SUMMARY OF BILL DRAFT [15.0176.04000] - PROPOSED STATE RETIREMENT PLAN CHANGES

This memorandum provides information on the current state retirement plans as well as proposed modifications to the state retirement plans under bill draft [15.0176.04000], which was approved by the Government Finance Committee on October 8, 2014.

CURRENT STATE RETIREMENT PLANS

The Public Employees Retirement System (PERS) is governed by North Dakota Century Code Chapter 54-52 and includes the PERS main system, judges' retirement system, National Guard retirement system, law enforcement with prior main service, law enforcement without prior main service, an optional defined contribution retirement plan, Highway Patrolmen's retirement system, Job Service North Dakota retirement plan, and retiree health benefits fund.

The Legislative Assembly authorized the use of the optional defined contribution retirement plan effective January 1, 2000. The defined contribution retirement plan is provided for under Chapter 54-52.6. Prior to October 1, 2013, the plan was available to state employees in positions not classified by Human Resource Management Services, excluding employees of the judicial branch and employees under the control of the State Board of Higher Education. Between October 1, 2013, and July 31, 2017, as a result of provisions of 2013 House Bill No. 1452, any new state employee who is eligible may elect to participate in the defined contribution plan. An eligible employee may make an election at any time during the first six months of employment to participate in the defined contribution plan rather than the defined benefit plan under Chapter 54-52. An election to participate in the defined contribution plan is irrevocable.

STATE RETIREMENT PLANS UNDER THE PROPOSED BILL DRAFT

The proposed bill draft provides for the following:

- An eligible state employee hired for the first time after December 31, 2015, would be required to enroll in the defined contribution plan under Chapter 54-52.6, rather than the defined benefit plan.
- The bill draft would not affect current or future Supreme Court or district court judges, employees eligible to participate in the National Guard retirement plan or the law enforcement plan, employees of a political subdivision, or employees of the State Board of Higher Education and state institutions under the jurisdiction of the board that are participating in the TIAA-CREF retirement plan.
- State employees currently participating in the defined benefit plan and those hired before January 1, 2016, who elect to participate in the defined benefit plan would continue to participate in the defined benefit plan. However, during the last six months of 2016, a state employee participating in the defined benefit plan may elect to transfer to the defined contribution plan. This election is irrevocable.
- The vesting period for employees in the defined contribution plan would be changed to allow employees to become fully vested in employer contributions after one year of service rather than a vesting schedule of 50 percent after two years, 75 percent after three years, and 100 percent after four years.

SUMMARY OF BILL DRAFT BY SECTION

Section 1 of the bill draft amends the definition of eligible employee under Section 54-52-01(4) of the **defined benefit plan** to include the following: employees who are participating members before January 1, 2016, Supreme Court judges and district court judges, employees eligible to participate in the National Guard retirement plan or a law enforcement retirement plan, and employees of a political subdivision.

Section 2 of the bill draft amends Section 54-52-02.5 of the **defined benefit plan** to designate which retirement plan newly elected and appointed state officials may participate in.

Section 3 of the bill draft amends Section 54-52-02.9 of the **defined benefit plan** to allow temporary employees to elect to participate under the defined benefit plan until December 31, 2015. New temporary employees hired after December 31, 2015, will not be able to elect to participate under the defined benefit plan. A temporary employee who is a participating member before January 1, 2016, may continue under the defined benefit plan. The bill draft also clarifies the contribution percentage of 14.12 percent, which is the sum of the original 8.12 percent plus 2 percent increases in each of 2012, 2013, and 2014.

Section 4 of the bill draft amends the definition of eligible employee under Section 54-52.6-01(3) of the **defined contribution plan** to include state employees hired after December 31, 2015, except: Supreme Court judges and district court judges, employees eligible to participate in the National Guard retirement plan or a law enforcement retirement plan, employees of a political subdivision, and employees of the State Board of Higher Education and state institutions under the jurisdiction of the board who are participating in the TIAA-CREF retirement plan. The bill draft also amends the definition of participating employees under Section 54-52.6-01(6), removing the election requirement for employees to participate under the defined contribution plan. The bill draft also amends Section 54-52.6-01 adding a definition of temporary employee, which includes temporary employees under the defined contribution plan. The new definitions would take effect on January 1, 2016.

Section 5 of the bill draft amends Section 54-52.6-02 of the **defined contribution plan** and provides that newly hired eligible employees have an option to elect to participate in the defined contribution plan until December 31, 2015. Beginning January 1, 2016, all eligible employees will be participating members under the defined contribution plan without an election.

This section also includes an election for all eligible employees, who are first employed before January 1, 2016, and who are members of PERS on June 30, 2016, to terminate membership under the defined benefit retirement plan and transfer to the defined contribution retirement plan. The election period would begin July 1, 2016, and would end December 30, 2016.

The section also makes clear that the contribution percentage under the section relating to temporary employee contributions is 14.12 percent, which is the sum of the original 8.12 percent plus 2 percent increases in 2012, 2013, and 2014.

Section 6 of the bill draft creates Section 54-52.6-02.1 under the **defined contribution plan** defining the membership under Chapter 54-52.6 of the defined contribution plan to include all eligible employees, as well as any temporary employees who elect to participate under the defined contribution plan. The effective date of the section would be January 1, 2016.

Section 7 of the bill draft amends Section 54-52.6-03 of the **defined contribution plan** to adjust the suspension date of the section from July 31, 2017, to December 31, 2015.

Section 8 of the bill draft amends Section 54-52.6-10 of the **defined contribution plan** and provides a participating member is 100 percent vested in the employer contributions made on the member's behalf upon completion of one year of service.

Section 9 of the bill draft provides that an employee who is a participating member in the defined benefit plan and is eligible to transfer to the defined contribution plan may request that PERS prepare an estimate of the employee's accumulated balance transfer amount by calculating the actuarial present value of the employee's accumulated benefit obligation.

ESTIMATED FISCAL IMPACT OF BILL

The Government Finance Committee received information regarding the actuarially calculated costs relating to the main defined benefit retirement plan if state employees hired after January 1, 2016, were required to participate in a defined contribution benefit plan.

The Segal Company Projections

The committee received information in March 2014 from The Segal Company, which is the consulting actuary for PERS. Segal reported that if the defined benefit plan was closed to new employees, the state portion of the plan would be able to pay benefits until the year 2046. There would be a projected contribution shortfall of $3,688,100,000 for future benefits to be paid after 2046. However, a payment of $162.8 million could be made to the retirement plan on July 1, 2015, to fully offset the state portion of the future projected contribution shortfall. The estimated payment of $162.8 million needed to fully fund the state portion of the plan is based on an 8 percent investment return. However, the asset allocation of the plan's investments may need to be adjusted by moving the investments to shorter-term investments near the projected end of the plan. The move to more short-term investments near the projected end of the plan could potentially reduce the plan's investment return.

Independent Review by Arthur J. Gallagher & Co.

The committee requested and received approval from the Legislative Management Chairman to enter into an actuarial consulting contract with Arthur J. Gallagher & Co. (Gallagher). Representatives of Gallagher reviewed the July 1, 2013 actuarial valuation of the PERS plan conducted by Segal as well as the March 2014 study conducted by Segal regarding estimated costs to close the main state employee defined benefit retirement plan.

Representatives of Gallagher reviewed assumptions used by Segal and suggested the committee consider reviewing plan projections using alternative assumptions. Suggested alternative assumptions were provided for investment returns, salary increases, payroll growth, employee mortality, and employee retirement rates.

Representatives of Gallagher reported minimal differences resulting from its review of Segal's July 2013 valuation report but did have differences compared to Segal's March 2014 study results. Gallagher estimated that 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 compared to 35 years as determined by Segal. The estimated one-time contribution on July 1, 2015, to fully fund the retirement plan would be $301 million as calculated by Gallagher compared to $162.8 million under Segal's projections.

Representatives of Segal provided comments regarding differences in the projected actuarial costs calculated by Segal and by Gallagher to close the main state employee retirement plan to new employees effective January 1, 2016. Segal indicated the major difference in the calculations is due to an adjustment made by Segal to the amount of future benefit payments. Segal inadvertently failed to report the adjustment to the PERS or to Gallagher when disclosing projection assumptions.

Method to Address Unfunded Liabilities

The Government Finance Committee approved a separate bill draft to address any unfunded liabilities of the defined benefit plan resulting from the bill draft to close the defined benefit plan to new state employees. The separate bill draft establishes a school construction assistance loan fund and a public employee retirement stabilization fund. The funds in the public employee retirement stabilization fund would be available to offset any unfunded liability of the main state employee defined benefit retirement plan. The State Investment Board would be responsible for investing the 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 a constitutional amendment by the Legislative Assembly in 2015 and by the voters in June 2016 to allow for additional uses of the foundation aid stabilization fund. The bill draft provides for a transfer of $250 million into the school construction assistance loan fund and a transfer of $200 million into the public employee retirement stabilization fund.