation of Social Security benefits, raised the full retirement age to 67, and it provided that coverage that existed under a 218 Agreement couldn't be terminated. Before that time, if you had elected coverage, you could elect to not be covered. But the 1983 amendments ended that and so for individuals or for state and local employees that were covered by Social Security, that's going to remain. So that option to go back doesn't exist anymore. It also stated that positions that were covered as part of that absolute coverage group under the state's or the political subdivision's 218 Agreement continue to be covered under Social Security even if the positions are later covered by a different state retirement system. They have Social Security coverage, they're going to keep it is kind of it in a nutshell. The other thing that's of importance and consideration for you became effective on July 2 of 1991 and that's mandatory Social Security coverage. That says for individuals that are not covered by a retirement plan that is Social Security equivalent, and that's determined by the Internal Revenue Service--and their Publication 963, about this big, has lots of information on that, that's an IRS decision--but if the retirement plan is not Social Security equivalent then the individual has to pay mandatory Social Security, kind of just to give everybody some kind of benefit that's at least going to actuarially be equivalent to Social Security. And again, the IRS makes those decisions and I'm sure it's very complicated, and I don't work for the IRS. Now Nebraska, of course, entered into a 218 Agreement and that was effective with January 1 of 1951, and that original agreement covered all of the state of Nebraska employees, many of your counties, cities, villages, and miscellaneous groups, noxious weed control districts and...except for those covered by the retirement system, and again that, at the state level, that's your State Patrol. The State Patrol Retirement System came into existence in 1947 and so, therefore, they were excluded, and there isn't anything else about them. Through the course, the state of Nebraska has had many, many, many modifications that have added groups and such over the course of the years, hundreds of them as a matter of fact. The Nebraska statutes, the Chapter 68-621 to 68-630, have information about Social Security coverage and primarily the referendum process and that information in there pretty much parallels what the federal guidelines are. Beyond that, beyond our role in whether or not a group is covered by Social Security, we don't have any role in what your other pensions do, whether the defined benefit, defined contribution, who pays what, what's paid out. We don't have anything to do with that, thankfully. We have enough to do with this. If you make changes, I mean and we were trying to brainstorm among us the information that we could give you to kind of point out issues that you might come across and things you'd want to consider here, issues that you would want to at least look at and consider, you know, if you make a change from not covered to covered by Social Security is there could be at least insured status issues. In order to receive benefits from Social Security you must have work and earnings under Social Security, and basically you need the equivalent of ten years' worth of work and earnings to qualify for benefits. It doesn't matter when, anytime in your lifetime, and it doesn't take necessarily a lot of earnings to get one of those credits: $1,120 this year gets you one credit; you may get up to four a year. And so you need 40 credits or the equivalent of ten years' worth of work and earnings somewhere in your lifetime to be due a benefit. Now to be due a benefit doesn't necessarily mean the benefit amount would be very high, and so, you know, that's one of the other issues. Social Security benefits are computed on your earnings over a lifetime. Unlike many of your other private retirement systems that maybe use a high three or a high five, Social Security benefits are computed based on the lifetime of earnings. And basically what we do is we take all of the years of earnings you have ever had, put them in current dollars, pick out the 30 years of highest earnings. So we use a lifetime of earnings, so if you have an individual that has many, many years of noncovered work, they have a lot of zero years, same as if they hadn't worked, for our purposes. So that is something that at least could be a consideration for you. There's, of course, our old friend WEP that we mentioned a little bit earlier and I have some fact sheets for you on that WEP that gives you a little more detail on how that works, but basically what the WEP, or the windfall elimination provision, does is it might reduce the benefits that an individual receives if they have a pension from work not covered by Social Security. Social Security is not an annuity program and Social Security is a social insurance program and our benefit formula, that normal formula how we pay benefits, is weighted very heavily at the low-income end, the assumption being an individual that's had a lifetime of earnings that are very low, in retirement, just to get by, they need a bigger rate of return, and that's what that windfall elimination provision did. That weighted...it took that weighting out of that first area. This year, just to give you a context for that, this year if an individual is subject to that windfall elimination provision the most that it would reduce their Social Security benefit by would be $374.50. Now it will not ever reduce a benefit to zero because it changes that first factor from 90 percent to 40, but this year it could reduce it by $374.50, and generally that goes up a little bit every year, but that certainly could impact what a person would receive. The other is government pension offset, which is a similar provision that applies to an individual who gets a pension from work not covered by Social Security that's getting a benefit from their spouse's record. Now that can reduce a benefit to zero. There is a provision in there, however, that says if the last five years of your employment was covered by Social Security in that same position, so if you went from being not covered to covered and worked five more years, then that government pension offset provision does not apply. And again, I have a fact sheet for you on that. And of course, this is the government. This is the federal government. There are rules and there are exceptions and "howevers" and "what-ifs," and that's why anything that comes up, any, you know, serious discussion you have, we will be very happy to work with you. Now Nebraska is what's called a majority vote state and I don't want to go through all of the nine separate, technical, legal documents that are involved in the process, but I want to explain a little bit about the majority vote state and its alternative, the divided vote. Missouri is a majority vote state. Missouri, well, Missouri is too, so is Nebraska, so are all of the states in the Kansas City region. It is possible that Nebraska could become a divided vote state. Now in order for that to happen would take an act of the federal Congress, which, I mean, does happen because we now have about half of the states are divided vote states, and then it would take conforming state provisions in your statutes. What the majority vote means is the majority of the members of your retirement system have to vote for Social Security coverage because it's voluntary, and what that means is, for example, if you have a retirement system that is voting for Social Security coverage that has 450 members, 226 people have to vote yes. If you don't vote, it's the same as voting no. So for most elections that we have in this country, that's a pretty darn high hurdle, but it's voluntary coverage. So the majority of people eligible to vote have to vote yes. It's a secret ballot. And if the vote is yes for Social Security coverage then everybody is covered by Social Security. If the vote is no, then nobody is covered. That divided vote works differently and the divided vote is an individual vote. So just in real simple terms here, in a divided vote if you vote yes, you're covered by Social Security; if you vote no, you are not covered by Social Security; all new hires are covered by Social Security. But again, for Nebraska to be able to be a divided vote state, that takes an act of the federal Congress and then your conforming state legislation. We do know of several states in the last decade or so where this has happened, so it's not like it's impossible. But that is at least something for you to consider. If you wanted to obtain Social Security coverage for everybody in your retirement system group then you would have the current employees, those that are currently employed, and all future hires would be covered by Social Security, and basically the step that starts that process is your board or your commission that oversees that would have to request a referendum and then would use those majority vote rules. It's a very formal, technical process. Your state Social Security administrator would work with our folks at Social Security. We have some sample documents that we've used from Missouri, that's also that majority vote state, and we would certainly assist in any way. But that's how that process would work and then it would be the vote of all of the current members of that retirement system. You know, it would also be possible, I would presume, if the current retirement system, if the benefits that were being paid by that were not Social Security equivalent under those IRS guidelines, then mandatory Social Security coverage would come in and, you know, I guess that's probably a possibility too, probably not a very good one maybe legislatively and what you might be wanting to look at long term, but I mean that that's at least a consideration. Any changes that would occur is going to be complex because you have a lot more to consider than just the Social Security. But anything that happens with this process is not simple. There aren't any quick and easy answers. And if you ask me any questions that are very hard, I'm sure I can't answer them because they take a review of the statutes and all of the provisions and, like I say, they're not simple in any way. The Social Security Administration is happy to assist and, you know, look at any proposals you might have or to work with you on, you know, what you might be wanting to accomplish. One of the things we would want you to understand that we would always do, if there's any kind of issue like this, is there would be educational meetings for yourselves and also for all of the individuals involved. We've been through this process a number of times in Missouri and what we've done is we've prepared estimates for all of the individuals that are involved saying, if you pay Social Security, here's what happens; if you don't, here's what will happen for you individually, and talk with all of the employees individually and, of course, as a group. And we think that that's very important because it is very complex and everybody's situation is different. Everybody's situation even for Social Security benefits is different, whether it's benefits on your own record or from a spouse's record, very complex issues and very important for long-term financial planning. We'll be happy to try and answer any questions that you have or certainly take any questions that you have and get you an answer for them. [LR210]

SENATOR NORDQUIST: Great. Well, thank you so much for being here and for coming up from Kansas City. One question I have on the majority vote process, is it a vote that from this point forward everyone is in Social Security or is it possible to structure a referendum to say we take a majority vote but those people that are within ten years of retirement, they're protected from it, or would you have to do a divided vote process for something like that? [LR210]

SUE ALT: You know, what you might be able to do, I mean the...if we have the majority vote referendum,... [LR210]

SENATOR NORDQUIST: Uh-huh. [LR210]

SUE ALT: ...it's going to have an effective date. [LR210]

SENATOR NORDQUIST: Okay. [LR210]

SUE ALT: And we're going to say effective this date, it's effective, and everybody from there on is covered. [LR210]

SENATOR NORDQUIST: Uh-huh. Okay. Okay. [LR210]

SUE ALT: You know, and so it would have an effective date that would apply to everyone. [LR210]

SENATOR NORDQUIST: Okay. [LR210]

SUE ALT: What you might be able to do is make some provisions in the other part of the retirement system... [LR210]

SENATOR NORDQUIST: Oh, sure. [LR210]

SUE ALT: ...that says for people that are whatever, whatever, we'll do this. [LR210]

SENATOR NORDQUIST: Uh-huh. Yeah. [LR210]

SUE ALT: And so that's probably a more... [LR210]

SENATOR NORDQUIST: That makes sense. Sure. [LR210]

SUE ALT: ...viable option, but that's what I can think of off the top of my head. [LR210]

SENATOR NORDQUIST: Yeah. [LR210]

SUE ALT: You got something, Christy? [LR210]

CHRISTY SCHMIDT (phonetic): Just to be clear, it does affect everyone. You could not opt out any members of the retirement system based upon years of service or for any other reason. So all current members would be affected by a majority vote referendum, whether it's no or yes. [LR210]

SENATOR NORDQUIST: Okay. Sure. Okay. Great. [LR210]

SUE ALT: As of the effective date... [LR210]

CHRISTY SCHMIDT (phonetic): Correct. [LR210]

SUE ALT: ..it will. We make the agreement; it's effective on this date. Right. [LR210]

SENATOR NORDQUIST: Sure. Okay. Okay. Any other questions from the committee?

No? All right. Well, we appreciate you being here and thank you so much. [LR210]

SUE ALT: Well, thank you very much.... [LR210]

SENATOR NORDQUIST: Yeah, very informative. [LR210]

SUE ALT: ...and we appreciate the opportunity to be here. And if you have questions, please let us know. [LR210]

SENATOR NORDQUIST: Will do. Thank you. Thank you. If anyone has any comments on that, we certainly would entertain those. Seeing none, we'll move to the final portion of the hearing today which is proposed legislation from Lancaster County that they've asked to bring forward to discuss before the committee. Kerry Eagan is here representing the county board and I'll let him talk about the issue. Thank you for being here. [LR210]

KERRY EAGAN: (Exhibits 2 and 5) Thank you. Good morning, Chairman Nordquist and members of the Retirement Systems Committee. My name is Kerry Eagan. I'm the chief administrative officer for the Lancaster County Board of Commissioners. Thank you for the opportunity to provide information on the funding and administration of the retirement system for Lancaster County. We operate a defined contribution retirement system under the provisions of Section 23-1118 of the Nebraska code. This statute requires a match of 150 percent of each employee's mandatory contribution. Under that statute, the combined contribution of the county and the employee cannot exceed 13 percent of the employee's salary. The county board for Lancaster County has two concerns with the county's mandated match of 150 percent. First, the match is significantly out of line with the private sector. The board has received numerous complaints that this generous match is unfair to similarly situated taxpayers working for private employers. In response, the county will introduce legislation reducing the match to 100 percent for new employees. Second, the county board believes a reduction in the match is necessary to help us control personnel costs and stay within budget lids. The last couple of legislative sessions have been hard on counties. Lancaster County has lost $3 million in combined state aid and prisoner reimbursement. Since 85 percent of our annual budget is for personnel services, it's pretty critical for us to control future personnel costs, and reducing the pension match would help accomplish this goal. By way of example, if we'd had a 100 percent match for 2010 of new employees that began contributing to the system for that year, we would have saved approximately $36,900. This represents about 37 employees. I should add, too, that we have a new corrections system, a new jail coming on-line, and we're going to have to add about 38 new employees on top of that for next year. But on an average, we're probably replacing about 37 to 40 new employees a year, so we could expect to see similar savings every year. In the long run, if you take the reduction in the match on our entire payroll for today it would be a savings of about $1,130,000, so pretty significant in the long run, built up with the legislation that we would add that it would apply to new employees. And a little bit less complicated than Social Security, I realize, so I'm sure you're thankful for that. [LR210]

SENATOR NORDQUIST: Sure. Sure. Well, thank you for being here and again this is just...the proposal from the board would just be for new employees making that change, right? [LR210]

KERRY EAGAN: It would be, yeah, the new employees, yes, and I think it also only applies to Section 23-1118, which I think Lancaster County is maybe the only one or one of a few that has a direct contribution under that section. [LR210]

SENATOR NORDQUIST: Uh-huh. Yeah. Okay. Great. All right. Any questions from the committee? Senator Louden. [LR210]

SENATOR LOUDEN: Yeah, thank you, Chairman Nordquist. Mr. Eagan, can you tell me any history? How come this...how come this ever got...was around at 150 percent?

When did it start and what's the history and what was the reasoning for it? [LR210]

KERRY EAGAN: If you look at the statute, I think it became effective in 1996 and, fortunately, I was around during that time and it was Lancaster County that came to the Legislature and asked for an increase from 100 percent match to 150 percent match. I know it was Senator Carol Hudkins that did introduce the legislation that provided for that. I guess those were happier times with better budgets. The other problem was that county employees worked side by side with city of Lincoln employees who are getting a two-to-one match with virtually no limit on the percentage of income, so they could get most of their defined contribution limits provided straight in their pension with that match. So that caused a little bit of consternation with the employees. There was a movement to do that and Lancaster County did sponsor that legislation back in the mid-'90s. [LR210]

SENATOR LOUDEN: Now is your plan now a defined contribution plan? [LR210]

KERRY EAGAN: Yes, it is. [LR210]

SENATOR LOUDEN: Okay. And how many...now my understanding, this will be...this will only work on employees after 2012 and just new employees. The employees that are there now will still get this 150 percent match? [LR210]

KERRY EAGAN: That's the way the statute is written, yeah, the proposal is written. [LR210]

SENATOR LOUDEN: Yeah. [LR210]

KERRY EAGAN: Yeah. [LR210]

SENATOR LOUDEN: Yeah. [LR210]

KERRY EAGAN: If it went to all of the employees during that time, the estimate is about $1,130,000 that would be the savings if all existing and new employees went to the 100 percent match. [LR210]

SENATOR LOUDEN: Now will there be a different...what's the employee's contribution rate now? [LR210]

KERRY EAGAN: It's 5.8 percent, I believe, is what the employees can contribute, then it's up to 13 percent, so it's 7.2 percent is what Lancaster County provides. No, excuse me, I got that backwards. It's 5.2 percent of the employee, 7.8 percent for the employer, Lancaster County. [LR210]

SENATOR LOUDEN: Comes up to 13 percent maximum. [LR210]

KERRY EAGAN: Thirteen percent, yes. That's correct. [LR210]

SENATOR LOUDEN: I see. And then if you drop this back to 100 percent, then they would both be at 5.8 or will they raise the employee's contribution? [LR210]

KERRY EAGAN: It would be...I think both would be at 6.5 percent, equal, at 13 percent. [LR210]

SENATOR LOUDEN: It would raise the employee's contribution... [LR210]

KERRY EAGAN: Yes, it would. [LR210]

SENATOR LOUDEN: ...in there. Are the employees unionized? [LR210]

KERRY EAGAN: We have three unions. We have AFSCME, which represents a general mix of employees; an FOP that represents the sheriff deputies; and an FOP that represents correctional officers. [LR210]

SENATOR LOUDEN: Now that would...okay, and it's on your...also on your sheriff's deputies and them, they're under this 150 percent match that you have to match for too? [LR210]

KERRY EAGAN: Yes. [LR210]

SENATOR LOUDEN: All the county employees. [LR210]

KERRY EAGAN: All county employees. [LR210]

SENATOR LOUDEN: How do these union people weigh in on this? [LR210]

KERRY EAGAN: Well, they haven't yet. I'm sure that they will, yeah. [LR210]

SENATOR LOUDEN: Okay. Well, thank you. [LR210]

KERRY EAGAN: You're welcome. [LR210]

SENATOR NORDQUIST: Would...is the county board asking that it be set in statute at 1 (sic) percent or that...would they be open to the idea of saying a floor of 1 (sic) percent and leaving the discretion up to them? [LR210]

KERRY EAGAN: Well, yes, we are asking for a statutory amendment for Lancaster County. It would be Section 23-1118 that would change the language. I don't know if I fully understand the question but if the board had the discretion to go to a one-to-one match, I think that would accomplish their purpose. [LR210]

SENATOR NORDQUIST: Yeah. Yeah, okay. And just so we don't maybe have them ten years from now again coming back in, asking to go back for some reason. That probably isn't likely. But I would think with this statute we would be able to say, you know, shall contribute no less than 1 (sic) percent and leave the flexibility up to the board as a possibility as well. [LR210]

KERRY EAGAN: Yeah. [LR210]

SENATOR NORDQUIST: Any other questions? Seeing none, thank you. [LR210]

KERRY EAGAN: Thank you. [LR210]

SENATOR NORDQUIST: Any additional comments regarding that? Seeing none, that will conclude our hearing today. Thank you all for being here. (See also Exhibit 6) [LR210]