TESTIMONY OF SCOTT MILLER

Engrossed Senate Bill 2046 – NDPERS Defined Benefit/Hybrid Plan Contribution Increase

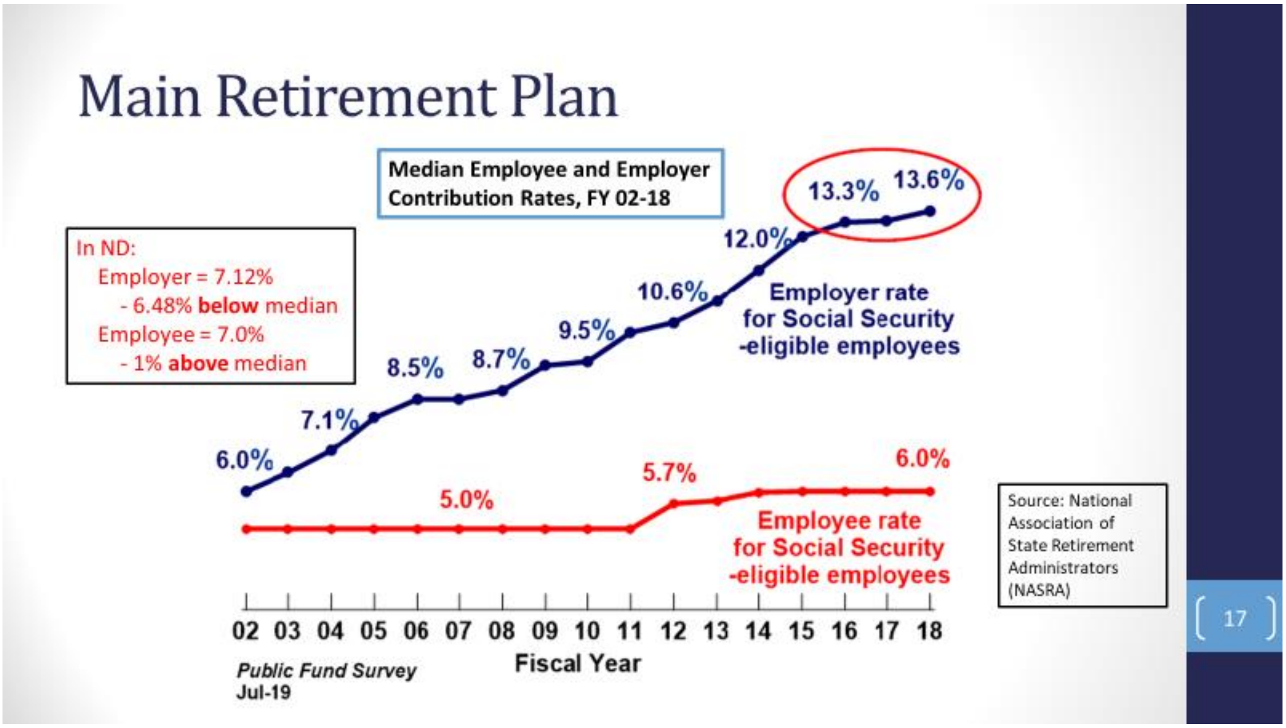
Good Afternoon, my name is Scott Miller. I am the Executive Director of the North Dakota Public Employees Retirement System, or NDPERS. I appear before you today on behalf of the NDPERS Board in support of Senate Bill 2046. Note that the Employee Benefits Programs Committee gave the original version of this bill a favorable recommendation.

As originally proposed, SB 2046 was the fourth, and final, year of the four-year recovery plan for the NDPERS Main Retirement Plan that was originally proposed in the 2011 session. Ten years ago the NDPERS Board proposed the recovery plan after working closely with the Employee Benefits Programs Committee, employers, and members. The original recovery plan proposal was four 1% contribution increases over the course of four consecutive years for both employers and employees. Had the recovery plan been approved at that time, we were projected to be 100% funded in 2041 – only twenty years from today. Unfortunately, the fourth year of that recovery plan has never been approved, and today we are projected to run out of money to pay benefits in 2120. At that point we will become a pay-as-you-go system, requiring Legislative appropriations every biennium to make hundreds of millions of dollars of retirement payments.

As amended, Senate Bill 2046 increases both the employer and the employee contributions into both the Main NDPERS Hybrid/Defined Benefit (DB) Retirement Plan and the Defined Contribution (DC) plan by 1/2% each, starting in January of 2022. Temporary employees, who pay both the employee and the employer contribution, will see a 1% increase.

- Employer: 7.12% → 7.62%
  - Main 2020 Employer: 8.26% → 8.76% (new employees)
- Employee: 7% → 7.5%
- Temporary Employee: 15.26% → 16.26%

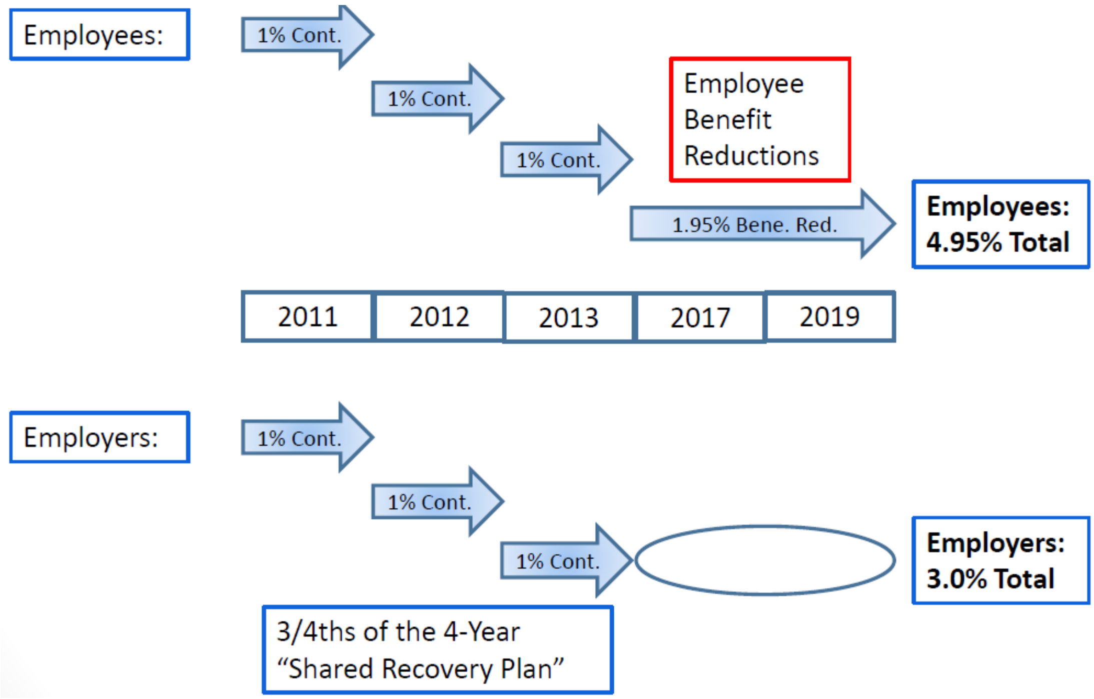
For comparative purposes, the median employer contribution rate in other state-wide public retirement systems is 13.6%, and the median employee contribution rate is 6%.



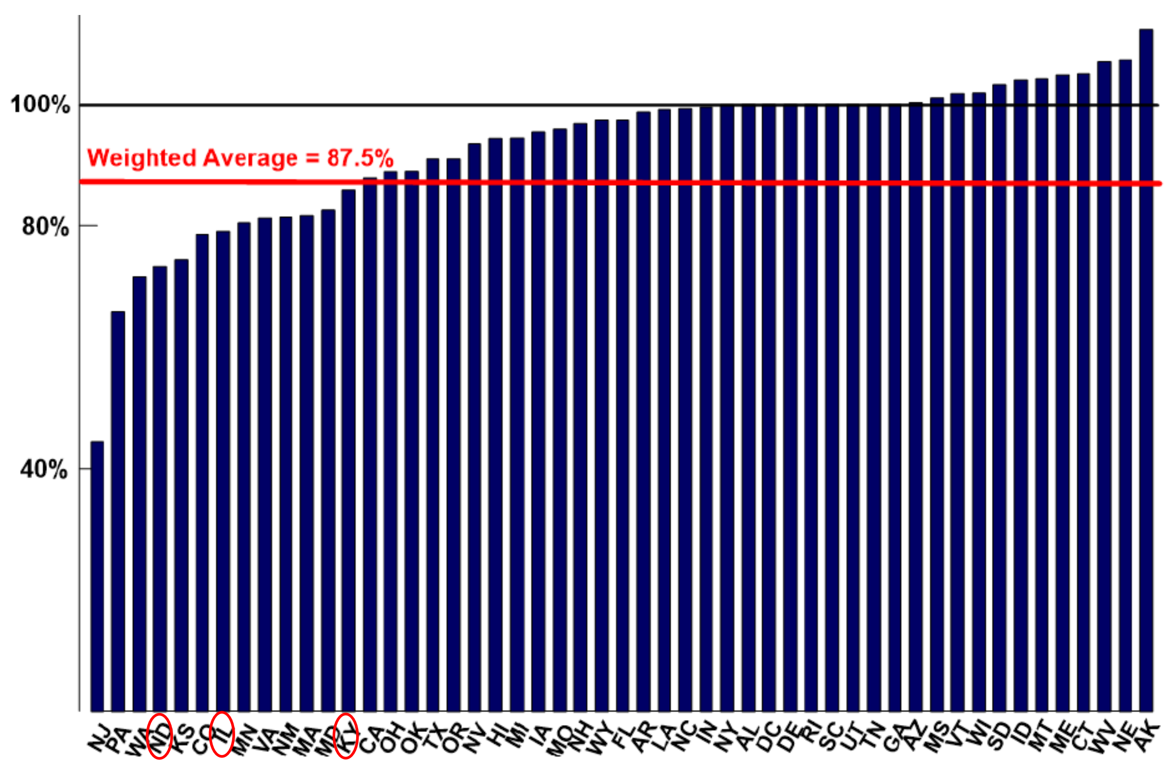
There are very few levers we can use to try to get the PERS plan back on the course to full funding. The general formula for funding a defined benefit retirement plan is below:

Contributions + Investment Returns = ***Benefits*** + Expenses

Since investment returns are not high enough to put us back on the course to full funding, and expenses are not significant enough to have any effect on the equation, we must look at altering either “Contributions” or “Benefits”. We have tried pulling both of those levers over the past ten years, implementing both contribution increases and benefit reductions. Every employer increase was accompanied by a matching employee increase, which raised the contributions by a total of 6%. On top of that, benefits have been cut for new employees – they now have the rule of 90 with a minimum retirement age of 60, instead of the rule of 85; they no longer receive the Retiree Health Insurance Credit; and their multiplier was reduced from 2% to 1.75% - a 12.5% reduction in benefit. The end result is that current employees have paid the same increases as the employers, and new employees are both paying the same and have significantly reduced benefits.



This bill, Senate Bill 2046, addresses the "Contributions" side of the equation. Our actuary has calculated that our statutory contribution rate is currently 5.78% below the ADC rate. That gives us the fourth-lowest percentage of ADC contributed to the plan in the country, according to the below graph from the National Association of State Retirement Administrators (NASRA). Note that we are below Illinois and Kentucky, two states that are experiencing even more dire funding problems.



While Senate Bill 2046 only increases contributions to the main PERS DB plan by a total of 1%, it is sufficient to get us back on the course to full funding. Our actuaries estimate that we would reach 100% funding by 2095.

Unfortunately, while SB 2046 does get us back on the course to full funding, it is not enough to help the State or the state's political subdivisions and their GASB liability reporting. GASB stands for "Governmental Accounting Standards Board". GASB provides "statements" that provide guidance for governmental entities, like the state and its political subdivisions, on how to report certain things in their financial statements. In the past few years, GASB issued a statement that requires governmental entities that have severely underfunded retirement plans – like the Main PERS plan – to report their liabilities using a discount rate that is below those plans' assumed rates of return. GASB calls that a "single discount rate".

The problem with using that single discount rate is that the rate is significantly below our assumed rate of return – our assumed rate of return is 7.0%, and the single discount rate we had to use last fiscal year is 4.64%. Using a lower rate to determine our liabilities results in a significant increase in those projected liabilities: using the 7.0% rate results in $1.4 billion of unfunded liabilities, whereas using the 4.64% rate results in over $3.1 billion in unfunded liabilities – a 121% increase in the unfunded liabilities.

GASB also now requires the state and its political subdivisions to report that higher unfunded liability figure in their financial statements. As a result, the pension liabilities that have to be reported in the financial statements are 121% higher than they would be if we were on the course to being 100% funded. That is causing a significantly negative impact on many of our participating political subdivisions' financial statements. Those increased liabilities may also result in negative rating outlooks from the rating agencies, or even a reduction in the bond rating for your political subdivisions, increasing their cost of borrowing money. Unfortunately, SB 2046 is not projected to improve our funding enough to avoid the single discount rate problem for our political subdivisions.

Another reason we need to get back on the course to full funding is to maintain the recruiting and retention edge that our covered employers currently have. As you can see from the research reflected in the below graphs, that is true for Millennials, as well.

Figure 22: **Across professions, state and local employees overwhelmingly agree that 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 I chose a public sector job in the first place.

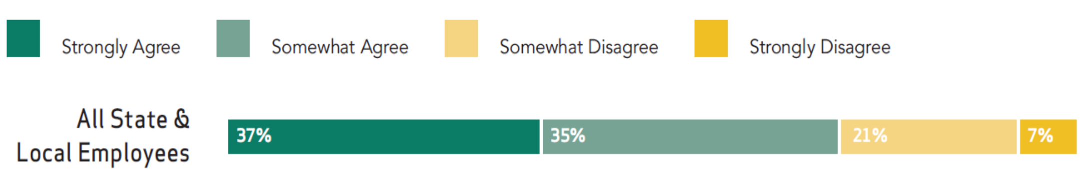
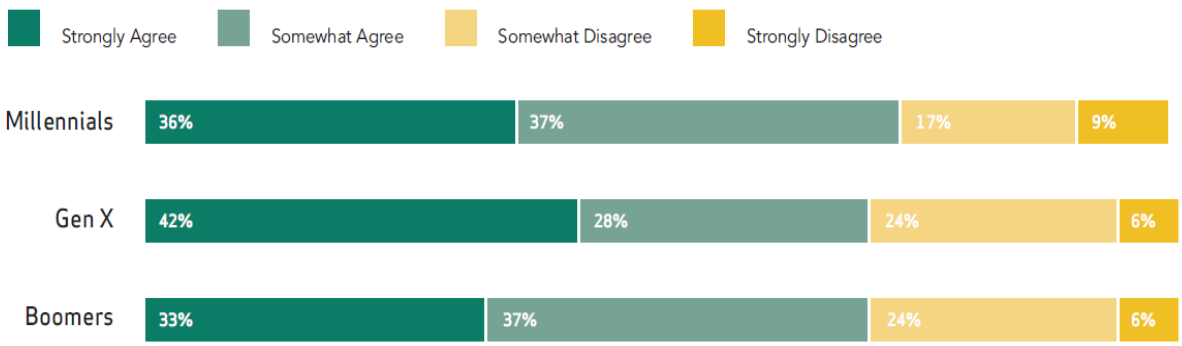


Figure 70: **74% of Millennial state and local employees say a pension benefit is a major reason they chose a public sector job.**

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.



"State and Local Employee Views on Their Jobs, Pay and Benefits" by Tyler Bond and Kelly Kenneally, National Institute on Retirement Security, 2019.

One question I have been asked recently is, "Why we can't just end the Defined Benefit plan and move everyone over to a Defined Contribution plan, or just allow the Defined Benefit plan to become bankrupt?" The answer to that question is in NDCC section 54-52-14.3, which provides the following: "Any provision of law relating to the use and investment of public employee retirement funds must be deemed a part of the employment contracts of the employees participating in any public employee retirement system." That section makes clear that the statutory provisions guiding the creation, administration, and benefit payments of the defined benefit plan are part of every members' employment contract with the state. If the plan were to go bankrupt, the State would still have the contractual obligation to pay the benefits the State promised.

Further, the GASB reporting issue I addressed earlier would grow and grow. We are already causing many of our political subdivisions' financial statements to be in the red – they are showing liabilities that greatly exceed their assets. Every actuarial loss we take as a result of insufficient funding will continue to add to the GASB reporting problems our political subdivisions are facing. Eventually, the ratings agencies will take that into account when those political subdivisions attempt to issue any bonds, and their cost of borrowing will go up. And remember, that could also happen to the State, since the State is also having to report those inflated liabilities. In fact, I have been advised that Standard and Poor's currently lists our pension liability as a negative and something that could affect our bond rating if not addressed.

Another question I have been asked is "how much would it take for us to be able to close the DB plan to new members?" The short answer is, billions. Last session the Legislative Assembly considered HB 1419. That bill proposed to close the DB plan to new entrants, allow DB plan participants to elect to transfer to the DC plan, and provided a $20 million per year cash infusion. The actuarial analysis of that bill showed that the latest the DB plan would become insolvent would be in 2052 – 54 years earlier than our current projection of 2106. In order to keep the plan from becoming insolvent, the employer contribution rate would have to have gone up by 12.22%. For just the state, that was an increase of over $160 million a biennium.

Other states have tried it. When Michigan decided to close its DB plan in 1997, the plan was 109% funded, with over $730 million in excess assets. In 2019, the plan was 64.7% funded, with an unfunded liability of $6.6 billion. If we take that as a potential guideline, we would need the Main PERS plan to be at least 120% funded, and probably closer to 130% funded, before we could be reasonably confident that closing the plan would not result in the State having to appropriate millions of dollars of additional monies every biennium in the future. In order for us to be 120% funded, we would need a cash infusion of over $2.6 billion. To achieve a 130% funding status, we would need over $3.1 billion. As I stated, it would take billions of dollars to be able to close the plan.

Finally, several people have speculated that the State could use some of the COVID stimulus money to provide a cash infusion into the plan. While we would welcome any help whatsoever, including a cash infusion, the stimulus plan that was passed prohibits the State from depositing the money into its public pension plans. As such, that is not a possibility.

The cost of Senate Bill 2046 is not insignificant. However, keep in mind that without a legislative change, we will become an insolvent, pay-as-you-go system. The question becomes this: do you want to pay for this now, or do you want to pay a lot more for this later? Every day we wait makes it more expensive. The cost now is a small fraction of the hundreds of millions of dollars we will need from you every year in the future to make ongoing retirement benefit payments.

I have provided some additional plan data below for your review if desired. I would be happy to answer any questions.

Main PERS Plan Design History:

PLAN	VESTING	CONTRIBUTION RATE	FAS	RULE	EARLY RETIREMENT	NORMAL RETIREMENT	BENEFIT CALCULATON FAS X Multiplier X YOS
Main System **Tier 1**	36 months or age 65 while actively employed	7% - EE 7.12% - ER 1.14% - RHIC	Highest 36 of last 180 mo. averaged as of 12/31/2019 <u>or</u> 3 highest 12-mo consecutive periods	85	55 6% reduction/year	65 or Rule of 85	2% Multiplier
Tier 2 (First enrolled 1/1/16- 12/31/19)	36 months or age 65 while actively employed	7% - EE 7.12% - ER 1.14% - RHIC	Highest 36 of last 180 mo. averaged as of 12/31/2019 <u>or</u> 3 highest 12-mo consecutive periods	90	60 8% reduction/year	65 or Rule of 90 with minimum age of 60	2% Multiplier
Tier 3 (First enrolled after 1/1/2020)	36 months or age 65 while actively employed	7% - EE 8.26% - ER No RHIC	Highest 36 of last 180 mo. averaged as of 12/31/2019 <u>or</u> 3 highest 12-mo consecutive periods	90	60 8% reduction/year	65 or Rule of 90 with minimum age of 60	1.75% Multiplier

Contribution History to the Main PERS Plan:

Main Contributions	Date of Change 1/1/2020	1/1/2014	1/1/2013	1/1/2012	8/1/2009	Prior to 8/1/2009
Employee*	7.00%	7.00%	6.00%	5.00%	4.00%	4.00%
Employer	8.26%	7.12%	6.12%	5.12%	4.12%	4.12%
RHIC	0.00%	1.14%	1.14%	1.14%	1.14%	1.00%
Total	**15.26%**	**15.26%**	**13.26%**	**11.26%**	**9.26%**	**9.12%**

*State pickup of employee contribution is 4%

PERS Investment Return History (commingled funds):

PERS Investment Returns (Net of Fees)	Calendar Year Ending 12/31/2020	Calendar Year Ending 12/31/2019	Calendar Year Ending 12/31/2018	Calendar Year Ending 12/31/2017	Calendar Year Ending 12/31/2016	Calendar Year Ending 12/31/2015	Calendar Year Ending 12/31/2014	Calendar Year Ending 12/31/2013	Calendar Year Ending 12/31/2012	Calendar Year Ending 12/31/2011
PERS Actual (Net of Fees)	**12.2%**	**18.0%**	**-4.1%**	**17.2%**	**7.1%**	**0.5%**	**6.0%**	**16.6%**	**13.4%**	**-0.8%**
PERS Policy Benchmark	12.0%	17.4%	-3.2%	14.2%	7.2%	0.1%	5.2%	15.3%	12.5%	0.4%

PERS Investment Returns (Net of Fees)	Fiscal Year Ending 6/30/2020	Fiscal Year Ending 6/30/2019	Fiscal Year Ending 6/30/2018	Fiscal Year Ending 6/30/2017	Fiscal Year Ending 6/30/2016	Fiscal Year Ending 6/30/2015	Fiscal Year Ending 6/30/2014	Fiscal Year Ending 6/30/2013	Fiscal Year Ending 6/30/2012	Fiscal Year Ending 6/30/2011
PERS Actual (Net of Fees)	**3.4%**	**5.5%**	**9.2%**	**13.1%**	**0.3%**	**3.5%**	**16.4%**	**13.4%**	**-0.1%**	**21.3%**
PERS Policy Benchmark	3.2%	6.4%	7.9%	11.9%	0.6%	2.2%	15.7%	11.8%	1.1%	20.6%

PERS Investment Returns (Net of Fees)	5 Years Ending 12/31/2020	10 Years Ending 12/31/2020	20 Years Ending 12/31/2020	30 Years Ending 12/31/2020
PERS Actual (Net of Fees)	**9.77%**	**8.34%**	**6.61%**	**8.35%**
PERS Policy Benchmark	9.27%	7.88%	6.60%	8.21%

PERS Investment Returns (Net of Fees)	5 Years Ending 6/30/2020	10 Years Ending 6/30/2020	20 Years Ending 6/30/2020	30 Years Ending 6/30/2020
PERS Actual (Net of Fees)	**6.20%**	**8.38%**	**6.61%**	**8.35%**
PERS Policy Benchmark	5.90%	7.93%	6.60%	8.21%

Main PERS Plan Funded Status and Benefit Multiplier History:

Year	Funded Status	Benefit Multiplier Change
7/1/1977	133.8%	1.04%
8/1/1983	91.7%	1.20%
7/1/1985	95.9%	1.30%
7/1/1987	103.8%	1.50%
7/1/1989	100.4%	1.65%
7/1/1991	100.7%	1.69%
7/1/1992	100.9%	
8/1/1993	99.7%	1.725%
1/1/1994	98.9%	1.74%
7/1/1995	102.8%	
7/1/1996	104.0%	
8/1/1997	108.9%	1.77%
7/1/1998	111.3%	
8/1/1999	108.8%	1.89%
7/1/2000	115.1%	
8/1/2001	110.6%	2.00%
7/1/2002	104.2%	
7/1/2003	98.1%	
7/1/2004	94.0%	
7/1/2005	90.8%	
1/1/2006	88.8%	
8/1/2008	93.4%	
7/1/2009	85.1%	
7/1/2010	73.4%	
7/1/2011	70.5%	
7/1/2012	65.1%	
7/1/2013	62.0%	
1/1/2014	64.5%	
8/1/2015	68.6%	
1/1/2016	66.7%	
8/1/2017	70.7%	
7/1/2018	72.5%	
7/1/2019	72.2%	
1/1/2020	69.1%	1.75%