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Nebraska Retirement Systems Committee
February 12, 2014

[LB1041 LB1042]

The Committee on Nebraska Retirement Systems met at 12:00 p.m. on Wednesday, February 12, 2014, in Room 1525 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on LB1041 and LB1042. Senators present: Jeremy Nordquist, Chairperson; Al Davis, Vice Chairperson; Russ Karpisek; Rick Kolowski; and Heath Mello. Senators absent: Danielle Conrad.

SENATOR NORDQUIST: All right. Good afternoon, everyone. I'm State Senator Jeremy Nordquist from District 7 in downtown and south Omaha and Chair of the Retirement Systems Committee. Today we will hear two bills, LB1041 and LB1042. To just go through our members up here. First, to my far right, is Laurie Vollertsen, our committee clerk; our legal counsel, Kate Allen. To my left, our page today is Nathan; he will help distribute any handouts or anything to the committee. In the back there are testifier sheets. Please fill those out and turn those in to Laurie when you come up to testify. Please state and spell your name for the record. Please silence your cell phones so they don't disrupt the recording. Joining us today, we have committee member Senator Russ Karpisek from Wilber; Senator Rick Kolowski from Omaha; Senator Al Davis, the Vice Chair of the committee, from Hyannis. I believe Senator Conrad will not be able to join us. And Senator Mello, I think will be joining us; Senator Mello is from Omaha. I have both bills up today so I will turn the Chair over to Senator Davis.

SENATOR DAVIS: Thank you, Senator Nordquist. And welcome to the Retirement Committee.

SENATOR NORDQUIST: Here we go, LB1041. Under LB1041, both the school employees retirement plan and the Class V retirement plan, which is the Omaha school employees retirement plan, under this bill new employees hired on or after July 1, 2014, would be required to work ten years before being eligible to purchase additional service credits, also known as air time. School employees who are members prior to July 1, 2014, would still only be required to work five years before they are eligible to purchase air time. There are several other changes to the Class V school plan, the Omaha plan, under this bill. First, it inserts a number of references to the Internal Revenue Code regarding the duties and responsibilities of the trustees who administer the plan. It clarifies that the school board or the board of trustees members will not be personally liable for their actions related to their retirement system duties except in cases of willful dishonesty, gross negligence, or intentional violations of the law. And the third provision is, beginning on March 1, 2015, and each March 1 after, any Class V school board will be required to annually present its most recent actuarial valuation to this committee, the reason being that this is the one defined benefit plan outside of the state system that receives significant General Fund dollars. But the main provision of the bill, the air time piece that applies to both plans, the general purpose of that is to ensure that workers put in a significant amount of time, ten years, before they're able to purchase additional

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years to enhance their benefit. We really think this is a fundamental fairness issue. With that I'd be happy to take any questions. [LB1041]

SENATOR DAVIS: Thank you, Senator Nordquist. Any questions from the committee? Senator Kolowski. [LB1041]

SENATOR KOLOWSKI: Thank you, Mr. Chairman. Senator Nordquist, would you describe the problems they were seeing in the system that brought this forward in this particular way? Because I've known lots of people between the suburban districts and the Omaha district that have gone back and forth between jobs as they've retired. [LB1041]

SENATOR NORDQUIST: Right. Well, we felt in working with some additional groups and through a number of discussions this interim with other colleagues, that there's a general concern about double-dipping going on; and this would create a little bit more of a barrier to prevent that from happening. The bill last year that we had on the school plan LB553 was probably the first time in my ten years around the Capitol here that awareness was really raised about retirement issues. And a lot of our colleagues began to really tune in to some of these issues, and this was one of the issues that came up a number of times this interim between other colleagues talking to me. So I tasked our legal counsel to look into it, to talk with both...all the representatives of the school plan, of the school members, and this is what we came up with, so. [LB1041]

SENATOR KOLOWSKI: If someone was going from Millard to OPS and this would be in place, if they went to Council Bluffs instead of OPS, is the Iowa law blocking them from doing the same thing they wanted to do in OPS? [LB1041]

SENATOR NORDQUIST: I think we looked into that but I can't remember. I think I would have to have Kate chat with you afterwards. I'm not...I can't remember what we... [LB1041]

SENATOR KOLOWSKI: Okay. Just a question. [LB1041]

SENATOR NORDQUIST: We did look at some other state models. [LB1041]

SENATOR KOLOWSKI: Try to think about what I might have to answer after we get out. Thank you very much. [LB1042]

SENATOR NORDQUIST: Sure. [LB1041]

SENATOR DAVIS: Any other questions? Senator Nordquist, the language that I guess I'll call it hold harmless language, it's a part of this bill; why was that added into it? [LB1041]

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SENATOR NORDQUIST: That was brought to us by the Omaha plan. There were questions and there will be an attorney representing the district behind me. I think there was just questions about who was liable and what the liability...where the liability landed. And I think they may have had issues maybe even recruiting some board of trustee members because of the questions around liability outside of the ones we identified: the gross negligence and the willful dishonesty. [LB1041]

SENATOR DAVIS: And so does it make the two plans synchronized? [LB1041]

SENATOR NORDQUIST: Yeah. So it would be right in line with the state plan. [LB1041]

SENATOR DAVIS: So this gives the Omaha plan the same benefits that the state plan already has. [LB1041]

SENATOR NORDQUIST: Right. With the...the PERB, yeah, that the PERB...the same liability protections. [LB1041]

SENATOR DAVIS: Any other questions? Thank you, Senator Nordquist. We'll now take proponent testimony. Are there any proponents for the bill? Welcome. [LB1041]

DAVID KRAMER: Thank you very much, Senator. Members of the committee, Mr. Chairman, my name is David Kramer, and on behalf of the Omaha Public Schools I'd like to thank you for the opportunity to testify here today. [LB1041]

SENATOR DAVIS: Mr. Kramer, could you spell your name, please? [LB1041]

DAVID KRAMER: Yes. It's K-r-a-m-e-r. I'm with Baird Holm LLP. We're at Woodmen Tower, 1700 Farnam Street, Omaha, Nebraska, 68102. I'm here as outside counsel to the Omaha Public Schools. The board of education asked me to share with you their general strong support for LB1041, and I would like to highlight a couple of the areas and answer some of the questions that have been raised here at this point. First of all, we are very pleased to see the support, and support the extension of the time and service necessary to be eligible to purchase additional service credit from five to ten years. That's Section 1 of this bill, which extends the amount of time you have to be employed before you can add the purchase of a service credit. Second of all, we very much appreciate the technical changes that are made in Section 2 of the LB1041. And I thought I would take just a moment to explain why it's important to the Omaha Public Schools. First of all, the current version of 79-980 consists of two subparts. The first subpart applies when the retirement system consists of only one Class V school district. That's the way we currently are now. The second subpart applies when the retirement system includes more than one Class V. And in 2012 there was language proposed and which was adopted by the Legislature to provide that certain provisions of the Internal

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Revenue Code be met by the administrator and the trustees when administering the plan. That language was added to subpart (2) of 79-980 which means that it applies only when there's more than one Class V school district currently. And so while it should have been added to subpart (1), it wasn't. This is just a technical change to include that language. And you'll note that the proposed language in Section 2 of LB1041 is actually duplicative of the language in the second paragraph that already exists in the current law. Third--and this goes to your question, Senator Davis--in examining the relationship established in 79-980 between OPS board of education and the trustees of the retirement system, we note that there's not really any defined liability standard for the members of the board of education when they act in their capacity as administrators and...as administrators of the retirement system and with respect to approval of fund investments. And with respect to this class...to this structure, the board of education is ultimately responsible and ultimately in charge of the retirement system. There are trustees who essentially serve in an advisory capacity, make recommendations to the board, but the board has ultimate approval. So what we proposed, and we appreciate very much the willingness to consider and include in this, was a liability standard. And the liability standard that we proposed be included applies to both the board of education and to the trustees, and that liability standard is the same that currently applies to the Nebraska Investment Council as set forth in 72-1237 and to the PERB in 84-1513. So we just transferred that same standard. And the reason we chose those two is because those two entities serve the same functions for the NPERS system that the OPS board and the trustees do, in this instance, for OSERS. We would ensure, by adopting this, that the board of education, which again has the ultimate responsibility for the retirement system, has the same liability standard that the Investment Council and PERB do. I would note that this same standard would also apply in that subpart (2) that I talked about when a Class V retirement system, if it were ever to get to be more than one...just one Class V school district. Fourth, I wanted to note with respect to Section 3 of LB1041, which deals with reporting, OPS OSERS is currently obligated and has been for some time to provide this committee with an annual report. We do that. It's consistent with obligations that are placed on NPERS as well. We understand that the current practice is following the submission of these annual reports that representatives of NPERS come in the fall to do a presentation at a public hearing before this committee. However, NPERS is not currently required by statute to do so, to attend that public hearing, and the Omaha Public Schools does not believe that it ought to be singled out in terms of having a single hearing that's designed solely for evaluation of the OSERS system. We understand that there are timing issues resulting from the different plan years, which might affect the ability to hold all of those hearings at the same time. That would be timely for this committee. But we think that those timing issues are relatively minor and we would be happy to work with the committee to ensure that we would testify at or about the same time as the others are testifying. And in the event that our final report has not been completed, that our actuary or appropriate person from the board of education could still come and testify. We would still propose that we would bring that report to this body as soon as it's complete. Our understanding

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is that this past year there was...the hearing on that was in November. The OPS report was approved by the board of education in its meeting in January, and so there might have been a two-month lag there in the time frame during this year. We also note that the city of...or that the Omaha Public Schools uses the same actuary that the state has recently retained; and so I think there would be some opportunity for discussion there without the need for a formal requirement in the statute that a hearing be held just for the one Class V school district that currently has a system. We would be happy to support that provision if a similar provision were inserted in language that relates to NPERS so that we would have the same obligations as NPERS does; but NPERS doesn't currently have that. And then while on the topic of reporting, I would just note a brief technical change that we would like to see. On page 7, line 11, we would like to see the addition of the words "of education," to follow the word "board," and strike out "of a retirement system established pursuant to 79-979." The purpose of this, from our perspective, is to clarify that ultimately as the law currently requires, the board of education is responsible for the management and operation of the retirement system, and therefore, it's the board of education that has the responsibility for the reporting back to this committee. Before I close, I would like to take a moment to share with the committee that the Omaha Public Schools is very appreciative of the time that Senator Nordquist and committee counsel Kate Allen have provided OPS as we work through the issues that have been raised in LB1041. We also have been very appreciative that they've reached out to us to address other issues related to the retirement system, and we remain very open and willing to work with you as individuals, Senators, if you have questions about what's happening at the Omaha Public Schools with this committee and with the Legislature as a whole, on all of the issues that affect our 51,000 students and our 8,000 men and women who devote their lives to serving those students. I would like to introduce briefly, if that's okay, Megan Neiles-Brasch. She is our new in-house counsel for the Omaha Public Schools. She's joined by John Lindsay and I don't know if Rochelle Mallett came in, who I know you know very well, are OPS lobbyists. Any time you have any questions about OPS, you should feel free to not hesitate to contact them. They have direct access to Mr. Evans, to the board, and to Ms. Neiles-Brasch. My partner, Gary Clatterbuck, who has worked with Ms. Allen on many occasions, who many of you may know is one of the Nebraska's experts on public sector pensions, is also available as a resource should you need it. Thank you again very much for the opportunity to be here on behalf of the Omaha Public Schools, and I would be happy to answer any questions the committee might have. [LB1041]

SENATOR DAVIS: Thank you, Mr. Kramer. Any questions? Senator Kolowski. [LB1041]

SENATOR KOLOWSKI: Thank you, Mr. Chairman. Mr. Kramer, on the...just to make sure I'm understanding what's taking place here now again, if someone came from a suburban district and extended their teaching time in OPS, five years would give them...they'd be vested into the retirement program, is that correct? Because we're talking about ten years. You have to be ten years in order to buy additional years.

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[LB1041]

DAVID KRAMER: Yeah. This provision--and Senator Nordquist, if you want to jump in--this provision is designed to identify at what point you can buy additional years. [LB1041]

SENATOR KOLOWSKI: And that's ten years. [LB1041]

DAVID KRAMER: Now it's currently five and this would move it to ten. [LB1041]

SENATOR KOLOWSKI: Correct. []

DAVID KRAMER: It does not address any aspect related to how long you serve if you came from a suburban district into OPS. [LB1041]

SENATOR KOLOWSKI: You must serve five in order to get a retirement possibility, is that correct? [LB1041]

DAVID KRAMER: Well, you...under the current retirement system, you begin to accrue...if you were an employee in any other school district than the Omaha Public Schools, and you came to the Omaha Public Schools, you begin to accrue retirement benefit from day one. You would have to wait five years of being employed with the Omaha Public Schools under current law to buy additional years of credited service. This law would change that to say you have to wait ten years to be able to do that. [LB1041]

SENATOR KOLOWSKI: But I'm talking about being vested in the retirement...in the OPS retirement plan. That happens at the end of five years, correct? []

DAVID KRAMER: I believe that's the same as the NPERS system. [LB1041]

SENATOR KOLOWSKI: Thank you. That's my final clarification. [LB1041]

SENATOR DAVIS: Any other questions? So just following up on this, is there going to be any fiscal ramification from the change in terms of helping the system or hurting the system? [LB1041]

DAVID KRAMER: None. We don't believe there's any fiscal impact here. If anything, this language...this would help, because some people who currently would buy in after five years, would have to wait ten to do that; and that may keep a lot of people from buying in at all. []

SENATOR DAVIS: Any other questions? Thank you, Mr. Kramer. []

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DAVID KRAMER: Thank you. [LB1041]

SENATOR DAVIS: Are there other proponents? Seeing none, any opponents? Anyone testifying in the neutral capacity? Senator Nordquist. With that, that will terminate the hearing on LB1041. We'll now take testimony on LB1042. [LB1041]

SENATOR NORDQUIST: Thank you. Again...sorry, for the record, State Senator Jeremy Nordquist from District 7, downtown and south Omaha. LB1042 was introduced to change the cost of repurchase of relinquished creditable service in the school employees retirement plan. The Nebraska Public Employees Retirement Systems has calculated that the cost currently assessed is not adequately covering the cost of restoring the service credits. And you may remember this is an issue that was raised during an interim study this fall. Service credits are relinquished when a member terminates employment and withdraws all accumulated contributions. If the person again becomes a school employee, he or she has the option to buy back those relinquished credits. The current cost charged to the member is equal to either the amount he or she withdrew plus interest if the application to purchase service is filed within three years of rejoining the system, or the amount he or she withdrew plus the actuarial assumed rate of return for the period if the application is filed after three years of rejoining the system. LB1042 would change the cost of repurchase to the actuarial cost to the school retirement system for restoration of the relinquished service credits. The actuarial cost for such repurchase would apply to members who file an application with the Public Employees Retirement Board for restoration of their services on or after an unspecified date. Eligible members who file an application for restoration of service prior to the unspecified date will be charged the current lower cost. So, obviously, we have to specify that date through our committee deliberations, but. So I'd be happy to answer any questions on this. [LB1042]

SENATOR DAVIS: Any questions? Senator Nordquist, if you can refresh my memory a little bit about the interim study. [LB1042]

SENATOR NORDQUIST: Right. [LB1042]

SENATOR DAVIS: Did we identify a specific number of people who have used this? [LB1042]

SENATOR NORDQUIST: Well, we know...and I don't know if Director Chambers will testify. The number that sticks out now is that there are about 2,400 people who have rejoined and would be eligible for purchasing, for buying back their service. And I think the question that will come up for us is, how do we treat those people that have rejoined but have not purchased yet? Where do we draw the line for those people? Or is it that people are rejoining, starting whenever we, you know, put the date into effect? So that's

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what we're going to have to deliberate on. I'm not...I know she handed out the interim study chart of the buybacks, but I don't remember those numbers. [LB1042]

SENATOR DAVIS: Thank you. Any other questions? Now we'll take proponent testimony on the bill. Welcome, Phyllis. [LB1042]

PHYLLIS CHAMBERS: (Exhibit 1) Good afternoon, Vice Chairman Davis and members of the Retirement Committee. For the record, my name is Phyllis Chambers, P-h-y-l-l-i-s C-h-a-m-b-e-r-s, and I'm director of the Nebraska Public Employees Retirement Systems. As has been stated, the school plan members have the ability to purchase service credit in order to increase their formula benefit and retire earlier than they would otherwise. By statutes, members pay the actuarial cost for air time, which is what was talked about in the last bill, leaves of absence, and out-of-state purchases. The actuarial cost of purchasing these services is based on the member's age, their current service credit, and their highest year of salaries at the time they purchased the credit. It is assumed that the member will retire at the earliest possible age to meet the Rule of 85. The practice of charging the member the actuarial cost of the service pays for the member's increased lifetime benefit and makes the purchase of service essentially cost neutral to the plan. Currently, school plan members do not pay the actuarial cost for buying back refunded service. The members pay, as stated, the refund amount plus interest or the refund amount plus the assumed rate, whichever is applicable. This practice does not pay for funding the increased liability of the member's lifetime benefit and shifts the cost of the refunded service purchase to other members, to the employers, and to the state. Last December 2013, the Retirement Committee held a legislative study, LR198, in which I testified about purchase of service credit in the school plan, and I have provided you with a ten-year history of NPERs's purchase of services. The study showed that 1,468 members purchased over 6,000 years of service credit...of refunded service credit for a total of \$21.5 million over that ten-year period. The members paid an average cost of \$3,500 a year, but if the members would have paid the actuarial cost, we estimate that to be about \$15,000 per year of service credit, the total would have been approximately \$91 million. That's a difference of almost \$70 million over the ten-year period from 2003-2013, which increased the unfunded liability of the plan by that amount. NPERs also, because we wanted...we didn't go back and look at all 2,000 of those; you'd have to pull each one and determine what the actuarial value was. We took a look at 40 of the last refunded purchases that we had of actual purchases in the last year, and we calculated that the actuarial cost per year of those services purchased was an average of \$17,000 per year. So we think \$15,000 is a reasonable estimate. The average cost charged to the member was \$4,900 per year. The members purchased anywhere from one to 25 years of service, with an average of 4.8 per year...excuse me, 4.8 years purchased. The members' ages ranged from 44 to 69 years of age, with an average of 58 years. The members' annual salaries ranged from \$36,000 to \$141,000, with an average of \$73,000 annual salary. We calculated that the unfunded liability to the school plan would have increased by \$1.8 million for

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those 40 members who did not pay the actuarial cost of the refunded service. Looking at the history of the school plan, the purchase of refunded service and out-of-state service has been in effect from the beginning of the plan when it was established in 1945. At that time, members had to return to work within three years of terminating and taking the refund. They were charged 3 percent interest on the purchase. It wasn't until 1981 that purchase of service changed to add leaves of absence; and in 1996 the purchases of out-of-state service and leaves of absences were changed to the actuarial cost. At that time it was discussed whether refunded service should be included in the actuarial cost in the change. In the 1996 legislative records, LB1119, there was discussion of whether...of changing the refunded service. The actuary at the time recommended that any buyback provision should not provide a significant indirect or unintended subsidy to the employee buying the service at the expense of continuing members. The experience of buyback provisions should be monitored so that adjustments can be made as necessary to the contributions required by employees. Also in the record, NPERS recommended that the committee consider requiring the actuarial cost, and it included the actuary assumes that if money is withdrawn, benefits will not be provided so that the additional matching contributions are used to offset other liabilities under the system. We commonly refer to these as forfeitures. When members repay withdrawn contributions, unfunded liabilities will arise due to the additional service credit even though previous contributions were made. A year later, in 1987, air time was added to purchase of service, and that was added at the actuarial cost to buy it. And in 2001, the Legislature removed the time limit to purchase refunded service and allowed purchases any time during the member's career. Up until that time, it had been within three years of returning to work. This change has significantly increased the number of members applying for refunded service, especially during the final years of employment. NPERS estimates that there are approximately 2,400 current members who have refunded service on the books. We have two employees assigned for purchase of service who normally process approximately 200 purchase of services each year, in addition to their other retirement work on school, judges, and patrol benefit processing. We estimate that if half the eligible members apply to purchase service, we would need to process 1,200 purchase of service within one to two years. And we don't know how many will actually want to apply, but once you set a cutoff date and we notify members and the discussion is out there, we think that many people will apply. A conservative estimate is that NPERS would need to hire two new retirement specialists to handle the workload. The future savings to the plan will more than offset the additional personnel costs. We anticipate that this is going to be a huge project. The implementation dates of LB1042 are not...have not been specified, but we understand that all new and rehired members would be required to pay the actuarial cost when the bill becomes effective, to limit any further increases to the unfunded liability and any other members coming in. And then we would like the bill to allow at least a year for current members to apply. That would give us time to notify members, to plan and manage the process, and spread the workload. Even then, we anticipate delays in processing refunded service depending on how many apply, the number of estimates that people request. Not

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everybody applies that receives an estimate, and sometimes they get more than one estimate until they decide how much they can afford to buy. And then there are various payment methods that they choose, and setting up those payments sometimes takes quite a while. So we estimate it takes about two months on average to set up somebody from beginning to end. And, of course, there are various stages of processing during that time. We also have demands of performing our regular benefit duties at that time, as well. The board has not formally voted to support LB1042, because our last board meeting was prior to the bill's introduction. I have discussed the legislation with Chairman Denis Blank and our legislative chair, Elaine Stuhr; and I am able to state that there is a general consensus of the board in favor of this legislation. Thank you for introducing this bill, and I would be happy to answer any questions. [LB1042]

SENATOR DAVIS: Thank you. Any questions from the committee? Thank you, Ms. Chambers. [LB1042]

PHYLLIS CHAMBERS: All right. [LB1042]

SENATOR DAVIS: You did a thorough job of explaining it. [LB1042]

PHYLLIS CHAMBERS: All right. Thank you. Good. [LB1042]

SENATOR DAVIS: We will now take supporters of the bill, proponents. [LB1042]

MIKE DULANEY: Senator Davis, members of the committee, my name is Mike Dulaney, D-u-l-a-n-e-y, and I'm the executive director for the Nebraska Council of School Administrators. And I, for one, appreciate the fact that you take your lunch hour to have these hearings; so thank you. Ms. Chambers did such a nice job in explaining the bill, there's no need for us to go over the details. We support what is being done in this bill and we think it's a good idea; so we support it and encourage you to move the bill forward. [LB1042]

SENATOR DAVIS: Thank you, Mr. Dulaney. Nice and brief. We like it that way. [LB1042]

MIKE DULANEY: You betcha. [LB1042]

SENATOR DAVIS: Any questions? Next proponent. Welcome. [LB1042]

JASON HAYES: (Exhibit 2) Hello. Good afternoon, Senator Davis and members of the Retirement Committee. For the record, my name is Jason Hayes, J-a-s-o-n H-a-y-e-s. I am here today representing the 28,000 members of the Nebraska State Education Association. NSEA is testifying in support of the bill. LB1042 represents another commonsense pension reform that, similar to what this committee did last year with

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LB553, will help ensure the continued financial soundness of the school employees retirement plan. We view the changes proposed in the bill as helping to make sure that the actions of a few school employees, who by removing their contributions prematurely, do not result in those same members receiving a special subsidy to the detriment of a cost being imposed upon the remaining members who leave their contributions in the plan. Actuarially speaking, the entire plan should not be covering the opportunity cost for a member who receives a refund and later repurchases service credit back from the plan. We thank Senator Nordquist for introducing the bill and the committee for continuing their work in making the school employees retirement plan a well-managed and responsibly run defined benefit plan. And I thank you for your time. [LB1042]

SENATOR DAVIS: Thank you, Mr. Hayes. Any questions? Seeing none, we appreciate you coming. [LB1042]

JASON HAYES: Thank you. [LB1042]

SENATOR DAVIS: Next proponent. Any opponents? Anyone testifying in the neutral capacity? Senator Nordquist? Senator Nordquist waives. That will conclude the hearing on LB1042. [LB1042]