Retirement Committee Initial Presentation

Scott A. Miller, Executive Director

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NORTH DAKOTA
PUBLIC EMPLOYEES
RETIREMENT SYSTEM

Topics to Cover

I. Current Status of the Main Defined Benefit Plan

II. Issues to consider in order to close the Main Defined Benefit Plan for all members

III. Additional issues to consider if the Main Defined Benefit Plan is divided into two different State and Political Subdivision Plans, and only the State Plan is closed

Main DB Plan Current Status

- Funded Ratio as of 7/1/20 (actuarial value): 68.3%
- Unfunded Actuarial Liability as of 7/1/20: $1.4 billion
- As of 7/1/20, projected to become insolvent in the next 100 years
- Contribution Deficiency: 5.78% of compensation
- Recent Positive Changes:
  - HB 1380 – "Legacy Funds Streams Bill" – approximately $55 million per biennium deposited in the Main DB Plan
  - Positive investment returns for FY 2020-2021 – estimated 26% return
    - We use a five-year smoothing period for returns, so this will be realized over five years
  - Effect of these will be seen in the 7/1/21 valuation, which we will receive in late October

Main DB Plan Closure Considerations

1. Imminent DB Plan insolvency
2. Impact on recruitment and retention
3. DC Plan structure to ensure a secure retirement
4. DB Plan administration will continue into the next century

Imminent DB Plan Insolvency

- Current contribution rate pays for the benefits being earned (the “Normal Cost”) and helps pay down (“amortize”) the unfunded liabilities (2.83%); eliminating those payments from new employees eliminates a payment source for those unfunded liabilities
- Gradual de-risking of investment portfolio will reduce the assumed rate of return, which in turn significantly increases the unfunded liabilities
  - Our current “GASB Liability” (Governmental Accounting Standards Board) may be viewed as a ballpark estimate of what that liability would look like: $3.1 billion
  - Of course, our GASB liability would also increase, which may affect bonding ratings for the state and political subdivisions
- Significant contribution increases would be required in order to avoid insolvency
- The impact of any proposal to close the DB plan can only be determined through a thorough actuarial analysis

Contribution Increases

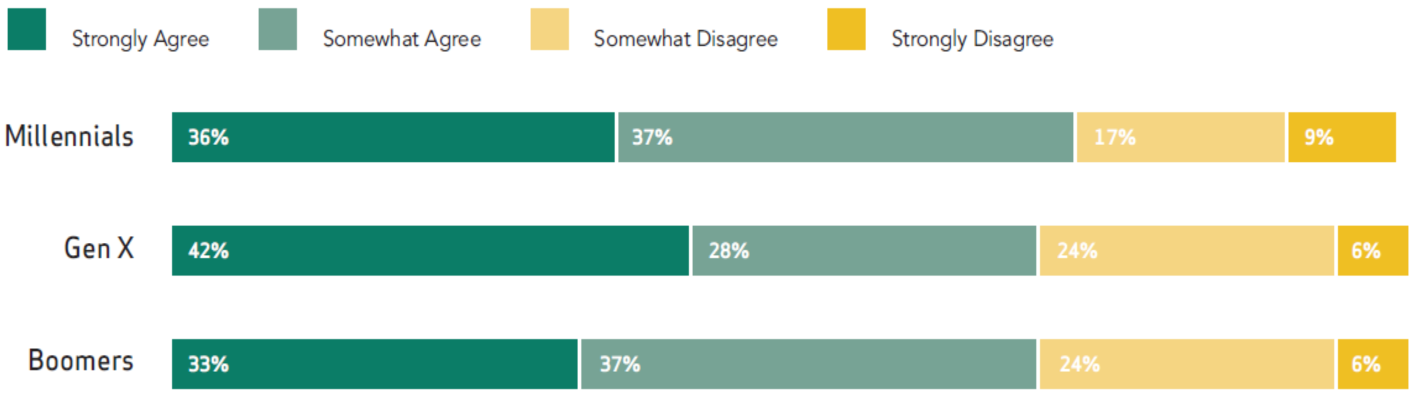
- Employer or employee contribution increases, or cash infusions
- Cash infusions are helpful but are perhaps not the most efficient
  - Currently, the general fund only pays about 48% of the employer contributions for state employees
  - The other 52% is paid for by special funds or federal funds
  - Cash infusions transfer that 52% back onto the State and leave federal and special fund dollars on the table
- Employee contribution increases may create more problems
  - Contract clause litigation
  - Employee contribution increase will result in increased retirements
    - 1,180 state employees are currently eligible to retire (1,093 political subdivision)
    - 1,867 state employees will be eligible to retire 1/1/2024 (1,932 political subdivision)
  - Future employee recruitment may be impaired

Impact on Recruitment and Retention

- Prospective employees who would begin employment before the effective date of the closure will be subject to the increased contributions, and may choose to avoid public service as a result
- Employees who join after the effective date will only have the DC plan as an option
    - Defined Benefit plans are a clear motivation for people to become public servants

Figure 70: **74% of Millennial state and local employees say a pension benefit is a major reason they chose a public sector job.**

To what extent do you agree or disagree with the following statement: A pension benefit is a major reason why I chose a public sector job.



Impact on Recruitment and Retention

- Previous experience with “irrevocable” elections to transfer from the DB Plan to the DC plan also shows that a DC plan mandate may affect recruitment and retention
  - The NDPERS retirement plan was originally a cash-balance DC plan, which the Legislative Assembly changed to a DB plan in 1977 because the DC plan was not providing a secure retirement for its employees; DC plan employees were given several opportunities to elect to transition to the DB plan
  - The 2013 Legislative Assembly expanded the eligibility for the DC plan to include all new employees
  - Only 3% of new employees chose the DC plan
  - Buyer’s remorse soon set in, and DC plan members lobbied the Legislative Assembly to allow them to transfer back into the DB plan
  - In 2017, the Legislative Assembly opened a window for DC plan members to move back into the DB plan
  - 75% of our DC plan members elected to transfer back into the DB plan
  - We currently have less than 100 active employees in our DC plan
  - Implies the DC plan is perceived to provide less of a benefit than the DB plan

Experience in Other States

- Michigan State Employees' Retirement System
  - Closed their DB plan to new employees in 1997 when it was 109% funded, with a **$734 million surplus**
  - In September 2019, it was funded at only 64.7%, with a **$6.6 Billion unfunded liability**
- West Virginia Teacher Retirement System
  - Closed the DB plan to new employees in 1991
  - Funded status dropped to 25%
  - A study showed that if they re-opened the DB plan to new teachers and gave current DC plan members a choice to switch back, they could provide equivalent benefits at half the cost
  - In 2005 they re-opened the DB plan, and 78% switched back
  - In 2019, the TRS plan was funded over 70%
- Texas and Minnesota
  - Both states did studies that showed closing the DB plan was too expensive and a DC plan provided an inadequate retirement, and declined to close the plans

DC Plan Structure

- **Policy Decision** – do you hope to give DC plan members a benefit that is roughly equivalent to that available through the DB plan?
  - What contribution rate is required to make this happen?
    - Note that for the same cost, DC plans can typically only provide a benefit that is 50-75% of the benefit provided by DB plans
    - Are you willing to pay more for a DC plan than you currently pay for a DB plan?
  - Would you like to offer a more robust investment education/financial planner program?
    - The DB plan monies are managed by professional investment managers
    - Current DC plan members have access to financial planners through our third-party administrator
    - DC plan participants will bear all the responsibility for setting up their individual investment portfolios, and all the risk of any loss for doing so poorly
    - Additional programs will increase the cost of the DC plan

Continuing DB Plan Administration

- As we experienced with the OASIS plan, we can expect to be administering the DB plan and making benefit payments to DB plan members well into the next century, regardless of whether we have anything in the trust fund
- **Policy Decision** – Will there be an election available for DB plan members to transfer to the DC plan? If so, how will those transfer calculations be made? How will the State pay for any actuarial damage to the DB plan as a result of those transfers?

Main DB Plan Split

1. Administrative difficulty of separating employees into “state” and “political subdivision” groups
2. Continued State responsibility for the Political Subdivision DB Plan (PS DB Plan)
3. State DB Plan funding would decline, and become insolvent even earlier

Administrative Difficulty

- Separating 25,000 active members, 11,000 deferred members, and 12,750 retirees into two different plans will require three temp employees for six months
  - A significant amount of our information is contained exclusively on microfiche
- Business system programming for our PERSLink system would require approximately 1,000 programming hours at a cost of about $80,000
  - We do not have an estimate of the cost for political subdivision programming requirements

Administrative Difficulty

Policy Decisions:

- Many of these members, deferred members and retirees have service with both the State and one or more political subdivisions, and perhaps even the Teachers' Fund for Retirement – how do we apportion that service?
- Do we split their pensions? Payments to their estates once they pass?
- How do we transfer people between systems if they leave one employer and start with another?
- Once a member is in the DC plan, do they stay there even if they go to a political subdivision?
- Does time in one plan help meet the "rule" in another?
- How do we account for service purchases?

PS DB Plan Administration

- During last session, there were many statements that the political subdivisions would somehow “take over” and administer the PS DB plan
  - Query what specific entity would “take over” the PS DB plan
  - Any entity other than NDPERS or TFFR would need to procure staff, an office, a pension administration system (software), etc.
  - Who would invest these funds?
- The State of North Dakota is the DB plan sponsor – the “settlor” of the trust
- The trust is established according to Internal Revenue Code (IRC) requirements; any amendment to the trust would need to similarly comply with the IRC
- I do not know of any IRC provision that would allow the plan sponsor to essentially abandon a retirement trust to another party
  - Alternatively, you could create another Board to oversee the administration of the PS DB plan, and have either NDPERS or some other entity administer the plan

Imminent State DB Plan Insolvency

- By splitting the Main DB plan, the State DB plan would be much worse funded, and become insolvent even earlier
  - During consideration of the DB plan closure amendment to SB 2046 last session, our actuary estimated that the State DB plan would have 62% of the current unfunded liability of $1.44 billion ($893 million)
  - Of the 24,654 active employees in the total DB plan, only 10,181 are state employees, and 14,473 are political sub employees
  - Of the 12,750 retirees, 7,078 were from State employment and 5,670 from political subs
  - Thus, there are far fewer active state employees than political subdivision employees, and the contributions on behalf of state employees go to pay for a larger share of the unfunded liability

Imminent State DB Plan Insolvency

- Perhaps the most comparative example of the probable impact of closing the DB plan for state employees is from Representative Steiner's 2018 proposal that was considered by the 2017-2019 Employee Benefits Programs Committee ("Bill 382"), which would have:
  - Transferred $108 million per year from the Legacy Fund principal into the NDPERS fund until it was 95% funded
  - Closed the DB plan to new state employees (not political subdivision employees) after December 31, 2019
  - All new state employees would have gone into the DC plan
  - Allowed current state DB plan members to elect to transfer into the DC plan
  - At that time, the Main NDPERS plan was projected to become insolvent by 2106
  - The result of the actuarial analysis of that proposal was that the Main NDPERS plan would become insolvent much earlier – between 2040 and 2074

Questions?

- Scott Miller
- scottmiller@nd.gov
- 701-328-3901