Retirement Roundup

"Providing Information to State & County Employees"

Nebraska Public Employees Retirement Systems — Vol. 17, No. 7, Fall 2002

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Frequently Asked Questions About Cash Balance vs. Defined Contribution

The choice you must make by December 1 between the new cash balance benefit and the current defined contribution benefit is a personal choice only you can make. You should consider your own financial objectives, the expectations you have of your retirement plan AND your ability to tolerate risk.

It is exciting to have a choice, but unfortunately it will not be an easy choice. In fact, once you make it you may second-guess yourself and wonder why you did what you did. Try to remember this: it is not a choice of "good vs. evil." What may be right for you may not be right for your neighbor. Also, no choice is a choice. If you do not return an election form by December 1, you will REMAIN in the defined contribution plan.

As proof of the importance of this issue, the turnout for the meetings describing the new cash balance benefit for state and county employees has been absolutely tremendous. We are delighted by the response! By mid-October we will have held nearly 150 sessions statewide.

We are getting insight from the members who attend the meetings based on the concerns/ questions they submit to us. The feedback has helped us develop a list of frequently asked questions, besides helping us refine our presentation. Here is a sample of questions we have been asked that we hope will assist you as you make your decision:

Q - Is the cash balance just like the School Retirement Plan?

A - No. The School Plan offers only a lifetime annuity at retirement and the amount is based on years of service and salary. By contrast, your cash balance benefit is based on your account balance (employer and employee contributions and interest), and you have multiple disbursement options. The School Plan has a "formula annuity" and cash balance uses your account balance to determine your annuity.

Q - Why was the cash balance chosen instead of a "defined benefit" which is already in place for school, judges and patrol employees?

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CONFIRMED!

In August, all State and County Plan members received a packet explaining the new cash balance benefit. Included in that packet was an election form which is to be completed and returned by members designating their choice to either convert to the new cash balance benefit or remain in the defined contribution benefit.

By mid December, **NPERS will issue a confirmation card** to individuals who have returned their signed election form.

Remember, the deadline for making your choice is *December 1, 2002*. If you do not submit an election form, you will automatically remain in defined contribution.

FAQ's

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A - Traditional defined benefit plans cost more to implement and, in these times of budget constraints, the Legislature did not want the added financial liability. The School Plan when first established in 1945 was similar to a cash balance plan, but has changed with many improvements over the years. The cash balance for state and county employees could be considered a "baby step" toward a defined benefit.

Q - How can the state guarantee a 5% floor rate of return with the cash balance when the market is currently not doing well?

A - The risk horizon in cash balance (as with the School, Judges and Patrol Plans) will always remain at 30+ years. This means we must look beyond the past several years to see the rate of return to compare to the guaranteed rate. The 20-year average rate in the School, Judges and Patrol Plans is around 11%. This is well above the cash balance guaranteed rate of 5% and also well above the federal mid-term rate plus 1.5 % (which averaged 8.45% in roughly the same period). Keeping a 30-year risk horizon in mind, there is little chance of the fund not meeting the guaranteed rate. In fact, it is more likely a reserve will be created that will cushion the fund from investment shocks like those we have experienced in the markets over the past 18 months. Any higher returns can be paid as "dividends" for members' accounts or can be used (as has been done in the School Plan) to enhance future retirement benefits.

The Investment Council monitors the money managers in *all* retirement plans administered by NPERS. These managers are measured against "benchmarks" as a way of comparing them to other similar money managers. Our money managers have met or exceeded their benchmarks. This means they were doing as good a job of managing the assets as their peer managers. The last 18 months have been unkind to all managers and all stocks – but 18 months is very short compared to the 30-year risk horizon. In the very unlikely event the guaranteed rate is not met, the state is obligated to use general fund tax revenue to cover the shortfall.

Q - What is the federal mid-term rate and how is it determined?

A - The federal mid-term rate is a rate published to reflect the average return of U.S. government bonds that mature between 3 to 9 years. The rate as of August 30, 2002 was approximately 3.75%. We will use the rate published at the end of the year and each quarter thereafter plus 1.5% to determine the interest credit rate for cash balance member accounts.

Q - What if an employee kept their defined contribution account, then terminated employment, and later came back to work for the state or a county?

A - That depends on the length of the termination. State and county employees with a termination "break" of *over 120 days* would be considered new employees and would participate in cash balance. Any prior retirement funds they had deferred (left invested on account) would be rolled into cash balance (even if they previously elected to remain in defined contribution). If the length of termination is *120 days or less*, they are not considered a terminated employee and would remain in the plan they previously selected. The member must repay any termination benefits.

Q - Once you make your choice to either convert to cash balance or keep defined contribution, can you ever change back?

A - No. Not under current legislation.

Q - Will there always be the 11 investment choices offered in defined contribution, or will there be more or fewer choices?

A - There are no plans to reduce or change the number of investment choices for members who remain in defined contribution. Keep in mind, these investment funds are also utilized for the Deferred Compensation Plan, which will remain unchanged.

Before NPERS and the Investment Council offer more fund choices, utilization of the current fund choices needs to increase.

Q - Why weren't employees allowed to phase into the new plan over a two or three year period? When converting to the new plan, there is a good possibility a person will sell at a low.

A - When the idea was first studied several years ago, the stock market was at a different point in the cycle than it is today – but the Legislature's action was completed in 2002. In creating cash balance, the Legislature was aware members needed to remain in cash balance through investment highs and lows to keep the plan stable. Those in the current plan are given a chance to "buy in" to the new benefit, but in the interest of stability, the Legislature did not leave this "buy in" window open indefinitely. It would not be prudent to allow people to attempt to "time the market" because it could destabilize the plan funding. Thus one date was chosen for the change and that date was the start of a new plan year (January 1, 2003). Another date could have been chosen, but because the market is uncertain, there is no guarantee the other day would have been any better than January 1. The Legislature would need to weigh the increase of choice against adding risk to the plan in deciding whether to reopen the window in the future.

Q - Will new members have a choice?

A - No. All employees who enroll in the retirement system after January 1, 2003 will receive the cash balance benefit.

Q - If we leave the funds where they are in the current plan, will this mean an increase in costs since new employees will be in the new plan?

A - The fees and costs in defined contribution are very low. They range

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FAQ's

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from 5 basis points in the S & P 500 Fund to 80 basis points in the International fund. By contrast, most retail mutual funds have fees ranging from 100 to 300 basis points. NPERS and the Investment Council use institutional fund managers who manage other assets (in the School, Judges and Patrol Plans) to help keep these fees low. This practice will continue even with cash balance in place.

With respect to record keeping, Ameritas will remain the provider of services to defined contribution and cash balance, as well as to the Deferred Compensation Plan. Ameritas' fees are set by contract, and are stable until the next time the contract is bid.

Q - Are the options at retirement the same with both cash balance and defined contribution? Why are the annuities calculated differently?

A - The disbursement options are nearly the same with two exceptions. Cash balance will not offer the systematic withdrawal option. Both will offer annuities, but cash balance will provide a higher annuity because the anticipated investment performance has been designed to not only provide the guaranteed rate of return, but to also create a reserve in order to fund the improved annuity. In other words, the improved annuity is an integral part of cash balance.

Information about the retirement options can be found in your retirement handbook, available from your personnel contact or on our web site at **www.nol.org/home/pers/**. Also on our web site is a benefit estimator you can use to calculate monthly estimates under all the annuity options.

Q - What is the difference between an annuity and systematic withdrawal?

A - With systematic withdrawal, you withdraw dollars from your account at

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LEGAL CORNER

by NPERS Legal Counsel,
Shawn Nowlan

State Retirement Plan vs. Deferred Compensation Plan (DCP)

I was speaking with two NPERS staff members, "Lucy and Ethel," about the new cash balance benefit and the choices they had to make. "Lucy and Ethel" asked me if the cash balance plan would affect their Deferred Compensation Plan accounts. Would these accounts be a part of the cash balance conversion?

The short answer was: "***NO** your cash balance decision does NOT affect your deferred compensation account*." However, "Lucy and Ethel" told me they could use a "refresher" on the difference between the "State Employees Retirement System" and the "Nebraska Deferred Compensation Plan." This Legal Corner will compare these two plans.

There are three *similarities* between your retirement plan and DCP:

- Your contributions to both plans are *pre-tax* (you are not taxed when you contribute to either plan; you are only taxed when you take money out).
- The same *investment choices* are available in the State Plan employee account if you stay in the defined contribution benefit and have a Deferred Compensation Plan account.
- When you cease state employment, you may leave your money invested in either plan *until you turn age 70½.*

There are six important *differences* between the plans:

Plan Feature	State Retirement Plan	Deferred Compensation Plan
Authorizing Federal Law	I.R.C. § 401(a)	I.R.C. § 457
Participation	MANDATORY after 12 continuous months of full-time service, and VOLUNTARY with part-time service and/or with 12 months of service within a 5-year period.	ALWAYS voluntary
Contribution Rate	SET BY STATUTE: 4.33% of pay until $864 contributed; then 4.8% of pay for all additional contributions	SET BY THE EMPLOYEE: Minimum = $25 per paycheck; and Maximum annual contribution = 100% of pay or $11,000 (whichever is less).
State Matching Contribution	156% of member amount	NO EMPLOYER MATCH
Distribution of Money – When Allowed:	Termination of employment or thereafter	Hardship *during* employment, OR Termination of employment or thereafter
Subject to Cash Balance Choice?	***YES***	***NO***

A Point to Consider

Those who choose cash balance may continue to invest in the market if they also participate in the Deferred Compensation Plan. By utilizing both plans, a member may receive a guaranteed rate of return on his/her cash balance account and a market rate of return on his/her deferred compensation account.

If you have questions on DCP, call NPERS at **800-245-5712** or **402- 471-2053.**

One Plan - Two Benefits

LB 687 brings unprecedented change to the retirement systems created for state and county employees. The process of accruing (accumulating) a benefit during a member's career is very different between the new benefit and the current benefit. The cash balance benefit accrues an account balance at a legally promised rate and offers an enhanced annuity, while the defined contribution benefit rises and falls with investment gains and losses.

Yet for all the change LB 687 makes to the ongoing accrual of a benefit, many things remain unchanged. Cash balance and defined contribution share the same basic retirement plan. This article reminds members of some aspects of the retirement plans that <u>both</u> benefits share.

Eligibility requirements are identical:

- All *full-time* employees are REQUIRED to join the retirement plan after 12 months of *continuous* service ("full time" means those who work ½ or more of the regularly-scheduled hours during each pay period);
- All employees (*full-time or part-time*) who serve 12 months within a 5-year period and are at least 20 years old MAY elect to join the retirement system voluntarily.

Employee contribution rates remain the same:

In the County Plan:

- Members contribute 4.5% of pay beginning January 1, 2003 (all sworn law enforcement officers contribute 5.5% of pay, except Sarpy County officers who contribute 6.5%);

In the State Plan:

- Each year members contribute 4.33% of pay until they have contributed $864 to the Plan ($19,954 in salary), the rate then increases to 4.8% for the remainder of the year.

Matching employer contributions remain the same:

In the County Plan:

- Employee contributions are matched at 150%;
- All sworn law enforcement officers' contributions, except for those from Sarpy County, are matched at 150% for the first 4.5% of contributions as of January 1, 2003, and 100% for the additional 1% (a total of 7.75% of pay);
- Sarpy County law enforcement officers' contributions are matched at 150% for the first 4.5% of pay and 100% for the additional 2%.

In the State Plan:

All contributions are matched at 156% of member contributions.

Vesting

Vesting for both plans now occurs after three years (includes the first 12 months of continuous service plus 2 years of plan participation), including any eligibility and vesting credit a member has been granted at the time of enrollment.

Pre-distribution death benefits remain the same:

If members die before taking a distribution from their account, the options available to their beneficiaries remain the same. The death benefit consists of the member's total account balance including employer and employee contributions – this means you are automatically vested if you die before terminating employment.

Most options at termination or retirement are shared:

In all plans, members have these options when ceasing employment:

- Purchase an annuity (a monthly payment for your lifetime);
- Take your money as a lump-sum distribution (taxable income);
- Roll your money into another tax-deferred account (rollover);
- Leave your money at NPERS until you turn 70½ years of age; or
- Choose a combination of the above.

NOTE: In defined contribution, you may also take systematic withdrawals of money from your account (you determine the frequency and dollar amount);

Annuity options are shared - dollar amounts differ:

You have the *same annuity options*. For example, you may choose a 5, 10, or 15 year "Certain and Continuous" option for both cash balance and defined contribution, however, cash balance will provide a greater annuity amount.

Cash Balance Video

Cash Balance vs. Defined Contribution meetings have been held across the state. Although we have made every effort, it is impossible for us to reach every State and County Plan member.

To ensure every member receives the information needed to make their decision, the Retirement Office has made a video tape of the presentation.

Copies of the video are available for state agencies and counties to "check out" for one week.

To reserve a copy, call NPERS at **402-471-2053** or **800-245-5712.**

FAQ's

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the frequency and dollar amount you determine. Your account balance may fluctuate in value depending on your investment returns. Once you have depleted your account, there is no more money available. With an annuity, you turn over a specified amount from your account in exchange for a monthly benefit guaranteed for your lifetime. Market fluctuations will not affect an annuity.

Q - If you decide to convert to cash balance, will just your employee account convert or will your employer matching account convert also?

A - Both your employers' and your contributions will convert at the close of business on December 31, 2002.

RETIREMENT ROUNDUP
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