Miscellaneous Document 4: Letter from Coates, Herfuth, & England to Kenneth Buck, Executive Secretary, Public Employees' Retirement System, regarding the liability of PERS. In Archives' files between 3/7/69 and 3/10/69 meetings.

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March 10, 1969

Mr. Kenneth Buck, Executive Secretary
Public Employees' Retirement System
State of Nevada
P. O. Box 637
Carson City, Nevada

Dear Mr. Buck:

Based on the personnel data furnished us by your office and the Statement of Resources and Liabilities reflecting the conditions of the Retirement Fund as of July 1, 1968, we have completed the investigation and valuation of the Nevada State Retirement System as of July 1, 1968.

It will be our recommendation to the State Legislature that no increases in benefits be considered at this time unless sufficient contributions are provided to fully fund the additional benefits.

We have taken the position that increased benefits must be offset by contributions sufficient to fully fund the benefits, not as an attempt to move in the direction of a fully funded plan, but rather to point out that we must review the existing funding method of the basic Plan as it now stands before creating greater deficits by the addition of unfunded benefits at this time.

It is our understanding that the State of Nevada never intended to become a funded System, but rather to exist as a "Modified Funded" System.

Recognizing that it is not your intent to become fully funded, we must ask whether it is your intent to allow the State to accrue an ever-increasing liability without consideration as to how the liability may be limited.

This "ever-increasing" liability is created by a failure to meet the interest expense on the unfunded liability. We must consider interest of this nature a requirement of the fund, because it is needed to provide for present Plan benefits.

The current unfunded liability as of July 1, 1968, under the present Plan is $117,052,000. Were this amount contributed as a lump-sum, then it is apparent that in the future interest would be earned on it and such interest would help offset the cost of present Plan benefits. It is also evident that were a lump sum in the amount of the unfunded contributed, this would completely liquidate the unfunded liability.

We believe that it follows that were only the interest attributable to the unfunded contributed, then this unfunded would not increase (we have limited it) and would always remain at a constant level, assuming our actuarial assumptions were exact.

Since we observe that the unfunded liability under this method is never liquidated, while at the same time it is neither increased nor decreased, we can now conclude that the System is still not fully funded. Rather we are merely keeping the potentiality of the State liabilities from increasing, ad infinitum.

In view of the above, it is our opinion that contribution levels must be raised to meet the interest requirement on the unfunded liability of the present System, prior to any consideration of increased benefits. Or, as discussed previously, if benefits are to be increased, then they must be fully funded. Only in this manner can you prevent the existing liability from increasing.

We deem the current year a critical one for legislative decision. Indicated below are the results of our valuation as of July 1, 1968. The rates of contribution shown are percentages of compensation.

Method #1 - Equal Rates

By Employee and Employer

	Present Rate	Fully Funded Rate	Interest Only Rate
Employee	6.00%	11.86%	8.19%
Employer	6.00	11.86	8.19

We have said this is a critical year for legislative decision. Why?

In our letter of February 28, 1967, we stated that based on the July 1, 1964, valuation the required contribution under the interest only "method," was 7.75% from each, the employer and the employee. Since that last valuation, the contribution rate has been increased 1/4 of 1% from the employer and employee. This should decrease unfunded costs. The current year's valuation as of July 1, 1968, was based on the assumption that future earnings of the fund would average 4½% as compared with 4% assumed July 1, 1964. This should decrease unfunded costs.

Notwithstanding the steps described above, we find that your contributions of 5-3/4% and then 6.00% in lieu of the suggested 7.75% rate, have in fact been deficient and have resulted in increasing the unfunded to $117,052,000. This amount of unfunded liability requires an "interest only" rate of contribution of 8.19% from each, the employee and employer.

We as your actuaries would of course prefer to see a rate of contribution between the "fully funded" rate of 11.86% and the "interest only" rate of 8.19%.

However, in lieu of our preferences, we must strongly recommend that you move at least to the "interest only" rate.

At present the differential between that now contributed and our recommendation is 2.19% (8.19% - 6.00%) from each, the employee and employer. We feel that unless you immediately move to 8.19%, the differential will certainly increase to such a point where eventually it will become "impossible" to make the change. The differential of 2.19% or actually 4.38% (employee and employer) must become 5, 6 or 7% or greater if the current practice is continued.

Shown below is a comparison of the unfunded liabilities of the System depending on the date the "interest only" rate is adopted. We have also indicated the combined additional employee and employer contributions required annually to change to the "interest only" rate as of the same date.

Estimated Unfunded Liability
July 1, 1968 to July 1, 1976

		Immediate Change to "Interest Only" Rate	Continuation of Present Contribution Rate
A-1	7-1-68	$ 117,052,000	$ 117,052,000
B-1	7-1-72	117,052,000	139,600,000
C-1	7-1-76	117,052,000	166,500,000

A-2 Estimated additional combined employee and employer contribution required to immediately change to "interest only" rate as of July 1, 1968:

$ 6,800,000

B-2 If 12% (6% employee and 6% employer) rate is continued, then the estimated additional combined employee and employer contribution required to change to "interest only" rate as of July 1, 1972:

$ 9,000,000

C-2 If 12% rate of contribution is continued, then the estimated combined additional employee and employer contribution required to change to "interest only" rate as of July 1, 1976:

$ 11,600,000

We ask that you eliminate this "problem" now, while still within your grasp. We ask that you consider increasing contributions while maintaining the present level of benefits. In addition, if benefits are to be increased, then their costs must be fully funded.

It may present a problem to the State to increase employee contributions without increasing benefits. With this in mind, we have determined what we shall refer to as "Method #2 - Unequal Rates." Under this method, the employee's rate of contribution remains at 6.00% of compensation, while the employer's rate provides the balance of costs.

Method #2 - Unequal Rates

	Present Rate	Fully Funded Rate	Interest Only Rate
Employee	6.00%	6.00%	6.00%
Employer	6.00	16.66	9.98

The reason the total "interest only" rate under Method #2 of 15.98% is less than the comparable Method #1 rate of 16.38% is because on termination of the employee the employer's monies remain in the fund to offset other benefit costs.

Each of the "interest only" methods of contribution is acceptable to us. Both methods will be described to the legislature with a strong recommendation that one or the other be adopted.

In addition to the above, we were asked to comment specifically on four proposed amendments. Three of these are contained in this memorandum, while the fourth, pertaining to vesting, will be discussed in a separate memorandum. In keeping with our above expressed position, we have indicated below the estimated percentage of contributions required from the employee and the employer under Method #1 and Method #2. Those estimated rates of contribution shown below will fully fund the proposed amendments.

I. S. B. 124 - Removal of 30-year limitation and the granting of a 1.5% of average 3-year compensation for all years in excess of 20 years.

	Method #1	Method #2
Employee	.67%	0%
Employer	.67	1.22

II. S. B. 266 - Increasing post-retirement benefits from 1.5% to 3.0%.

	Method #1	Method #2
Employee	1.80%	0%
Employer	1.80	3.28

The above is based on the present law which provides a fixed dollar increase each year. Compounding annually as provided in S. B. 266 would require that the above rates be multiplied by an approximate factor of 1.04. We therefore note that the major impact is in moving to the 3% level as opposed to the effect of compounding.

III. A. B. 560 - Reduce retirement ages by 5 years.

	Method #1	Method #2
Employee	2.05%	0%
Employer	2.05	3.72

We trust that this memorandum clearly states our position, and the position we will take before the legislative session on March 18. Should you have any questions or wish to discuss any matters described herein, by all means let us hear from you.

Respectfully submitted,

COATES, HERFURTH & ENGLAND
Consulting Actuaries

By Sanford M. Jacobson
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SMJ/sap