NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

GOVERNMENT FINANCE COMMITTEE

Tuesday, August 5, 2014
Harvest Room, State Capitol
Bismarck, North Dakota

Representative Jeff Delzer, Chairman, called the meeting to order at 9:00 a.m.

Members present: Representatives Jeff Delzer, Larry Bellew, Joshua A. Boschee, Bette Grande, Craig Headland, Rick Holman, Kylie Oversen, Don Vigesaa, Clark Williams; Senators Dwight Cook, Gary A. Lee, Donald Schaible, Ronald Sorvaag, Terry M. Wanzek, Rich Wardner

Members absent: Representative Lisa Meier

Others present: Sean B. Smith, Legislative Council, Bismarck
Dick Dever, State Senator, Bismarck
Representative Jim Schmidt, member of the Legislative Management, was also in attendance.
See Appendix A for additional persons present.

It was moved by Representative Vigesaa, seconded by Representative Grande, and carried on a voice vote that the minutes of the July 1, 2014, meeting be approved as distributed.

STUDIES OF STATE EMPLOYEE BENEFIT ISSUES

Update on Actuarial Review

Mr. Doug Anderson, Area Senior Vice President of Actuarial and Retirement Services, Arthur J. Gallagher & Co., Bloomington, Minnesota, provided an update (Appendix B) on the actuarial review of the state employee retirement plan. He reviewed the status of the following tasks:

Task	July 1 Status	Comments
Review participant data	Done	• No issues found for over 99 percent of participant records • Outstanding issues would not significantly impact results
Assumptions review	Done	• No significant issues with current assumptions • National 10-year trend to lower investment return assumption
July 1, 2013, valuation audit	Done	• Present value of benefits matched within 1 percent
Assumption recommendations	Done	• Suggested consideration of both favorable and unfavorable set of assumptions to demonstrate reasonable range of results
Plan closure study audit	In progress	• Significant differences between Gallagher and Segal in both projected insolvency dates and amounts needed to fully fund certain scenarios remain to be reconciled

Mr. Anderson said Gallagher had minimal differences resulting from its review of The Segal Company's July 2013 valuation report but did have differences compared to The Segal Company's March 2014 study results. Mr. Anderson presented the following three significant findings:

	Gallagher Finding	Gallagher Comments
Finding 1 - Disclosure	• Segal made adjustments to the valuation outputs to reduce projected benefit payments from years 2014 through 2028 without disclosing in their report the reason for the change or the cost impact.	• Actuarial Standards of Practice (ASOP) No. 41 states that an actuarial report should "identify the methods, procedures, assumptions, and data used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary's work as presented in the actuarial report." • Segal's March 6, 2014, study states that "cost estimates are based on the July 1, 2013 actuarial valuation."

	Gallagher Finding	Gallagher Comments
Finding 2 - Methodology	• Segal explained the reduction in projected benefit payments was due to "The current valuation assumptions (as approved by the Board of Trustees) appear to have higher rates of assumed retirement than are currently being observed." • Segal said no other adjustments were made. This implies: No larger benefit payments for deferred retirements. No adjustments for higher contributions due to fewer retirements.	• Gallagher results, as demonstrated on July 1, have shown that adjustments to retirement assumptions do not significantly impact present values (i.e., either the plan pays a retiree less for longer or more for a shorter period). • Segal's actuarial valuation shows no change to the contribution requirement in the prior year due to retirement experience.
Finding 3 - Omission	• Segal excluded from the study the impact of participants entering after July 1, 2013, and before the assumed closure date of January 1, 2016.	• The inclusion of participants during this period adds significant benefit payments to the plan. However, additional assumed member and employer contributions are nearly offsetting.

Mr. Anderson reviewed several projections which displayed the effect the significant findings had on the projections for the state retirement plan provided by Segal compared to Gallagher's projections. He indicated the findings create a significant difference between Segal's projections and Gallagher's projections. He indicated if only the state employees group was closed and separated from nonstate employees, the insolvency date of the plan would be in 30 years as determined by Gallagher compared as to 35 years as determined by Segal. He said the estimated one-time contribution would be $301 million as calculated by Gallagher compared to $163 million under Segal's projections. If the plan were closed to both state employees and nonstate employees, he said, the insolvency date would be in 32 years as determined by Gallagher compared to 42 years as determined by Segal. He said the one-time contribution would be $445 million as calculated by Gallagher compared to $99 million under Segal's projections.

In response to a question from Senator Wanzek, Mr. Anderson said Gallagher used January 1, 2016, as the date on which the one-time contribution would be made.

Mr Anderson reviewed the the actual investment returns under the North Dakota Public Employees Retirement System (PERS) and indicated that volatility in the fund can have a large impact on funded status of the plan. He indicated it is especially true when a fund is a closed plan.

Mr. Anderson also presented a comparison (Appendix C) of the components of a defined contribution retirement plan compared to the PERS defined benefit retirement plan. He highlighted aspects of both types of plans and provided comparisons between the two plans.

Representative Grande expressed concern that contributions into the plan are currently less than the benefit payments being made under the defined benefit plan. She said a concern with the defined benefit plan is that the plan uses current employee contributions to pay for the retirement benefit payments of currently retired employees.

Senator Cook suggested Segal be requested to attend the next meeting to have an opportunity to respond to the Gallagher results.

Chairmen Delzer asked that when complete, Gallagher's final report be provided to committee members and Segal to allow Segal to review the results before the committee's next meeting.

Current State Employee Defined Contribution Retirement Plan

Mr. Sparb Collins, Executive Director, Public Employees Retirement System, presented information (Appendix D) regarding the state's current defined contribution plan. He presented information on the current enrollment under the defined contribution plan and said the current enrollment in the plan totals 416 employees. He presented survey results indicating that only 20 percent of employees who have elected the defined contribution plan believe they made the right decision.

He provided a letter and a packet of information (Appendix E) mailed to new employees informing them of the defined contribution retirement program election.

Mr. Collins presented information on the PERS 457 plan (deferred compensation). He indicated the 457 plan is a supplemental plan that includes only voluntary employee contributions. He said the plan is in addition to the defined benefit plan and defined contribution plan. He presented survey results which indicated 72 percent of participants believe they are on schedule to have adequate funds for retirement with the deferred compensation plan.

Mr. Collins presented information (Appendix F) on the investment options under the PERS 457 plan (deferred compensation). He highlighted the PERS deferred compensation companion plan under TIAA-CREF and indicated the plan does not have have any fees in addition to the annual expense fees.

Mr. Collins presented information on the state employee health insurance plan. He provided a trend analysis on the PERS health plan. He indicated the current claims experience trend is 5.4 percent for active members and 0.9 percent for medicare retirees on January 1, 2014. He provided information on the current state health insurance and the health insurance plan reserves. He said the current health plan reserves are $34,100,000 and the total health plan reserves are anticipated to be $40,378,000 on July 1, 2015.

Mr. Collins provided information on the effect of the federal Affordable Care Act (ACA) has on the provision of health insurance to temporary employees. He said the ACA requires the state to change its definition of temporary employee under the plan to meet the requirements of the ACA. He said there will be fewer eligible temporary employees under the new definition, but the ACA requires the employer to contribute to the cost of health insurance premiums for eligible temporary employees.

Modification to the Main State Employee Retirement Plan

Mr. Sean B. Smith, Fiscal Analyst, Legislative Council, presented bill draft [15.0176.01000] and a memorandum entitled *Summary of Bill Draft [15.0176.01000] - Proposed State Retirement Plan Changes*. He reviewed the proposed changes under the bill draft. The changes would modify the state retirement plan providing that new state employees hired after December 31, 2015, would be required to participate under the defined contribution plan rather than the defined benefit plan. The bill draft would also permit eligible employees of PERS employed before June 30, 2016, a one time election to transfer to the defined contribution plan.

STATE BUDGET INFORMATION

Status of the General Fund and Major Special Funds

Ms. Pam Sharp, Director, Office of Management and Budget, presented information (Appendix G) regarding the status of the general fund and major state funds, including reasons for variance in tax collections. She presented the following information on the current status of the general fund for the 2013-15 biennium:

Unobligated general fund balance - July 1, 2013		$1,396,059,186
Balance obligated for unspent emergency appropriation authority		165,874,199
Balance obligated for authorized carryover of appropriations		89,503,462
Total beginning general fund balance - July 1, 2013		$1,651,436,847
Add:		
Revenues collected to date	$2,927,373,944	
Remaining forecasted revenues	2,794,795,964	
Total revenues		5,722,169,908
Total available		$7,373,606,755
Less:		
Legislative appropriations - One time	($2,433,567,701)	
Legislative appropriations - Ongoing	(4,429,019,653)	
Contingent appropriation - Dickinson State University	(6,000,000)	
Contingent appropriation - Department of Public Instruction	(5,000,000)	
Authorized carryover from previous biennium	(89,503,462)	
2013-15 emergency appropriations used in 2011-13	163,812,041	
Total appropriations		(6,799,278,775)
Estimated ending general fund balance - June 30, 2015		$574,327,980[1]

[1]Pursuant to North Dakota Century Code Section 54-27.2-02, any end-of-biennium balance in excess of $65 million must be transferred to the budget stabilization fund, up to a maximum of 9.5 percent of general fund appropriations.

Ms. Sharp presented the following information regarding the balance of major state funds as of June 30, 2014:

Budget stabilization fund	$583,545,799
Legacy fund	$2,303,852,423
Foundation aid stabilization fund	$487,932,679
Property tax relief fund	$657,000,000
Strategic investment and improvements fund	$1,252,602,646[1]

[1]Includes $887,220,055 of obligated funds.

Ms. Sharp presented information regarding tax collections by tax type compared to the legislative forecast. She indicated, as of June 2014, a total variance of 9.1 percent comparing the legislative forecast of total general fund revenues to the actual total general fund revenues for the 2013-15 biennium.

Ms. Sharp presented an update on the submission of agency budget requests to Office of Management and Budget (OMB), including the number of extensions granted and the new submission deadlines. She indicated that of the 70 agency budgets, only 15 have been submitted to date.

In response to a question from Chairmen Delzer questioning why so many agencies are granted extensions, Ms. Sharp indicated certain agencies have unique situations and circumstances which require extensions to be necessary.

Ms. Sharp presented information on tax collections, including the amount of increased collections due to new filers and the amount of increased collections due to higher wages. She said there were 86,254 new filers with a net tax liability of $39.4 million in 2012 and 73,556 new filers with a net tax liability of $16.7 million in 2013. She said the 2013 net tax liability amount is not final due to tax extensions being granted. She said growth in wages in the state resulted in an estimated $23 million increase in tax collections in 2012.

Ms. Sharp presented information on tax collections related to agriculture. She said individual income taxes paid by farmers totaled $72.5 million in 2012 and $46.2 million in 2013. She said the 2013 amount is not final due to tax extensions being granted. She said sales tax collections on new farm machinery were $19.6 million in 2012 and $23 million in 2013.

Ms. Sharp presented an update on the development of the revised 2013-15 biennium revenue forecast and the preliminary 2015-17 revenue forecast, including the economic-related statistics being used to develop the forecasts. She said OMB is currently in the process of preparing the forecasts. She presented information (Appendix H) provided by Moody's which lists the economic-related statistics being used to develop the forecasts. She discussed labor industry statistics and said the future employment growth is anticipated to be within the metropolitan areas of the state. She said oil production is anticipated to be from 1.2 million to 1.3 million barrels of oil produced each day during the 2015-17 biennium compared to the current level of approximately 1 million barrels per day.

Status of the Budget of the Department of Public Instruction

Ms. Stephanie Gullickson, Director of Fiscal Management, Department of Public Instruction, presented information (Appendix I) regarding the department's 2013-15 budget, including the status of federal funding and one-time funding. She provided information (Appendix J) on the expenditures for the first year of the biennium for the Department of Public Instruction (DPI).

Ms. Gullickson provided information on the status of federal funding for DPI. She said 13.6 percent of the department's $2.16 billion budget is federal funds. She said the department anticipates receiving all of the federal funds included in the budget.

Ms. Gullickson provided information on the status of one-time expenditures for DPI. She said the one-time expenditures include the DPI initiative pool, information technology staffing analysis, governing North Dakota textbook, early childhood care and education study, and the CPR training grants for students. She indicated the department expects to use all of the appropriated funds for the programs, with the exception of the CPR training grants for students. She said of the $450,000 provided for CPR training, only $20,858 was requested by 19 schools during the first year of the 2013-15 biennium. She said the department expects fewer schools applying in the second year of the biennium.

Status of State School Funding the Department of Public Instruction

Mr. Jerry Coleman, Director of School Finance and Organization, Department of Public Instruction, presented an update (Appendix K) on the status of state school aid funding. He presented a schedule providing the status of state aid school funding. He said the total 2013-15 biennial appropriation for state school aid was in excess $1.8 billion. He anticipates $19.8 million of this amount will not be spent.

Mr. Coleman presented information on school construction project loans, rapid growth enrollment grants, and safety grants. He said the total funding available under the school construction loans has been committed with a waiting list as funds become available.

Mr. Coleman provided a historical overview of the population of North Dakota and of the enrollment in public schools in North Dakota. He said after a decline by 25,000 students over a 15-year period ending in 2010, statewide projections show moderate enrollment increases over the next decade. He expects enrollment to increase by 3,500 students annually. He said the department estimates an additional $275 million will be needed for the 2015-17 biennium relating to the increased projected enrollment. Of this amount, he said, the state share would be approximately $200 million. He indicated the enrollment is expected to remain steady or increase in North Dakota's major cities' school districts, while enrollment in many of the small rural school districts is expected to experience declines.

STUDY OF THE FOUNDATION AID STABILIZATION FUND

The Legislative Budget Analyst and Auditor presented resolution draft [15.3010.02000] relating to the foundation aid stabilization fund. The resolution draft would amend Article X, Section 24, of the Constitution of North Dakota. The provisions of the resolution draft would permit the Legislative Assembly to appropriate or transfer any principal balance in the foundation aid stabilization fund in excess of 15 percent of the general fund appropriation for state school aid for the most recently completed biennium for the purpose of:

1. Making low-interest loans for school construction projects;
2. Addressing existing or anticipated unfunded benefit obligations of state retirement funds; or
3. Other education-related purposes.

The Legislative Budget Analyst and Auditor presented a memorandum entitled *Foundation Aid Stabilization Fund Uses - Based on Concurrent Resolution Draft [15.3010.01000]*. The memorandum includes a schedule providing various minimum balance levels for the foundation aid stabilization fund based on state school aid funding appropriated for the 2013-15 biennium. The memorandum also includes a schedule detailing how much funding would be used from the foundation aid stabilization fund and budget stabilization fund to offset a potential general fund revenue shortfall.

The Legislative Budget Analyst and Auditor presented bill draft [15.0189.01000]. The bill draft would establish the funds for appropriations or transfers from the foundation aid stabilization fund. The funds include a school construction assistance loan fund and a public employee retirement stabilization fund. The bill draft includes a contingency that would make the transfers into these funds from the foundation aid stabilization fund effective only upon approval of the resolution draft by the Legislative Assembly in 2015 and by the voters in June 2016.

Representative Boschee said that while he supports the use of the foundation aid stabilization fund for education purposes, he does not support the use of the fund for addressing the unfunded liability of the state retirement plan.

Senator Wardner suggested a portion of any excess funds in the foundation aid stabilization fund be transferred into the common schools trust fund, after transfers are made into the construction assistance loan fund and public employee retirement stabilization fund.

Chairmen Delzer asked the Legislative Council staff to prepare estimates of the foundation aid stabilization fund balances in the 2015-17 biennium.

COMMITTEE DISCUSSION

Senator Sorvaag suggested the committee receive additional supporting information on the actuarial estimates before the committee makes any recommendations regarding the defined benefit plan.

In response to a question from Senator Wanzek, Mr. Collins said allowing existing employees to elect to transfer to the defined contribution plan from the defined benefit plan would affect the unfunded liability of the defined benefit plan. He said the actuarial estimates prepared by Segal and Gallagher did not include the actuarial effect of existing employees transferring to the defined contribution plan. If existing employees are allowed to make this election, he anticipates the estimated one-time payment needed to close the defined benefit plan would increase.

Mr. Collins expressed concern with allowing existing employees to elect to transfer to the defined contribution plan using the formula in bill draft [15.0176.01000]. He said the potential costs to PERS to implement the option to transfer to the defined contribution plan could be substantial. He said options are available that would reduce the costs.

Mr. Stuart Savelkoul, Assistant Executive Director of Political Advocacy, North Dakota United, said North Dakota United opposes bill draft [15.0176.01000]. He said the bill draft would affect the ability of the state to recruit and retain employees.

Senator Vigesaa suggested Gallagher be asked to provide actuarial results at a 7.5 percent assumed investment return.

No further business appearing, Chairman Delzer adjourned the meeting at 2:40 p.m.

Brady A. Larson
Assistant Legislative Budget Analyst and Auditor

ATTACH:11