NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

EMPLOYEE BENEFITS PROGRAMS COMMITTEE

Thursday, November 20, 1997
Harvest Room, State Capitol
Bismarck, North Dakota

Representative Francis J. Wald, Chairman, called the meeting to order at 9:00 a.m.

Members present: Representatives Francis J. Wald, James O. Coats, Glen Froseth, Leland Sabby, Allan Stenehjem; Senators Ed Kringstad, Elroy N. Lindaas, Carolyn Nelson

Member absent: Senator Karen K. Krebsbach

Others present: See Appendix A

It was moved by Representative Coats, seconded by Representative Stenehjem, and carried that the minutes of the August 12, 1997, meeting be approved as mailed.

TEACHERS' FUND FOR RETIREMENT

At the request of Chairman Wald, Mr. W. Michael Carter, Enrolled Actuary, Watson Wyatt Worldwide, Dallas, Texas, presented the July 1, 1997, actuarial valuation of the Teachers' Fund for Retirement and a review of actuarial principals and the valuation process. A copy of the overheads used in his presentation is attached as Appendix B. Mr. Carter said the primary purpose of the actuarial valuation of the Teachers' Fund for Retirement is to determine the adequacy of the current employer contribution rate. Other purposes, he said, are to determine the margin, if any, in the employer rate available for benefit improvements; to trace the change in funding and funding cost from the beginning of the year to the end of the year; to calculate gains and losses for the year; and to provide an annual snapshot of the status of the fund. He said the Teachers' Fund for Retirement experienced a significant gain during the past year due to investment returns and this gain caused the unfunded liability to increase less than had been actuarially anticipated.

In response to a comment from Representative Wald, Mr. Carter said both the employer and employee contribution under the Teachers' Fund for Retirement is 7.75 percent of payroll. He said this contribution rate began August 1, 1997. Prior to that date, he said, both the employer and employee contributions under the fund were 6.75 percent of covered compensation.

Concerning the valuation process, Mr. Carter said, the actuarial consultant analyzes any legislative changes and incorporates them into their computer programs. He said the actuary next requests, reviews, checks, and accepts member data and then requests, reviews, checks, and accepts asset data. In reviewing asset data, he said, the role of the actuary is to calculate the actuarial value of assets and spread realized and unrealized gains and losses over a five-year period to smooth out market fluctuations. Next, he said, the actuarial consultant prepares cost summaries including asset gains or losses, liability gains or losses, any changes in the actuarial assumptions, any changes in the method used, and any benefit enhancements enacted by the Legislative Assembly. Next, he said, the consultant analyzes and reviews the results, prepares a report, and presents the report to the Teachers' Fund for Retirement Board of Trustees.

Mr. Carter said information gained from the actuarial valuation process includes the funding period based upon the current contribution rate; the funding margin, if any, available in the current rate; the size of asset and liability gains or losses; the unfunded liability; the current funding status; an estimate of investment returns based on actuarial assets; member statistics; and cash flow during the past year. He said actuarial liabilities are created by a promise to pay if certain events occur or certain conditions are met in the future. He said the components of actuarial cost are comprised of two pieces. He said these are the normal cost and the amortization charge for the unfunded liability. He said the normal cost is the ongoing cost of the plan or what the cost is for the benefits that will be earned by the average new member and actuarial assumptions are exactly met. He said the unfunded liability is the liability created by giving retroactive credit for a benefit change or providing postretirement benefit increases. Finally, he said, the amortization charge is the annual rate at which the unfunded liability is paid off. He said the meaning of normal cost, actuarial accrued liability, and unfunded actuarial accrued liability differ depending upon the valuation method used. He said the normal cost is the current annual cost if no unfunded or overfunded liability exists. The sources of unfunded liability, he said, are if the actual experience differs from the assumed experience, the Legislative Assembly grants benefit credit for service before the system was created, and the granting of retroactive credit for benefit enhancements. He emphasized that there is nothing wrong or bad about having an unfunded liability if systematic progress is being made in amortizing it over a reasonable time. Likewise, he said, there is nothing wrong with a benefit enhancement that increases unfunded liability if it is properly funded. He said the actuarial consultant examines trends and comparisons over a period of years and does not become overly concerned with specific numbers.

In response to a question from Representative Froseth, Mr. Carter said a significant market correction would not jeopardize the state's pension funds. He said that the actuarial valuations are based on the actuarial value of the fund assets, not their market value, and thus any significant market fluctuations are smoothed over a period of years.

Mr. Carter next presented the actuarial valuation of the Teachers' Fund for Retirement as of July 1, 1997. A copy of the overheads used in his presentation is attached as Appendix C. Concerning the actuarial valuation, Mr. Carter said, the number of active members increased from 9,797 in 1996 to 10,010 in 1997. However, he said, the number of retired members decreased over the same time from 4,503 to 4,462. He said there has been a .7 percent average increase in active members since 1990 and a 1.4 percent average increase in retired members since 1990.

Mr. Carter said the active payroll increased from $281.2 million in 1996 to $294.1 million in 1997. He said there has been a 3.5 percent average increase in active payroll since 1990. He said the average salary for members of the Teachers' Fund for Retirement is $29,382 with the average benefit being $8,748. He said there has been an average increase of 2.8 percent in salary since 1990 and an average increase in benefits of 8.4 percent during this same period. He said the market value of Teachers' Fund for Retirement assets was $1,001,000,000 as of June 30, 1997. However, he said, the actuarial value, using the smoothing approach, was $823.4 million. He said there has been a 9.9 percent average increase in the actuarial value of the Teachers' Fund for Retirement assets since 1990 and a 12.1 percent average increase in Teachers' Fund for Retirement market value since 1990. He said the actuarial value of assets is 82.3 percent of the market value of the assets. He said the estimated yield for 1997 based on market value of assets was 18.5 percent while the actuarial yield was 12.6 percent. He said the Teachers' Fund for Retirement has averaged an 11.1 percent compound rate of return on market value since 1989 and averaged an 8.5 percent compound return on actuarial value since 1989. In 1994, he said, the Teachers' Fund for Retirement began to pay out more in benefits than it receives in contributions and for the year ending June 30, 1997, the fund paid out $42.9 million in benefits and refunds while receiving $40.2 million in member and employer contributions. However, he said, external cash flow as a percentage of market value is only -.3 percent, which is still a very healthy percentage. He said this means the system is easily able to meet its benefit and refund payments out of interest and dividend income and this would not become a concern unless the external cash flow as a percentage of market value reached -7 to -10 percent. In this event, he said, the Teachers' Fund for Retirement would have to change its cash management system and reallocate its assets in order to increase its liquidity to meet benefit payment requirements.

Mr. Carter said the unfunded actuarial accrued liability increased from $118.3 million to $153.6 million during the year ended June 30, 1997. He said the increase in the unfunded liability was a result of benefit enhancements enacted by the 1997 Legislative Assembly but only lowered the funded ratio from 86.1 to 84.3 percent. He said the unfunded actuarial accrued liability is 52.2 percent of payroll and is well within actuarially accepted levels. He said the required contribution rate is 6.37 percent. Thus, he said, the available margin is 1.38% or 7.75% (the employer contribution rate) - 6.37% (the required contribution rate for the plan year) = 1.38% (the available margin). In summary, he said, the Teachers' Fund for Retirement is being adequately funded in a responsible manner. He said the June 30, 1997, actuarial valuation is positive and the Teachers' Fund for Retirement is in a healthy position.

In response to a question from Representative Wald, Mr. Carter said the Taxpayer Relief Act of 1997 was very beneficial for public pension plans. He said the Act granted public pension plans a moratorium from the more onerous tax regulation provisions of the prior existing tax code. In response to a further question from Representative Wald, Mr. Carter said the cost would be minimal to lower the vesting requirement but there would be no real benefit to a lower vesting requirement. In response to a further question from Representative Wald, Mr. Carter said the Teachers' Fund for Retirement has the typical service purchase and service transfer provisions for a public pension plan.

At the request of Chairman Wald, Mr. Carter presented information concerning the calculation of unfunded actuarial accrued liability. A copy of the overheads used in Mr. Carter's presentation is attached as Appendix D. He said that based upon a 1996 University of Wisconsin study of 81 statewide public pension systems, the North Dakota Public Employees Retirement System is funded at a 104 percent funding ratio and is one of 24 systems that has a 100 percent or more funded ratio and that the North Dakota Teachers' Fund for Retirement has a funding ratio of 98.1 percent and is one of 14 public pension systems that has a funded ratio between 90 and 99.9 percent.

In response to a question from Representative Wald, Mr. Carter said the last multiplier increase prior to 1997 was in 1993. He said the 1991 Legislative Assembly increased the benefit multiplier from 1.275 percent to 1.39 percent and the 1993 Legislative Assembly increased the benefit multiplier from 1.39 percent to 1.55 percent. He said these benefit enhancements were made without any increase in contribution rates. He said there were no material changes in 1995, but the 1997 Legislative Assembly increased the Teachers' Fund for Retirement's benefit multiplier from 1.55 to 1.75 percent. He said the 1997 Legislative Assembly increased both the employer and employee contribution rate one percent.

In response to a comment from Senator Nelson, Mr. Carter agreed that the benefit multiplier could have been increased from 1.55 to 1.61 percent and an ad hoc increase could have been provided without increasing the employer and employee contributions. He said employers supported the increase in the contribution rate because they felt that there would be overall payroll savings because older, more highly compensated employees would retire under the enhanced benefit and these employees would be replaced by younger, lesser compensated employees resulting in an overall payroll savings for the affected school districts.

PUBLIC EMPLOYEES RETIREMENT SYSTEM

At the request of Chairman Wald, Mr. Roderick B. Crane, Vice President, and Ms. Leslie Thompson, Enrolled Actuary, The Segal Company, Denver, Colorado, presented the July 1, 1997, actuarial valuations of the Public Employees Retirement System main system, judges' retirement fund, National Guard retirement fund, Highway Patrolmen's retirement fund, and the retiree health benefits fund. Copies of the actuarial valuations are on file in the Legislative Council office and a copy of the overheads used by Mr. Crane and Ms. Thompson in their presentation is attached as Appendix E. Concerning the main system, Mr. Crane said, the total number of active members increased from 15,398 to 15,596 for the year ending June 30, 1997. He said this was an increase of 1.3 percent and the average age of active members increased from 43.7 years to 44.1 years. He said the average annual salary also increased from $22,126 to $22,710 and total payroll from $341 million to $354 million, or a 3.8 percent increase. He said the number of active members in the judges' system remained the same but the average age of active members increased one year. He said there was a two percent increase in average annual salary and a 2.6 percent increase in total payroll. He said there was an increase of one in the total number of active members in the National Guard retirement system, a decrease of approximately 3.5 months in average age of active members, 5.2 percent average annual increase in salary, and an 8.8 percent increase in total payroll. He said fluctuations in the smaller funds are more dramatic because of the smaller memberships.

Mr. Crane said the total assets of the Public Employees Retirement System and Highway Patrolmen's retirement system as of June 30, 1997, was $869 million valued at market value. He said the actuarial value of these assets was $729 million or 81 percent of market value. He said the rate of return on the actuarial value of assets was 13.14 percent which was 5.14 percent higher than the actuarially assumed rate of return of eight percent. He said the 10-year average rate of return has been 9.85 percent.

Ms. Thompson reviewed the calculation of the cost rates for the main system, judges' system, and National Guard system. For the main system, she said, the employer cost rate for 1997 is 2.94 percent while the statutory contribution rate is 4.12 percent. Thus, she said, the contribution margin for 1997 is 1.18 percent (4.12 - 2.94 = 1.18). For the judges' system, she said, the employer cost rate is 9.18 percent while the statutory contribution rate is 14.52 percent, providing a margin of 5.34 percent (14.52 - 9.18 = 5.34). For the National Guard retirement system, she said, the employer cost rate is 2.81 percent while the contribution rate established by the Public Employees Retirement System Board is 8.33 percent, providing a margin of 5.52 percent (8.33 - 2.81 = 5.52).

Concerning the retiree health insurance credit fund, Mr. Crane said, the total number of members increased from 15,590 as of June 30, 1996, to 15,801 as of June 30, 1997. He said the total number of members in the retiree health insurance credit fund increased 1.4 percent during the past actuarial year. He said the average age of active members increased five months, the average annual salary increased 2.6 percent, and the total payroll increased four percent. He said the assets, at market value, in the retiree health insurance credit fund were $16.6 million as of June 30, 1997. He said this correlates to an actuarial value of $13.7 million or 82.5 percent of market value. He said the market value rate of return was 19.64 percent while the actuarial value rate of return was 13.40 percent or 5.4 percent in excess of the eight percent investment return assumption.

Concerning the North Dakota Highway Patrolmen's retirement system, Mr. Crane said, the total number of active members increased from 112 to 124, a 10.7 percent increase, from June 30, 1996, to June 30, 1997. However, he said, the average age of active members declined and the average annual salary declined while the total payroll increased 10.5 percent.

Ms. Thompson said the employer cost rate for the Highway Patrolmen's retirement system for 1996 was 11.69 percent, the plan experience a -.89 percent, benefit improvements 3.84 percent, and a change in assumptions .02 percent leaving the employer cost rate for 1997 at 14.66 percent. She said the statutory contribution rate is 16.70 percent; thus, the contribution margin is 2.04 percent or 16.70% - 14.66% = 2.04%. She said the funded ratio of the Highway Patrolmen's retirement system is 90 percent.

In response to a question from Representative Wald, Mr. Sparb Collins, Executive Director, Public Employees Retirement System, distributed a Social Security Administration publication entitled *A Pension From Work Not Covered by Social Security* which describes how this type of benefit affects Social Security retirement or disability benefits. A copy of the publication is attached as Appendix F.

In response to a question from Representative Wald, Ms. Thompson said that the five-year vesting period of the Public Employees Retirement System is the normal vesting period for pension plans. She said that she spent a considerable time as a benefits consultant for technology firms in the Silicon Valley region of California which are attempting to design benefit packages to attract intellectual capital. She said these firms have discovered that vesting is not important in solving this problem and lowering the vesting period will not have much of an impact on attracting and retaining employees. In response to a further question from Representative Wald, she said that Montana is studying a hybridization of defined benefit and defined contribution plans, under which a plan would be designed composed of the most attractive elements of a defined benefit plan and a defined contribution plan. She said a hybrid plan could be designed to protect older employees while attracting young employees.

UNIFORM GROUP HEALTH INSURANCE PLAN

At the request of Chairman Wald, Mr. Collins addressed the committee. He presented a chart showing the claims versus premiums for higher education, state agencies, and political subdivisions for calendar years 1995 and 1996. A copy of this chart is attached as Appendix G.

In response to a question from Senator Nelson, Mr. Collins said the current premium as billed to the state of North Dakota is $301 and the current premium that is paid to Blue Cross Blue Shield for state contracts is $322. He said the single rate for employees of a political subdivision that participates in the uniform group health insurance plan is $150.42 and the family premium is $371.70. He emphasized that this is for political subdivisions that already participate in the plan and that the premium for new political subdivisions entering the plan is higher. He said this premium is $159.66 for a single plan and $397.81 for a family plan.

Considering participation by political subdivisions in the uniform group insurance program, Mr. Collins distributed a summary of the guidelines that political subdivisions must comply with in order to participate. A copy of the guidelines is attached as Appendix H.

At the request of Chairman Wald, Mr. Collins presented a schedule comparing the uniform group health insurance program with other Blue Cross Blue Shield health insurance plans. A copy of this schedule is attached as Appendix I. In summarizing the schedule, he said, the average employer cost for the North Dakota Public Employees Retirement System was $97.54 from July 1996 through June 1997. He said this compares with an average of $104.17 for all other Blue Cross Blue Shield employer groups or 6.8 percent less than other employer groups.

Concerning the report on pension portability that the Office of Management and Budget and the Public Employees Retirement System are to produce pursuant to 1997 S.L. ch. 15, § 18, Mr. Collins said the Public Employees Retirement System staff and staff from the Office of Management and Budget have begun work developing the report. He said the staffs have reviewed the portability provisions of other states' pension plans. He said this report will be presented to the Public Employees Retirement System Board at its January meeting and presented to the committee at the end of January or the first part of February.

At the request of Chairman Wald, Mr. Mark A. Johnson, Executive Director, North Dakota Association of Counties, addressed the committee. A copy of his comments is attached as Appendix J. He said he had received a memorandum from the state supervisor of assessments for the State Tax Department indicating that Senate Bill No. 2195, enacted by the 1997 Legislative Assembly, did not accomplish what the sponsors intended. Thus, he asked the committee to consider a bill to amend North Dakota Century Code Section 54-52-05 to provide that an employer may pay employee contributions from the Old-Age and Survivor Insurance System levy established in Section 57-15-28.1(5).

In response to a question from Senator Nelson, Mr. Johnson said that the Tax Department has reviewed the proposed bill draft and informed Mr. Johnson that the amendment addresses the Tax Department's concerns.

It was moved by Representative Coats, seconded by Senator Lindaas, and carried on a voice vote that the Legislative Council staff prepare in bill draft form the proposal submitted by the Association of Counties.

STAFF DIRECTIVES

Senator Nelson requested that Mr. Collins and Blue Cross Blue Shield of North Dakota provide a detailed review of the uniform group health insurance plan and provide information on the exclusive provider organization and preferred provider organization options. She said the review should include how the present plans are operating and which employees are making use of which options.

Senator Nelson requested that the Teachers' Fund for Retirement staff and the Legislative Council staff provide information concerning the process and difficulties encountered when teaching employees of the higher education system switched from the Teachers' Fund for Retirement to TIAA-CREF. She said this experience may help the committee in its discussions on changing from a defined benefit plan to a defined contribution plan.

Representative Coats requested that the Legislative Council staff provide information on the number of public safety pension funds which have members who are not covered by Social Security.

No further business appearing, Chairman Wald adjourned the meeting at 2:00 p.m.

Jeffrey N. Nelson
Counsel

John D. Olsrud
Director

ATTACH:10