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February 23, 2015

Mr. Sparb Collins
Executive Director
State of North Dakota Public Employees' Retirement System
400 East Broadway, Suite 505
P.O. Box 1657
Bismarck, ND 58502

Re: **Technical Comments – Bill Draft No. 15.0137.03000 (House Bill No. 1080)**

Dear Sparb:

The following presents our analysis of the proposed changes found in draft Bill No. 15.0137.03000 (House Bill No. 1080):

Systems Affected: North Dakota Public Employees Retirement System (PERS) Hybrid Plan and Defined Contribution Plan

Summary: The bill would adjust member contribution rates for Peace officers in the Hybrid Plan employed by the State bureau of criminal investigation, for which member contributions would decrease by 0.5% of monthly salary. While not part of the draft bill, we have assumed the employer contributions will not decrease in 2016 unless approved by the PERS board.

The proposed legislation would also make the following benefit modifications for Hybrid Plan members (except for National Guard security officers, peace officers or correctional officers employed by the Bureau of Criminal Investigation or by a political subdivision, or a Supreme Court or district court judge) first enrolled after December 31, 2015:

- Final average salary would be based on the five highest periods of twelve consecutive months employed during the last one hundred eighty months immediately preceding retirement, excluding months without earnings. Currently, final average salary is based on the highest salary for any thirty six months employed within the last one hundred eighty months of employment, with no requirement for any months to be consecutive; and

- The minimum age at which unreduced benefits could begin (normal retirement date) would be increased to a combined total of years of service credit and years of age equal to ninety where member is at least sixty years old (Rule of 90). Currently, normal retirement age requires attaining age 65 or Rule of 85 with no minimum age; and

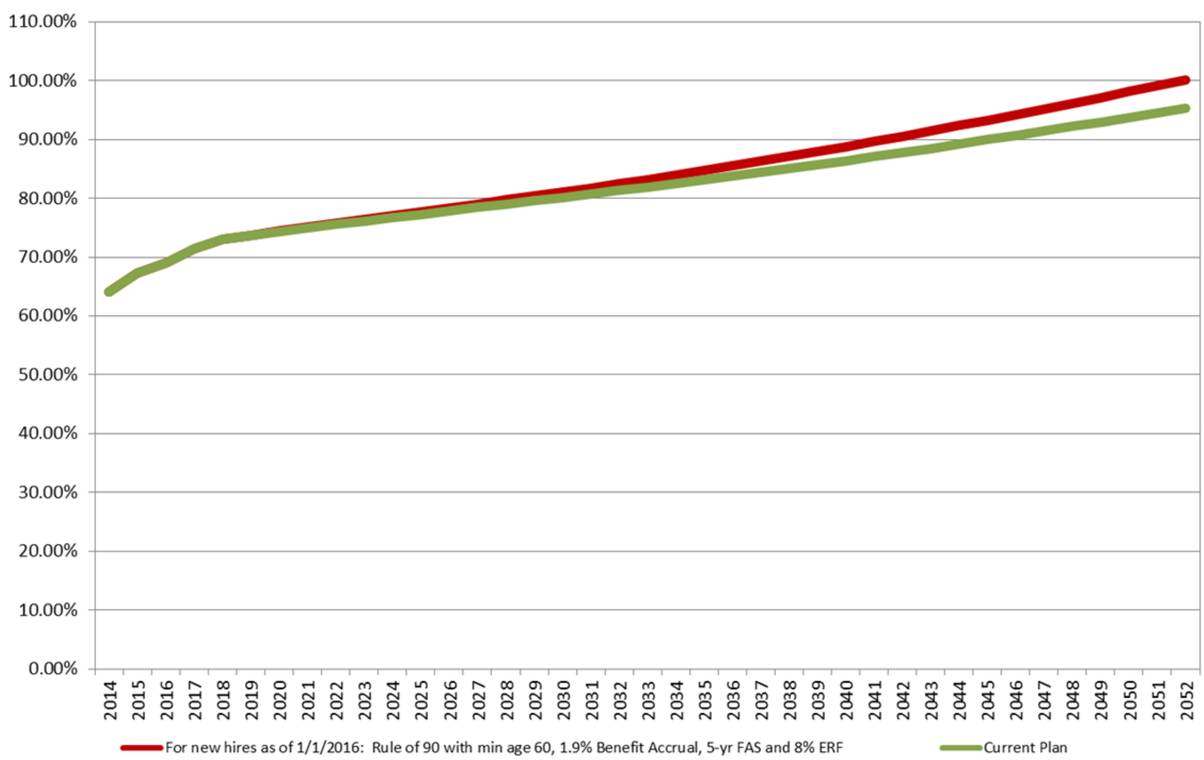
- The early retirement reduction would be changed from an actuarial reduction to account for benefit payment prior to normal retirement date to a fixed rate of eight percent per year benefit payments begin prior to normal retirement date; and

- The service benefit would be based upon 1.9% of final average salary per year of service. The current retirement benefit is based upon 2.0% of final average salary per year of service.

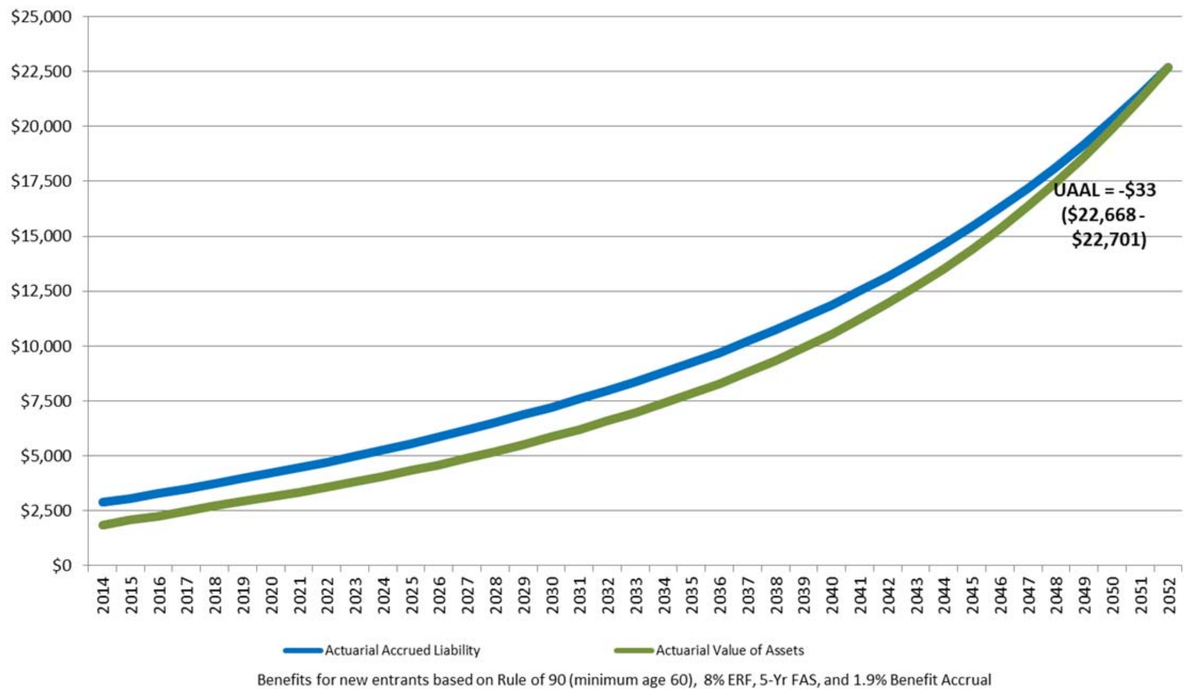
Actuarial Cost Analysis:

This bill would positively affect the current funding level of the Hybrid Plan. As a result of the proposed plan changes, the Normal Cost of the Main System will be reduced from 10.36% to 9.90%, a decrease in the actuarially required contribution of 0.46% of payroll. Approximately one-half of this decrease, or 0.20% of payroll, would be a result of the change in the benefit multiplier from 2.0% to 1.9%. The cost savings would be very gradual and would be expected to take 20 to 30 years to completely take effect.

To illustrate the effect, the funded ratios (Actuarial Value of Assets compared to Actuarial Accrued Liability) for the Main System are compared in the graph below for the current plan of benefits (green line) and the proposed changes (red line). We have assumed an 8% market value return for all years.



To further illustrate the impact, the graph below shows that the Main System is projected to have an Actuarial Value of Assets (green line) in excess of the Actuarial Accrued Liability (blue line) by July 1, 2052.



Technical Comments: Our comments on the bill are as follows:

<u>General</u>

The changes applicable to new members enrolled after December 31, 2015 would not provide immediate costs savings but would be realized over a period of years as new members replace those currently in the System.

<u>Benefits Policy Issues</u>

- <u>Adequacy of Retirement Benefits</u>

  For new members enrolled after December 31, 2015, the changes in final average salary, normal retirement date, early retirement reductions, and benefit multiplier would have the effect of reducing the overall adequacy of retirement benefits as compared to existing members. Such effect will vary based on the individual experience of the member.

- <u>Benefits Equity and Group Integrity</u>

To the extent decreased member contributions raises the take-home pay of members, this bill would rebalance salary equity between peace officers/correctional officers employed by political subdivisions and peace officers employed by the State Bureau of Criminal Investigation, so that members in both groups will be required to make contributions equal to 5.5% of pay effective in 2016. Currently, peace officers/correctional officers employed by political subdivisions make member contributions equal to 5.5% of pay, while peace officers employed by the State Bureau of Criminal Investigation make member contributions equal to 6% of pay.

For new members enrolled after December 31, 2015, the changes in final average salary, normal retirement date, early retirement reductions, and benefit multiplier would have the effect of reducing the overall equity of retirement benefits as compared to existing members. This means that a new employee working in the same position with similar job duties as a current employee would be paying the same member contributions but accruing less valuable retirement benefits.

- Competitiveness

  Due to the changes to final average salary, normal retirement date, early retirement reductions, and benefit multiplier under this bill, new members enrolled after December 31, 2015 would receive a lower compensation package than is currently offered by participating employers in the System.

- Purchasing Power Retention

  No impact.

- Preservation of Benefits

  The bill would not provide increased funding to the System in the form of additional employer and member contributions. Increases to contributions would reduce the unfunded actuarial accrued liability of the System at a faster rate than currently projected.

- Portability

  No impact.

- Ancillary Benefits

  - No impact.
  - Social Security: No impact.

Funding Policy Issues

- Actuarial Impacts

As previously noted, the bill will have a positive actuarial impact on the Hybrid Plan.

- Investment Impacts
  - Cash Flow: The bill would have a positive impact on cash flow.
  - Asset Allocation: The bill does not create new investment asset allocation issues.

Administration Issues

- Implementation Issues

This bill would have an impact on administrative costs of the PERS as new benefit structures would be added for new employees.

In addition, pursuant to rules under Internal Revenue Code section 414(h), participating employers (including the State) would be required to take formal, written action to elect to pick up the decreased member contribution amounts for 2016, in order for such contributions to be made on a pre-tax basis.

- Administrative Costs

No impact.

- Needed Authority

The bill appears to provide appropriate levels of administrative and governance authority to the PERS Board to implement the changes made by the bill.

- Integration

No impact.

- Employee Communications

Employee communications will be necessary to describe the impact of decreased member contributions on employee pay for peace officers/correctional officers employed by political subdivisions and peace officers employed by the State Bureau of Criminal Investigation.

Employee communications provided to new members (e.g., member handbooks) will need to be updated to describe the benefit modifications to final average salary, normal retirement date, early retirement reductions and benefit multiplier.

- Miscellaneous and Drafting Issues

The language regarding a change to the multiplier for service benefits and prior service benefits indicates that the new multiplier applies to "retirees first enrolled after December 31, 2015". Our analysis is based on the assumption that the multiplier change applies to retirees who were first enrolled *in the plan* after December 31, 2015. However, this language appears to be unclear as to whether the multiplier change applies to members who first enrolled in the plan after such date or retirees who first enrolled in retirement benefits after such date.

The projections were made using generally accepted actuarial practices and are based on the July 1, 2014 actuarial valuation. Calculations were completed under the supervision of Laura Mitchell, MAAA, EA.

Projections, by their nature, are not a guarantee of future results. The modeling projections are intended to serve as estimates of future financial outcomes that are based on the information available to us at the time the modeling is undertaken and completed, and the agreed-upon assumptions and methodologies described herein. Emerging results may differ significantly if the actual experience proves to be different from these assumptions or if alternative methodologies are used. Actual experience may differ due to such variables as demographic experience, the economy, stock market performance and the regulatory environment.

The information contained in this letter is provided within our role as the plan's actuary and benefits consultant and is not intended to provide tax or legal advice. We recommend that you address all issues described herein with your legal counsel. Please call if you have any questions or comments.

Sincerely,

Brad Ramirez, FSA, MAAA, FCA, EA
Vice President and Consulting Actuary

Sincerely,

Melanie Walker, JD
Vice President

/cz

cc: Tammy Dixon
Laura Mitchell

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