

2011 HOUSE GOVERNMENT AND VETERANS AFFAIRS

HB 1228

2011 HOUSE STANDING COMMITTEE MINUTES

House Government and Veterans Affairs Committee
Fort Union Room, State Capitol

HB 1228
January 21, 2011
13228

Conference Committee

Committee Clerk Signature

Carmen Hart

Explanation or reason for introduction of bill/resolution:

Relating to a defined contribution retirement plan for state employees

Minutes:

Chairman Bette Grande opened the hearing on HB 1228.

Jeff Nelson, Staff Attorney, Legislative Council, and also serve as committee counsel for the Employee Benefits Programs Committee, appeared and gave an overview of the bill. HB 1228 concerns the public employees retirement system and would establish a defined contribution retirement plan for most state employees. Section 1, Page 1, Line 7—this is the definitional section for the current defined benefit or hybrid plan and would define eligible employee as all permanent employees who are first employed before August 1, 2011. On August 1 if an employee is employed, they remain or have the option to remain in the defined benefit plan. Beginning August 1 new employees, new hires would become members of the defined contribution retirement plan. Page 1, Line 16—eligible employee does not include state employees who are first employed after July 31, 2011. Eligible employee does include employees of the judicial branch remain in the defined benefit, employees eligible to participate in the national guard retirement plan or a law enforcement retirement plan, so the public safety type employees remain in the defined benefit. This does not affect political subdivision and employees of higher education and state institutions under the jurisdiction first employed before August 1, 2011 and not participating in TIAA/Cref. Page 2, Section 2—newly elected and appointed officials. Again, new officials before August 1, 2011 would be members of the defined benefit plan. Line 11—after July 31, 2011 an individual elected or appointed to a state office for the first time must from and after date that individual qualifies and takes office become a participating member of the retirement plan established under Chapter 54-52.6. That is the current defined contribution plan. Page 2, Line 17, Section 3 deals with temporary employees. The same provisions apply before August 1, defined benefit, after July 31 or beginning on August 1, defined contribution. Page 3, Section 4—this is the definitional section for the defined contribution retirement plan contained in Chapter 54-52.6. I would like to point out eligible employee means a permanent state employee except an employee of the judicial branch or an employee of the board of higher education and state institutions under the jurisdiction of the board eligible to participate in the teachers' insurance and annuity association of America while TIAA/Cref retirement plan and an employee eligible to participate, as we talked about, national guard or a law enforcement retirement plan, those public safety type

employees, who is 18 years of age. Then eligible employee would also mean a temporary employee who elects to participate after July 31 in the retirement plan established under this chapter, the defined contribution retirement plan. Page 4, Section 5 is the election provision. This section provides that the board is to provide an opportunity for eligible employees for members of the defined benefit plan on February 28, 2012 to transfer to the defined contribution retirement plan by electing in writing to terminate membership in the public employees' retirement system and elect to become participating members in the defined contribution retirement plan. The remainder of that section sets out how the election will be handled and the dates by the public employees' retirement system board. Section 6 also deals with the election in that it is the transfer of accumulated fund balances and provides how the public employees' retirement system board is to determine the amount to be transferred and provides that the board shall calculate the amount using the two formulas. One, the actuarial present value of the individual's accumulated benefit or Subsection 2, Line 27, the actual employer contribution made, and the board is required to transfer the greater of the two amounts calculated.

Rep. Lisa Meier: Once an employee transfers there is no opportunity to transfer back. Is that correct?

Jeff Nelson: Yes.

Rep. Karen Karls: We have a lot of new members on this committee. Could you just briefly tell us T...

Chairman Bette Grande: TIAA/CREF. We don't do TIAA/CREF. Actually, that is what the university systems use. We always make sure we exempt them out, because we are not trying to mess with Rep. Winrich's retirement plan at all. Committee members, you have heard my testimony. I am not going to stand up and reiterate it.

Bill Shalhoob, ND Chamber of Commerce, appeared in support. You also heard my testimony. I just refer back to it, and again I see no reason to repeat it.

Dustin Gawrylow, Executive Director, ND Taxpayers Association, appeared in support. **Attachment 1.**

Sparb Collins, Executive Director, North Dakota Public Employees Retirement System (PERS), appeared in a neutral position. **Attachment 2.**

Chairman Bette Grande: Chairman Grande asked this question during testimony. I need a clarification here in my mind. I like the fact that we can use an analogy because there are a lot of freshmen on the committee, and sometimes this is a hard concept. When we make this, and we are making the comparisons DB and DC and we are talking about the challenge of paying off the unfunded liability—first with this analogy—this example we are talking about a level dollar amount amortization, correct?

Sparb Collins: In this example for the mortgage we are just conceptualizing how this payment is made over time. It is an increase for the DC plan. What that does is that is

spread over the working career of the members. When the last working member quits, we should have...

Chairman Bette Grande: I feel like I am comparing an apple to an orange. This kind of analogy is based on level dollar versus level percentage. I am bringing in an apple and an orange and I am trying to do an analogy on it. If we could talk to level percentage, that is what the actuary is dealing with in a defined benefit plan. All of a sudden I am talking about a level dollar.

Sparb Collins: I understand what you are saying, but the basic concept here is that you have a certain number of dollars to be paid and when there are less members it is a little higher per member. Now we can spread that level dollar. We can spread it level percent, but it is going to be the same amortization situation. If it would be helpful, I would be happy to do that.

Chairman Bette Grande: That is okay. I'll walk it through with the committee too.

Chairman Bette Grande: Committee, as you heard earlier with TFFR and with Mr. Collins, I did have discussion with both of them as this draft came out. I had put in the opt out provisions. Part of the discussion was that we most likely would be removing that. If we don't, this bill has to go through quite an extensive process, because that means it has to go out to the actuaries, get full new reports, come back in, go to the Employee Benefits Committee, then come back to this committee. I am going to ask for the committee to remove that portion just so you are aware as to why they have both made that comment.

Brad Ramirez, Segal Company, appeared. We are consultant and actuary for North Dakota PERS. **Attachment 3.** I am just going through the specifics of how it affects the PERS system with a couple of quick charts.

The following were in opposition.

Marlowe Kro, Associate Director, AARP North Dakota, appeared in opposition. **Attachment 4.**

Rep. Roscoe Streyle: Why is it assumed that individuals simply are not prepared to handle the risk or responsibilities? To me you are assuming that they are not smart enough to be able to do it themselves when the private sector apparently is?

Marlowe Kro: History has taught us and a lot of the research on the difference between a defined benefit plan and a defined contribution plan indicate that most persons unless you are a professional in the field of investing do not necessarily have the ability to make all of the correct choices all of the time. That is what I am referring to here too.

Stuart Savelkoul, Executive Director, North Dakota Public Employees Association, appeared. **Attachment 5.**

Chairman Bette Grande: During the testimony Chairman Grande asked for clarification. That is not carte blanche, and that is why we have hired the Hay Group to continue

because the market evaluation was flawed, so we will correct those numbers. You can't just say all are. We only have certain groups that are, so I do want to just be real cautious when we make a carte blanche 10 to 12 across the board.

Stuart Savelkoul: I will defer to the Hay Group on what they meant by the figures 10-12%.

Chairman Bette Grande: Do you feel that it is fiscally conservative or prudent to the taxpayers for us to continue on a plan that is running out of money and that has its ups and downs where it had continuously times where employer has had to pay into the plan to keep shoring it up?

Stuart Savelkoul: I would defer somewhat to Sparb Collins on the official history of the fund, but to speak to your question, Rep. Grande. It is my understanding that ND PERS has an 8% assumption rate. Over the history of the fund including the market collapse of 2008, we received a return of somewhere around 8 ½%. I would say that the recent market collapse of 2008 is relatively unprecedented and certainly unprecedented over the lifetime of the fund. For us to assume, as we seem to have continually done today, that the fund simply is not sustainable is an assumption that I don't think has quite enough facts to support it.

Chairman Bette Grande: The beauty of it is we can all claim our own assumptions. We can have our debate later.

Rep. Roscoe Streyle: Why in the opposing testimony do we always assume it is a lesser benefit to not have a defined ...I work in the private sector? I don't think it is any less benefit to have a defined contribution nor does anybody I know that works in the private sector. The word deserve—why does anybody deserve a fixed amount of retirement?

Stuart Savelkoul: Your two questions first entered on whether or not the assumption that defined benefit is a superior plan. We will tell you that for the people that have them they have spoken without any confusion on the matter, they feel it is a superior plan. To speak to people in the private sector, there were several testimonies that were given that said the private sector can't afford to sustain a defined benefit plan although corporate earnings are at an all time high. While I am sure that there individuals like yourself, Rep. Streyle, that have had some success with defined contribution plans, I don't feel that their existence is lengthy enough. We all know that defined contribution plans got their start in 1977. Defined benefit plans have existed for much longer than that. Do we have enough of a track record to show that people can provide themselves with an adequate retirement when their lifetime career has been spent not getting a pension but rather getting a defined contribution plan? The second part of your question was why does anybody deserve anything? I think that anybody that works hard whether it is in public or private service, if you work hard for a living and devote your career to educating young people or providing high quality public services—this bill itself implies that some people deserve a defined benefit because it exempts various people in the ND PERS system from being subject to the defined benefit plan. I guess, Rep. Streyle, as Rep. Grande mentioned, we all have our assumptions, but I could only assume that the authors of this bill assumed that some people deserved a guaranteed benefit.

Rep. Roscoe Streytle: I also take point to the race to the bottom? Are you presuming that if we vote for this bill—I guess the whole premise of North Dakota is racing to the bottom by giving their employees flexibility and then make their own choices?

Stuart Savelkoul: As is always the problem with written testimony, sometimes you have to expect certain arguments. While we were in a hearing for SB 2108 last week, the question was constantly posed why should public employees get this benefit when people in the private sector don't get it? My assumption was that they assumed this was a superior benefit, and so since we can't make sure everybody in the private sector has a pension we should take it away from the people in the public sector that do have it. That is what I meant by race to the bottom.

Chairman Bette Grande: I will quickly clarify just for you and me. The judges' plan is so totally different it is hard to convert it, and we would have to just deal with that on a different basis than in this bill. The other group that is out is almost all non social security, and so it is again hard to convert within inside this bill. You were asking why some got to stay out. It is a process.

Stuart Savelkoul: Of course. All that I am saying is that if you are saying that it is because they are not in social security, then again I would say there is some assumption that people should some guaranteed retirement.

Chairman Bette Grande: It is a three legged stool.

Stuart Savelkoul: We believe in the three legged stool.

Chairman Bette Grande: Oh, okay. Why is the one 60%? One is only 30% and the other is not being accomplished. You and I will continue our debate.

Justin Adolf, President of the Professional Firefighters of North Dakota, appeared asking for a do not pass recommendation. Part of the group that I represent is actually a part of NDPERS. They are a part that would not be forced into the DC plan, but the increased liability that would be taking the rest of the state out is something we don't like to see. Without that funding being brought forward and seen, we ask for a do not pass.

Bill Kalanek, Association for Public Employees, appeared. **Attachment 6.**

Vice Chairman Randy Boehning: You are talking about the current economic environment. I am assuming you are thinking that we are in pretty tough shape. Why would the taxpayers that are suffering with economic downturn have to shore up public employees' pensions when they are struggling as well?

Bill Kalanek: As referred to earlier, I meant the economic environment within the scope of the PERS plan. In previous bienniums ad hoc adjustments have been made based on returns from the plan. Under the current status of the fund those wouldn't be allowable under the plan. Typically in the past it was almost required that it be at 90 or 95% minimum before you consider any sort of ad hoc adjustment.

Vice Chairman Randy Boehning: Is it fair to the taxpayer out there that is in a hardship? We should maybe be giving some of those a tax break instead of funding more of the state employees. Their taxes are going up. We are funding employees' pensions. With the one current plan out there, we would be funding some areas at 24% on teachers' funds. This here is going to be 16%. At what point is enough?

Bill Kalanek: I personally am not here to debate what is the appropriate tax level for everybody in this room and everybody throughout the state. I do know that there are very good state employees at the state level who pay their taxes and contribute to it as well. In essence, paying their own salaries to some degree. Nobody wants to be overtaxed, but accommodations need to be made at some point or another to pay for the services that state employees provide.

Rep. Lisa Meier: How many members do you have currently?

Bill Kalanek: Approximately 1,000 members.

Bill Lardy, Retired ND Insurance Department Employee, appeared. He retired at the end of 2006 after more than 15 years with the ND Insurance Department. I have prior service with the North Dakota Highway Department and was employed at Dickinson State for ten years. I am an army veteran having served from 1967-1969, and I must say that I am very grateful that I was fortunate enough to not have to go to Vietnam. Altogether I have about 18 years as part of the NDPERS retirement system including my two years of army service which I purchased with my own dollars while I was employed at the insurance department. These 18 years provide a retirement benefit of just under \$1,200 a month for my wife and me. The PERS income is not our only source of income for us, but it is a major share and we depend heavily on it. The defined benefit plan is important to my wife and me, and it will remain an important benefit for as long as we might live. I believe passage of this bill will jeopardize that income that we have come to depend on and rely upon. I believe so because we will be removing so many participants from the plan, and it will jeopardize not just the income my wife and I enjoy but the income of all the current retirees and those who will remain on the plan as of August 1. I strongly urge the committee to do not pass this particular bill.

Gordy Smith, CPA, Office of the State Auditor, appeared in opposition of the bill.

Attachment 7. Some other comments made were: I don't know enough about the study that the Hay Group did. I do know that in there they did indicate that our auditor 2 and 3s which are middle level, and in which we have our most turnover rate, in there they were listed with others that were paid more than 15% under what their peers were. It seems now if we are able to keep people 8 or 10 years, they stay, and I think the reason they stay is because they know what they are going to have in retirement. They are going to be able to count on it. They can measure how much that is going to be.

Rep. Lonny Winrich: Clearly, the higher turnover rate that you are experiencing is costing the state some money. Do you have any idea how we might address the question of what the cost of training a new person—how could we assess a cost on that?

Gordy Smith: I don't have a rule of thumb off the top of my head, but I can promise you that when we are hiring in the professional field, we are competing against private industry. We also compete with CPA firms and those kinds of things. In the business we do, any new hires require a lot of supervision and training. That is what takes a lot of our time. Whenever we have been blessed, like we were last session, with some equity money I can promise you that the management of the Auditor's Office gives that money to the staff. Frankly, if I can give somebody \$100 or \$200 a month and they stick around because there is that promise every once in awhile that they can get that, it is well worth us not taking it.

David Kemnitz, President of the North Dakota AFLCIO, appeared. We support the workers and the organizations on behalf of the defined benefit plan. I am not a financial counselor or advisor, but I did look at the websites of NDPERS and read much of the material from both sides including Dustin's and what I can add is I am about to be 62. I have looked over all these plans. I do have a defined benefit, and I do have some defined contribution. I can tell you that the future looks much better and brighter for a retiree with a fixed income that is adequate than one that looks big and spread out over time defeats the very purpose of longevity or wishing to be because it may not be there. A reward for work, should lock it in. Is the promise given should be a promised kept. Adequate income equals a strengthened economy. Fewer and lower social payments are included in that which is part of what you do as well. In a defined contribution Oliver Wendell Holmes said one time and I think it applies when I look at that and my defined contribution plan, he said on something else may fortune send a little more than I shall spend. That is the defined contribution you hope is there. In the defined benefit Adam Smith said in reality high profits tend much more to raise the price of work than high wages. The question of what are the benefits to government and to workers and to services is that if you pay them well and they serve well, then we all as a community are better off.

The hearing was closed.

2011 HOUSE STANDING COMMITTEE MINUTES

House Government and Veterans Affairs Committee
Fort Union Room, State Capitol

HB 1228
February 3, 2011
13995

Conference Committee

Committee Clerk Signature

Carmen Hart

Explanation or reason for introduction of bill/resolution:

Relating to a defined contribution retirement plan for state employees

Minutes:

Chairman Bette Grande opened the meeting by discussing HB 1228. The amendment was presented. **Attachment 1.** The reason why this amendment doesn't look quite the same as how it did in TFFR by removing that opt out is because we already have that language because there is a defined contribution plan in PERS already. That language already existed. Now we are just going to have remove those dates about electing to be a part of that. What we are trying to deal with here is just to remove the opt out as we did earlier today.

Rep. Roscoe Streyle made a motion to adopt the amendment..

Rep. Glen Froseth seconded the motion.

A voice vote was taken. Motion carried.

Chairman Bette Grande: I also have similar amendments from this morning. **Attachment 2.** This is the same intent language that will only allow expenditures relating to this act for the first, and again, we are going to make that adjustment. Change the word four to two after enactment are for administrative costs of implementing this Act during which time the legislative management shall receive two annual actuarial valuations of the public employees retirement system to identify the fiscal effect of this Act.

Rep. Roscoe Streyle made a motion to adopt the amendment.

Rep. Vicky Steiner seconded the motion.

Chairman Bette Grande: We are dealing with two different types of bills shoring up and that is over in the senate.

A voice vote was taken. Motion carried.

Rep. Roscoe Streyle moved a **Do Pass** as amended.

Rep. Glen Froseth seconded the motion.

Rep. Lonny Winrich: I would just like to say that I have the same objections to this bill as I did to 1258, but we discussed the philosophy of that extensively the other day.

DO PASS AS AMENDED, 8 YEAS, 4 NAYS, 1 ABSENT. Chairman Bette Grande is the carrier of this bill.

FISCAL NOTE
 Requested by Legislative Council
 02/14/2011

REVISION

Amendment to: HB 1228

1A. State fiscal effect: *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

| | 2009-2011 Biennium | | 2011-2013 Biennium | | 2013-2015 Biennium | |
|----------------|--------------------|-------------|--------------------|--------------|--------------------|--------------|
| | General Fund | Other Funds | General Fund | Other Funds | General Fund | Other Funds |
| Revenues | | | | | | |
| Expenditures | | | \$41,971,310 | \$37,556,460 | \$39,527,207 | \$35,369,445 |
| Appropriations | | | | | | |

1B. County, city, and school district fiscal effect: *Identify the fiscal effect on the appropriate political subdivision.*

| 2009-2011 Biennium | | | 2011-2013 Biennium | | | 2013-2015 Biennium | | |
|--------------------|--------|------------------|--------------------|--------|------------------|--------------------|--------|------------------|
| Counties | Cities | School Districts | Counties | Cities | School Districts | Counties | Cities | School Districts |
| | | | | | | | | |

2A. Bill and fiscal impact summary: *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

Contributions for state employees in the DB plan will need to increase by 7.79% of payroll according to an actuarial study done for the Employee Benefits Committee. This cost is in addition to the cost in SB 2108. This fiscal note does not include any costs associated with the transfer provision.

B. Fiscal impact sections: *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

This increase is due to having fewer members in the PERS defined benefit plan to pay off the unfunded liability. This bill would place all new state employees in the PERS defined contribution plan. This would result in fewer members in the PERS defined benefit plan. The existing unfunded liability in the plan would remain about the same however this bill would mean there would be less members to pay off the unfunded liability therefore the contribution amount required from the remaining members is higher in order to generate approximately the same amount of funds to make the necessary payments to retire the unfunded liability. The contribution amount is lower when there are more members to help with the payment. The changes in the first engrossment of HB 1288 do not change the fiscal note.

3. State fiscal effect detail: *For information shown under state fiscal effect in 1A, please:*

A. Revenues: *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. Expenditures: *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

The implementation date of the bill is 8/1/2011. From this date forward new state employees will go to the defined contribution plan. The number of members in the existing PERS retirement plan will start to decline. The actuary has determined that this declining membership will mean the remaining members will need a higher contribution to raise approximately the same amount of funds to pay off the unfunded liability. These actuarial effects will start to take place with implementation of the bill. If contributions are not increased and funds are not appropriated to pay the additional contribution for the remaining members and the actuarial assumptions are met this cost will continue to

accrue and roll over into future bienniums for payment.

C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

| | | | |
|----------------------|---------------|-----------------------|------------|
| Name: | Sparb Collins | Agency: | PERS |
| Phone Number: | 328-3901 | Date Prepared: | 02/14/2011 |

FISCAL NOTE
 Requested by Legislative Council
 02/08/2011

Amendment to: HB 1228

1A. State fiscal effect: *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

| | 2009-2011 Biennium | | 2011-2013 Biennium | | 2013-2015 Biennium | |
|----------------|--------------------|-------------|--------------------|--------------|--------------------|--------------|
| | General Fund | Other Funds | General Fund | Other Funds | General Fund | Other Funds |
| Revenues | | | | | | |
| Expenditures | | | \$41,941,310 | \$37,556,460 | \$39,527,207 | \$35,369,445 |
| Appropriations | | | | | | |

1B. County, city, and school district fiscal effect: *Identify the fiscal effect on the appropriate political subdivision.*

| 2009-2011 Biennium | | | 2011-2013 Biennium | | | 2013-2015 Biennium | | |
|--------------------|--------|------------------|--------------------|--------|------------------|--------------------|--------|------------------|
| Counties | Cities | School Districts | Counties | Cities | School Districts | Counties | Cities | School Districts |
| | | | | | | | | |

2A. Bill and fiscal impact summary: *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

Contributions for state employees in the DB plan will need to increase by 7.79% of payroll according to an actuarial study done for the Employee Benefits Committee. This cost is in addition to the cost in SB 2108. This fiscal note does not include any costs associated with the transfer provision.

B. Fiscal impact sections: *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

This increase is due to having fewer members in the PERS defined benefit plan to pay off the unfunded liability. This bill would place all new state employees in the PERS defined contribution plan. This would result in fewer members in the PERS defined benefit plan. The existing unfunded liability in the plan would remain about the same however this bill would mean there would be less members to pay off the unfunded liability therefore the contribution amount required from the remaining members is higher in order to generate approximately the same amount of funds to make the necessary payments to retire the unfunded liability. The contribution amount is lower when there are more members to help with the payment. The changes in the first engrossment of HB 1288 do not change the fiscal note.

3. State fiscal effect detail: *For information shown under state fiscal effect in 1A, please:*

A. Revenues: *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. Expenditures: *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

The implementation date of the bill is 8/1/2011. From this date forward new state employees will go to the defined contribution plan. The number of members in the existing PERS retirement plan will start to decline. The actuary has determined that this declining membership will mean the remaining members will need a higher contribution to raise approximately the same amount of funds to pay off the unfunded liability. These actuarial effects will start to take place with implementation of the bill. If contributions are not increased and funds are not appropriated to pay the additional contribution for the remaining members and the actuarial assumptions are met this cost will continue to accrue and roll over into future bienniums for payment.

C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

| | | | |
|----------------------|---------------|-----------------------|------------|
| Name: | Sparb Collins | Agency: | PERS |
| Phone Number: | 328-3901 | Date Prepared: | 02/10/2011 |

FISCAL NOTE

Requested by Legislative Council
01/11/2011

Bill/Resolution No.: HB 1228

1A. State fiscal effect: *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

| | 2009-2011 Biennium | | 2011-2013 Biennium | | 2013-2015 Biennium | |
|----------------|--------------------|-------------|--------------------|--------------|--------------------|--------------|
| | General Fund | Other Funds | General Fund | Other Funds | General Fund | Other Funds |
| Revenues | | | | | | |
| Expenditures | | | \$42,496,000 | \$37,556,000 | \$40,417,000 | \$34,974,000 |
| Appropriations | | | | | | |

1B. County, city, and school district fiscal effect: *Identify the fiscal effect on the appropriate political subdivision.*

| 2009-2011 Biennium | | | 2011-2013 Biennium | | | 2013-2015 Biennium | | |
|--------------------|--------|------------------|--------------------|--------|------------------|--------------------|--------|------------------|
| Counties | Cities | School Districts | Counties | Cities | School Districts | Counties | Cities | School Districts |
| | | | | | | | | |

2A. Bill and fiscal impact summary: *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

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B. Fiscal impact sections: *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

This increase is due to having fewer members in the PERS defined benefit plan to pay off the unfunded liability. This bill would place all new state employees in the PERS defined contribution plan. This would result in fewer members in the PERS defined benefit plan. The existing unfunded liability in the plan would remain about the same however this bill would mean there would be less members to pay off the unfunded liability therefore the contribution amount required from the remaining members is higher in order to generate approximately the same amount of funds to make the necessary payments to retire the unfunded liability. The contribution amount is lower when there are more members to help with the payment

3. State fiscal effect detail: *For information shown under state fiscal effect in 1A, please:*

A. Revenues: *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. Expenditures: *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

The implementation date of the bill is 8/1/2011. From this date forward new state employees will go to the defined contribution plan. The number of members in the existing PERS retirement plan will start to decline. The actuary has determined that this declining membership will mean the remaining members will need a higher contribution to raise approximately the same amount of funds to pay off the unfunded liability. These actuarial effects will start to take place with implementation of the bill. If contributions are not increased and funds are not appropriated to pay the additional contribution for the remaining members and the actuarial assumptions are met this cost will continue to

accrue and roll over into future bienniums for payment

C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

| | | | |
|----------------------|---------------|-----------------------|------------|
| Name: | Sparb Collins | Agency: | PERS |
| Phone Number: | 328-3901 | Date Prepared: | 01/20/2011 |

Attachment
1228

11.0397.02001
Title.

Prepared by the Legislative Council staff for
Representative Grande
January 28, 2011

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1228

Page 1, line 2, after the third comma insert "and"

Page 1, line 2, remove ", and 54-52.6-03"

Page 4, line 16, remove the overstrike over "~~September 30, 2001, and who has not~~"

Page 4, line 17, remove the overstrike over "~~made a written election under this section~~"

Page 4, line 17, remove "February 28, 2012."

Page 4, line 18, remove the overstrike over "~~before October 1, 2001, to elect~~"

Page 4, line 18, remove "by electing"

Page 4, line 21, remove the overstrike over "~~The board~~"

Page 4, remove the overstrike over lines 22 through 26

Page 4, line 27, remove the overstrike over "~~written election~~"

Page 4, line 27, remove "transfers to the defined contribution plan"

Page 4, line 28, remove the overstrike over "~~effective twelve midnight~~"

Page 4, line 29, remove the overstrike over "~~December 31, 2001;~~"

Page 4, line 29, remove "and"

Page 8, remove lines 10 through 30

Page 9, remove lines 1 and 2

Re-number accordingly

Date: 2-3-11
Roll Call Vote #: 1

2011 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 1228

House GOVERNMENT AND VETERAN AFFAIRS Committee

Check here for Conference Committee

Legislative Council Amendment Number 11. 0397.02001

Action Taken Do Pass Do Not Pass Amended Adopt Amendment

Rerefer to Appropriations Reconsider

Motion Made By Streyle Seconded By Froseth

| Representatives | Yes | No | Representatives | Yes | No |
|------------------------------|-----|----|-----------------|-----|----|
| Chairman Bette Grande | | | Bill Amerman | | |
| Vice Chairman Randy Boehning | | | Ron Guggisberg | | |
| Glen Froseth | | | Lonny Winrich | | |
| Karen Karls | | | | | |
| Lisa Meier | | | | | |
| Gary Paur | | | | | |
| Karen Rohr | | | | | |
| Mark Sanford | | | | | |
| Vicky Steiner | | | | | |
| Roscoe Streyle | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

Total (Yes) _____ No _____

Absent _____

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

*voice vote
adopt
amendment
motion
carried*

11.0397.02002
Title.

Prepared by the Legislative Council staff for
Representative Grande
February 2, 2011

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1228

Page 1, line 3, after "employees" insert "; and to provide a statement of legislative intent"

Page 9, after line 2, insert:

"SECTION 7. LEGISLATIVE INTENT. It is the intent of the legislative assembly that the only allowable expenditures that may be made relating to this Act during the first four years after enactment are for administrative costs of implementing this Act during which time the legislative management shall receive four annual actuarial valuations of the public employees retirement system to identify the fiscal effect of this Act."

Renumber accordingly

Date: 2-3-11
Roll Call Vote #: 2

2011 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 1228

House GOVERNMENT AND VETERAN AFFAIRS Committee

Check here for Conference Committee

Legislative Council Amendment Number 11.0397.02002

Action Taken Do Pass Do Not Pass Amended Adopt Amendment
 Rerefer to Appropriations Reconsider

Motion Made By Streyle Seconded By Steiner

| Representatives | Yes | No | Representatives | Yes | No |
|------------------------------|-----|----|-----------------|-----|----|
| Chairman Bette Grande | | | Bill Amerman | | |
| Vice Chairman Randy Boehning | | | Ron Guggisberg | | |
| Glen Froseth | | | Lonny Winrich | | |
| Karen Karls | | | | | |
| Lisa Meier | | | | | |
| Gary Paur | | | | | |
| Karen Rohr | | | | | |
| Mark Sanford | | | | | |
| Vicky Steiner | | | | | |
| Roscoe Streyle | | | | | |
| | | | | | |
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| | | | | | |

Total (Yes) _____ No _____

Absent _____

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

*voice to adopt
vote to amend
motion carried*

VR
2/3/11

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1228

Page 1, line 2, after the third comma insert "and"

Page 1, line 2, remove ", and 54-52.6-03"

Page 1, line 3, after "employees" insert "; and to provide a statement of legislative intent"

Page 4, line 16, remove the overstrike over "~~September 30, 2001, and who has not~~"

Page 4, line 17, remove the overstrike over "~~made a written election under this section~~"

Page 4, line 17, remove "February 28, 2012."

Page 4, line 18, remove the overstrike over "~~before October 1, 2001, to elect~~"

Page 4, line 18, remove "by electing"

Page 4, line 21, remove the overstrike over "~~The board~~"

Page 4, remove the overstrike over lines 22 through 26

Page 4, line 27, remove the overstrike over "~~written election~~"

Page 4, line 27, remove "transfers to the defined contribution plan"

Page 4, line 28, remove the overstrike over "~~effective twelve midnight~~"

Page 4, line 29, remove the overstrike over "~~December 31, 2001;~~"

Page 4, line 29, remove "and"

Page 8, remove lines 10 through 30

Page 9, remove lines 1 and 2

Page 9, after line 2, insert:

"SECTION 6. LEGISLATIVE INTENT. It is the intent of the legislative assembly that the only allowable expenditures that may be made relating to this Act during the first two years after enactment are for administrative costs of implementing this Act during which time the legislative management shall receive two annual actuarial valuations of the public employees retirement system to identify the fiscal effect of this Act."

Renumber accordingly

Date: 2-3-11
 Roll Call Vote #: 3

2011 HOUSE STANDING COMMITTEE ROLL CALL VOTES
 BILL/RESOLUTION NO. 1228

House GOVERNMENT AND VETERAN AFFAIRS Committee

Check here for Conference Committee

Legislative Council Amendment Number 11. 0397.02003

Action Taken Do Pass Do Not Pass Amended Adopt Amendment

Rerefer to Appropriations Reconsider

Motion Made By Streyle Seconded By Jusselt

| Representatives | Yes | No | Representatives | Yes | No |
|------------------------------|-----|----|-----------------|-----|----|
| Chairman Bette Grande | ✓ | | Bill Amerman | | ✓ |
| Vice Chairman Randy Boehning | ✓ | | Ron Guggisberg | | ✓ |
| Glen Froseth | ✓ | | Lonny Winrich | | ✓ |
| Karen Karls | | ✓ | | | |
| Lisa Meier | | | | | |
| Gary Paur | ✓ | | | | |
| Karen Rohr | ✓ | | | | |
| Mark Sanford | ✓ | | | | |
| Vicky Steiner | ✓ | | | | |
| Roscoe Streyle | ✓ | | | | |
| | | | | | |
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| | | | | | |

Total (Yes) 8 No 4

Absent 1

Floor Assignment Rep Grande

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1228: Government and Veterans Affairs Committee (Rep. Grande, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (8 YEAS, 4 NAYS, 1 ABSENT AND NOT VOTING). HB 1228 was placed on the Sixth order on the calendar.

Page 1, line 2, after the third comma insert "and"

Page 1, line 2, remove ", and 54-52.6-03"

Page 1, line 3, after "employees" insert "; and to provide a statement of legislative intent"

Page 4, line 16, remove the overstrike over "~~September 30, 2001, and who has not~~"

Page 4, line 17, remove the overstrike over "~~made a written election under this section~~"

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Page 8, remove lines 10 through 30

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Re-number accordingly

2011 TESTIMONY

HB 1228



Attachment 1
1228

Subject: Reforms to the Public Pension System

Bill: HB 1228

Testimony Provided By: Dustin Gawrylow

Lobbyist #160

Presented To: House Government and Vet Affairs

January 21st, 2011

I am here on behalf of the members of NDTA to support any and all efforts to reform the public pension system. It is our firm stance that the status quo of the public pension is not acceptable, and that the state should not even entertain the notion of any bailout until significant reforms to the system are made.

We fully support a freeze on new enrollment in the current define benefit program for all new employees, and any current employees with legal binds to the defined benefit program.

I would also like to offer a constructive suggestion for how to truly reform the pension system.

The goals of this suggestion are simple:

- Remove the state from the pension and retirement equation entirely.
- Empower public employees to have greater control and options with regard to their own retirement decisions.
- Fully compensate employees with a hold-harmless requirement on the transition process.

These three goals can be fully achievable within this conceptual framework and are far more acceptable to both ends of the political spectrum than one might think at first glance.

I've included a basic diagram with my written testimony that makes this concept easily understandable. I also sent a copied to you via email yesterday.

Again, this is a conceptual framework and its details have yet to be determined.

The concept we propose is a far more efficient and cost-effective way to promote overall reform than for the legislature to dictate new rules to try changing the

The North Dakota Taxpayers' Association is a membership-funded advocacy group designed to get taxpayers a voice in legislative matters. NDTA is 100% in-state funded, and counts over 500 North Dakotans as current dues paying members, with an additional 5,000 North Dakota receiving regular email updates. NDTA is the only organization with a full time lobbyist dedicated to advocating on behalf of the taxpayer.

North Dakota Taxpayers' Association

NDTaxpayers.com • 1720 Burnt Boat Drive Suite 102 • Bismarck, ND 58503 • (701) 751-2530



previous agreements. We need to look at how public employees at the grassroots level can come to you and demand reforms from the bottom-up.

The keys to this proposal include:

- Taking the 8.14% that the state currently puts into the retirement fund for each employee and package that with the Governor's proposed 3&3 salary increase that includes bumping the 8.14% up to 10.14%
 - This will address the so-called 12% Salary Equity Deficit that the Public Employees Association and the Hay Group claim exists without a fiscal note beyond the Governor's proposed salary budget.
- Once the employee's salary has been increased by the level of current retirement contribution, the entire 10.14% retirement portion will be deducted from each employees paycheck. Even with the increased salary, simply seeing that retirement deduction on the paystubs will immediately make every employee demand more control and more options over that payroll deduction.

This plan will create a natural attrition rate of current enrollees asking to be removed from the current program and into the new defined contribution programs.

While there will be costs to this transition, eliminating the threat of an ever growing, unfunded liability will render a huge return.

Just as with any defined contribution plan, the state will need to decide which contribution matching level is sufficient and desired, but that will no longer be an open-ended, bottomless pit of future obligation that the current system mandates.

The time is now for the state to get out of the retirement planning business, normalize salaries to where interest groups claim those levels should be, empower state workers to control over their own finances, and do so without breaking the bank or creating a never ending bailout.

The choice is yours. Thank you.

The North Dakota Taxpayers' Association is a membership-funded advocacy group designed to get taxpayers a voice in legislative matters. NDTA is 100% in-state funded, and counts over 500 North Dakotans as current dues paying members, with an additional 5,000 North Dakota receiving regular email updates. NDTA is the only organization with a full time lobbyist dedicated to advocating on behalf of the taxpayer.

**No Fiscal Impact Beyond Governor
Dalrymple's Budget**

**Current 8.14%
Contribution**

Paid by the state

**½ of which is
considered to be
the employee's
contribution**



**Proposed 2%
Increase In
NDPERS
Contribution
Rate**

**Proposed
2% & 2%
Salary Increase**

**Transfer 100% of
Retirement
Funding and
Responsibility to
the Employee**

**14%
Effective
Salary
Increase**

**12% Claimed
Salary "Equity"
Deficit
ELIMINATED**

- **Same fiscal impact As Governor's Budget**
- **Removes Legislature from directly funding retirement plans**
- **Allows for Employees to choose current program, 401k, or CASH**

The Bismarck Tribune

www.bismarcktribune.com

75 cents

Pension woes beg for shakeup Lawmakers consider retirement savings plans for some

By DALE WEITZEL
Associated Press Writer

North Dakota lawmakers are willing to consider excluding newly hired teachers and government workers from state pensions, and putting them instead into retirement savings plans that do not have guaranteed benefits, an Associated Press survey shows.

The financial woes of pension funds managed by the North Dakota Public Employees Retirement System and the Teachers' Fund for Retirement, as well as a drumbeat of reports about other states' pension difficulties, have made North Dakota legislators more open to shaking up the system, its detractors say.

"We're in the zone of being able to do something about this," said Dustin Gawrylow, the director of the North Dakota Taxpayers Association and a critic of the state's pension structure. "If you can deal with it now, it's better to fix the problem, and address the problem early, rather than letting it stew."

The Associated Press, in a survey of North Dakota lawmakers, asked whether

Continued on 4A

Pension woes

they would support closing the two funds to new members and enroll new hires instead in a plan similar to the 401(k) plans common in private business.

Among North Dakota House members who responded, 51 supported the idea, 16 opposed it and nine said they were undecided. In the Senate, 24 favored the proposal, nine did not and five said they were undecided.

The survey was conducted by regular mail and electronic mail during December. Thirty-eight of the Legislature's 47 senators and 76 of its 94 House members replied, a response rate of 81 percent.

The Public Employees Retirement System's \$1.63 billion pension fund covers almost 20,000 workers, and has about 6,400 retired employees drawing benefits.

Participants include most North Dakota state government employees, 48 of the state's 53 counties and the cities of Fargo, Grand Forks and Williston.

The \$1.54 billion teachers'

fund has about 9,700 contributing employees and about 6,500 retirees.

Both funds were hammered by the stock market's severe downturn two years ago, and the market's subsequent rally hasn't restored the funds to their former values.

Analysts say both funds are likely to exhaust themselves within 30 years unless pension contributions are increased. A North Dakota legislative committee that reviews pension legislation has recommended bills to raise the employer and employee contributions for both funds.

If contributions rise, a plurality of the survey's respondents in both the House and Senate said the cost of making such changes would be too high. Their employers, however, said asking for more money to increase their contribution

A proposal to bolster the teachers' fund with \$75 million from the state's general fund got little support from lawmakers in the survey. The Legislature's pension oversight committee considered the idea earlier this year but

declined to recommend approval.

The pension committee also rejected a proposal to close the pension funds to new hires and route them instead to tax-deferred savings plans that do not offer the guaranteed benefit of a traditional pension plan.

Analysts said the change would carry large start-up expenses, and would exhaust the assets of the traditional pension funds more quickly than if the status quo were maintained.

The AP survey shows, however, that the entire Legislature is willing to take up the idea.

"I think we have our work cut out for us in showing what the cost of making such changes would be," said Stuart Savelkoul, director of the North Dakota Public Employees Association.

The traditional pension fund that now covers public employees is called a "defined benefit" plan. Once an employee has worked in his or her job long enough, he or she is entitled to a monthly payment upon retirement,

Continued from 1A

which depends on each worker's salary history and length of service.

A North Dakota Public Employees Retirement System pensioner is eligible for full benefits once his or her age and time in the job adds up to 85; for example, a 55-year-old worker with 30 years of service may retire with full benefits.

Advocates of the traditional pension say it provides the assurance of a guaranteed monthly benefit, which is paid without regard to the vagaries of the stock market.

A 401(k) plan, which allows employees to save money tax-free until they retire, is an example of a

"defined contribution" plan. It allows workers to control how their retirement savings are invested, and direct how any leftover retirement money is used after they die.

Traditional pensions, while they are a common benefit for public employees, are increasingly rare for private workers, which has raised the argument of whether private employees — whose retirement savings suffered in the recent market downturn — should have to guarantee the pension benefits of public workers.

"We are going to have a debate about whether we should have two separate systems," Savelkoul said.

North Dakota's Public Pension Funds: Where Will the Buck Stop?

By Dustin Gawrylow

While the stock market gyrations of the last two years have affected everyone, the state of North Dakota's investment funds designed to fulfill the pensions of public employees and teachers have taken what many would say an unacceptable beating.

For the fiscal year ending June 30, 2009, the \$2.8 billion North Dakota Pension Investment Pool lost 25.56% of its value on paper (unrealized loss) and the Insurance Investment Pool loss of 10.38% on paper during that same period.

Note: Unless otherwise noted, all dollar and percentage figures cited in this article are from the June 30, 2009 Comprehensive Annual Financial Report.

Why the Discrepancy?

The 2009 Comprehensive Annual Financial Report (CAFR) investment section shows that state pension funds have been drastically overexposed and overly diversified.

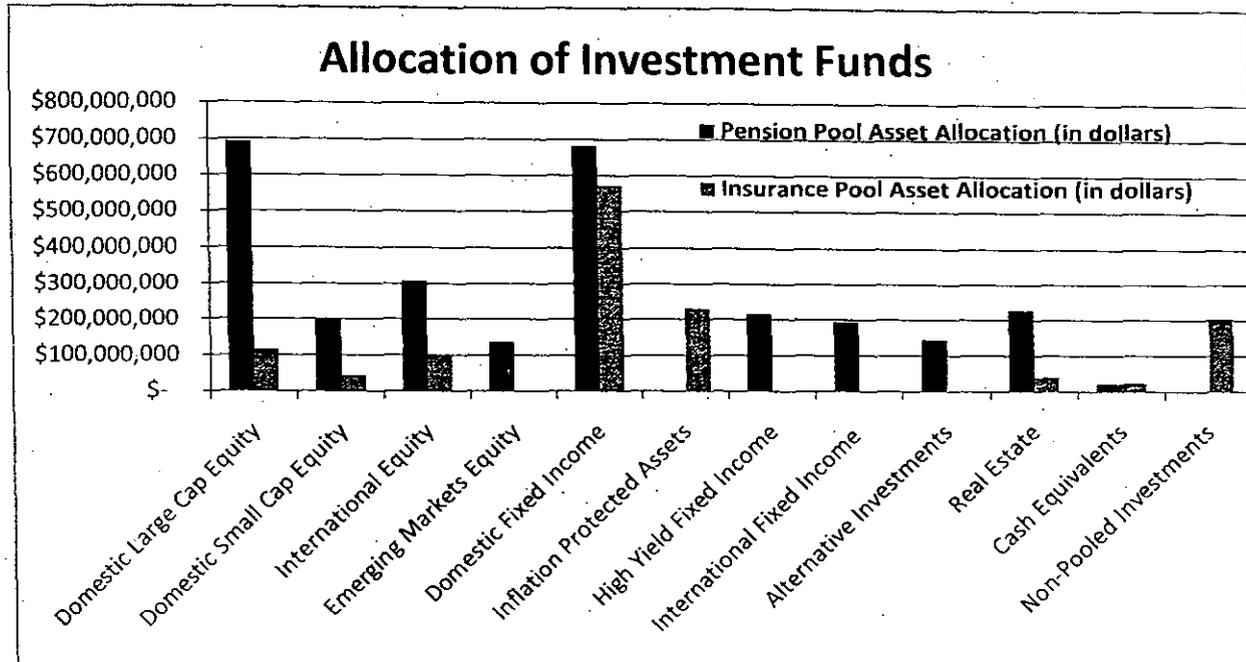
The first indicator of pension fund overexposure is the portion of funds assigned to "safe" fixed income investments.

The Pension Pool has \$682 million (24%) of its total \$2.8 billion assigned to Domestic Fixed Income investments. This portion lost only 3.04% of its value while the entire Pension Pool lost 25.56%.

The Insurance Pool has \$573 million (44%) of its total \$1.3 billion assigned to Domestic Fixed Income. This portion gained 1.04% of its value while the entire Insurance Pool lost 10.38%.

The Pension Pool had barely half the protection through fixed income investment as the Insurance Pool. It does not take a market expert to understand that assigning fewer assets to protected Fixed Income Investments increases the potential for loss.

Note: High Yield Fixed Income and International Fixed Income are two other Fixed Income categories and segregated from Domestic Fixed Income: This article does not compare these categories because the Insurance Pool does not allocate anything to them whereas the Pension Pool allocates \$216 million to High Yield Fixed Income and \$194 million to International Fixed Income. High Yield Fixed Income lost 20.08% while International Fixed Income gained 0.21%. One can deduce that International Fixed Income fits the classical definition of Fixed Income while High Yield Fixed Income refers to investments with high payable dividends that simply do not match the drop in investment face value.

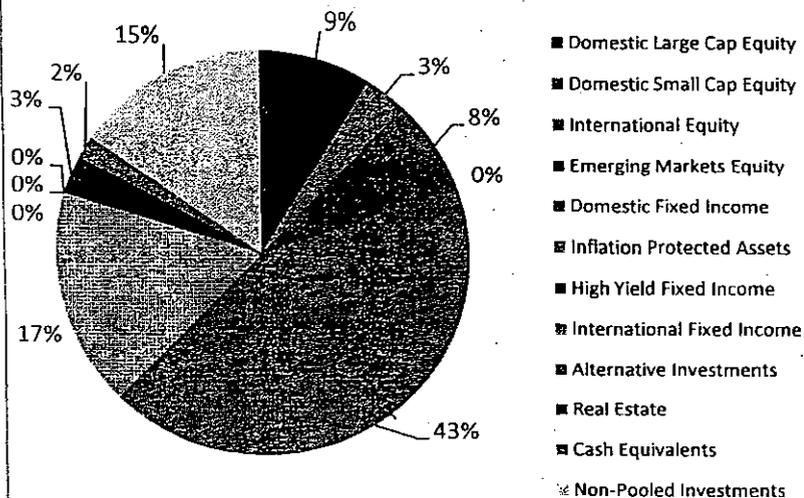


Further evidence of Pension Pool over diversification is the fact that its dollars are invested in almost 90 separate line item investment vehicles with over two dozen different investment firms. (Compare this to only 25 separate line item investment vehicles under the Insurance Pool.)

Why Two Investment Styles?

CAFR does not explicitly explain why two distinct investment styles exist, but one glaring difference does stick out.

Insurance Pool Asset Allocation (as percentage of whole)



fund the Unemployment Insurance Program.

It is easy perceive that when government entities are "customers", their money is treated more conservatively than when retirees are the "customers". Although no material evidence confirms this point, the raw material does invite this perception.

Victims of Outright Fraud

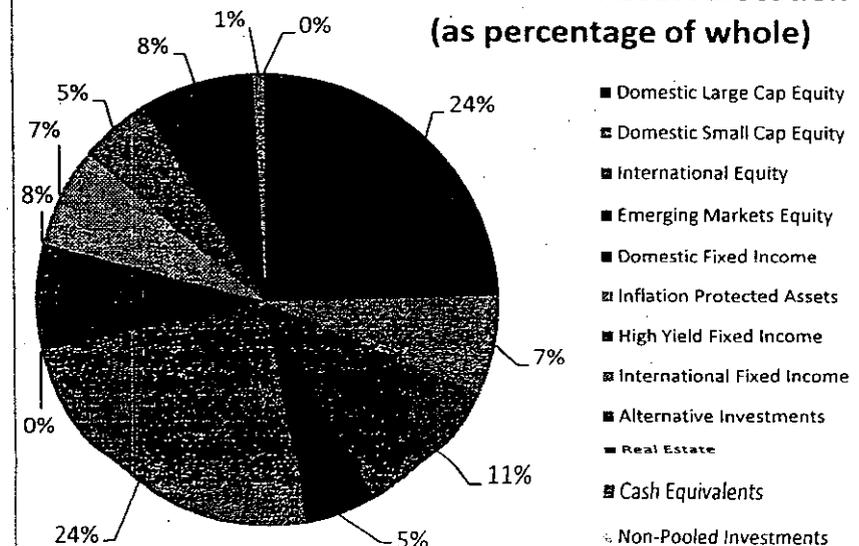
The WG Trading situation is a scary one. WG Trading has been accused, with pretty conclusive evidence, of being a part

Insurance Pool recipients are mostly government entities. The Workforce Safety and Insurance Fund tops the list by receiving \$1 billion of the total \$1.3 billion. Other major recipients include the Budget Stabilization Fund at \$190 million, the State Fire and Tornado Fund at \$22 million, and the City of Fargo FargoDome Permanent Fund at \$17 million. Minor participants include the North Dakota Association of Counties, the City of Bismarck, the Insurance Regulatory Trust Fund, the State Risk Management Fund, and the Healthcare Trust Fund.

On the other hand, Pension Pool recipients include individual retirees via the Teachers Fund for Retirement, the Public Employee Retirement System, the Bismarck City Employee Retirement Fund, the City of Fargo Pension Fund, and the City of Grand Forks Pension Fund.

Note: Job Service has a \$72 million stake in the Pension Pool that helps

Pension Pool Asset Allocation (as percentage of whole)



of the Bernie Madoff investment scam. North Dakota is not the only state scammed by this outfit, but relations with this firm accounts for a considerable amount of the Pension Pool losses.

As Reuters News Service reported:

“New York money managers Paul Greenwood and Stephen Walsh, whose fund operation catered to large investors, are accused of looting client accounts to buy expensive homes, horses, rare books and collectibles including an \$80,000 teddy bear, according to court documents.

Authorities say that in a scheme that lasted more than a decade, the men misused the bulk of the \$667 million that clients had thought was invested in an "enhanced equity index" strategy.

A court-ordered freeze has been imposed on their personal assets and those of their affiliated companies, which include the WG Trading broker-dealer with offices in Connecticut, New York and New Jersey, and the Westridge Capital Management investment adviser in Santa Barbara, California.”

It is likely that the North Dakota State Investment Board accepted this scam because so many other large government entities were investing with the firm - a high-stakes mistake of “following the leader.”

Note: A more in-depth investigation into why the state invested with this firm was not available at the time this article was written.

What's Next?

The writing on the wall says that a taxpayer bailout is in store.

Although neither investment pool has fully recovered from these lows, substantial improvements have been seen. Now the issue is whether the current Pension Pool investment style will change or will State Investment Board inaction keep taxpayers on the hook.

An unofficial update provided by a state legislator shows that each pension fund is up 20% since the most recent CAFR. It could be argued that now is the time to consolidate these funds into an investment that is protected from the volatility triggered by the current European Public Debt and Public Pension crisis.

With a destabilizing global equity market, now is the time to seek shelter in safe investments. At the bare minimum, the Pension Pool should be managed exactly as the Insurance Pool is managed. There is no reason to manage them differently.

So, Where Does the Buck Stop?

In the end, the buck stops with the State Investment Board. This board consists of three elected officials (the Lt. Governor, State Treasurer, and State Insurance Commissioner), eight gubernatorial appointees (the Executive Director of Workforce Safety and Insurance, Land Commissioner, three Public Employee Retirement System (PERS) representatives, and three Teachers Fund for Retirement (TFFR) representatives).

Some believe that only the elected officials on this board deserve blame, but we must remember that they hold only three of eleven total votes. There are more PERS and TFFR representatives than elected and appointed members combined.

With that said, it will be interesting to see which, if any, board members warned of problems. Regardless of whom board members represent or how they were seated on the board, each is equally accountable to taxpayers.

The Board needs to get a hold of the situation before the legislature even discusses a bailout.

Suggested Reforms

The root cause of this mess is the type of retirement benefits that have been promised.

All of these pension funds still provide Defined Benefit Plans - an unsustainable retirement plan abandoned long ago by the private sector.

The ultimate solution to the pension crisis is to convert these Defined Benefit Plans to Defined Contribution Plans so employees can manage their own retirement plans and thereby relieve the state of market gyrations. These are generically called 401(k) plans.

If there is a taxpayer bailout, a transition to Defined Contribution is required. This must be a sticking point for legislators.

Another component that must be included in any taxpayer funded bailout of the pension system is a buy-out provision to encourage those already locked into the current Defined Benefits system to move to the Defined Contribution plan. The more people that are allowed to convert to the reformed system the less the taxpayer bailout will cost.

Conclusions

This crisis will not be solved overnight, but steps to fix it must be taken immediately.

Allowing this to become a scandal will require an even larger taxpayer bailout and likely cost double what it costs to act now.

However, reality suggests that a taxpayer bailout is likely only because the state currently has money.

Actions to minimize the magnitude of a taxpayer bailout cannot be delayed and must include the suggested reforms.

Legislators sincerely seeking to fix the problem must embrace and enact the transition from Defined Benefits to Defined Contributions.

Not Easy, But Worth It

Lawmakers spent the past five years shoring up public retirement plans.

BY RON SNELL

The battering state budgets have taken in the past few years has drawn more public attention to another huge financial issue: public pension systems.

There are 24 million active and retired members of state pension systems. When markets plunged two years ago, the assets in those systems were pummeled. Newspaper headlines since have raised alarms about the solvency of the systems and whether states are dealing with the issue adequately.

State lawmakers have engaged in a flurry of activity in 2010 to address concerns in their public pension systems. No year in memory has seen as many significant retirement bills enacted as this year.

Colorado cut back previously promised post-retirement increases for people who have already retired. Illinois increased the normal retirement age to 67, probably a first for state plans. Utah completely redesigned its retirement plans. Virginia and Wyoming converted noncontributory plans to ones that require employee contributions.

Illinois Senator Donne Trotter says risk containment and balancing intergenerational costs were key to his state's 2010 revisions—the same impetus for reforms across the country.

"How do we protect the next generation? How do we balance costs between this generation and the next?" he asks.

By May, 11 states had enacted major changes to increase employee contributions, restrict or eliminate future cost-of-living adjustments, increase age and service requirements for retirement, cap benefits, and tighten rules for retired people who want to return to government work. They include Colorado, Illinois, Iowa, Michigan,

Ron Snell is NCSL's expert on public pension plans.

"Colorado's changes were a bipartisan effort to ensure that the pension fund is actuarially sound. This effort took shared sacrifices from retirees, current and future employees."

Colorado Representative Mark Ferrandino

Minnesota, Mississippi, New Mexico, Utah, Vermont, Virginia and Wyoming. Benefit increases have been almost nonexistent, though putting retirement systems on a more solid footing is a benefit for everyone.

States have not just now awakened to the problem. In fact, lawmakers have been aware of and studying it since the middle of the decade. In the last five years, many have increased employee contributions, lengthened how long employees need to work to receive benefits and changed cost-of-living increases.

RADICAL AND CONSERVATIVE

These changes can be seen as radical, or they can be seen as conservative.

For decades, states have made retirement

plans more flexible and generous. Before 2000, legislatures regularly improved the benefit packages—reducing the time it took to earn a pension, increasing the amount of salary a pension would replace, protecting benefits against inflation, and easing the restrictions against retiring and coming back to work, often called double-dipping.

Reversing this trend is a radical change in direction. But that is exactly what states have been doing.

"We have to ensure we can meet 100 percent of the commitments we've made," says Utah Senator Daniel Liljenquist, explaining the reasoning behind the changes. "We have to remove the risk of bankrupting the state."

But the changes are also conservative. They preserve the structures of the past. Although half the states have made significant changes in retirement plans since 2005, only Alaska, Georgia, Michigan and Utah have changed the basic structure of statewide plans.

CHANGE IN PLANS

When the private sector began to abandon traditional, defined benefit plans for 401(k) plans in the early 1980s, state and local governments considered moving in the same direction.

A 401(k) plan is a defined contribution plan. It does not guarantee an annuity based on compensation and length of service, but instead allows participants to convert their account to an annuity at retirement. The amount of the annuity depends on the con-



SENATOR
DONNE TROTTER
ILLINOIS



SENATOR
DANIEL LILJENQUIST
UTAH

Contributions employers and employees have made and how well the investments have done. It moves the risk from the employer, who bears it in defined benefit plans, to the employee.

Traditional benefit plans are too expensive, place too much burden on taxpayers, and lack the flexibility of 401(k) plans, say advocates of defined contribution plans.

There are a few state models. Nebraska had a defined contribution plan for state employees between 1967 and 2002, when it changed it to a cash-balance plan to provide better investment returns for members. West Virginia began enrolling teachers in a defined contribution plan in 1990. It was replaced with a traditional defined benefit plan in 2005, again because members were experiencing such small investment growth that they would be poorly prepared for retirement. Michigan started placing state employees in a defined contribution plan in 1997. A few states offer both a defined contribution plan and a defined benefit plan for all members. In the 1990s, other states began offering defined contribution plans as an option employees—and in rare instances, teachers—could choose. But the general practice in state and local government is unchanged: 91 percent of full-time state and local government employees are covered by a traditional, defined benefit retirement plan.

The funding for those plans reached an historic high in 2001 when 31 of the 73 statewide funds that use the most widespread form of accounting method reported assets that were more than 100 percent of their accrued liabilities—the amount they eventually would have to pay beneficiaries. Another 18 reported assets between 90 percent and 100 percent of accrued liabilities. Since experts advise a ratio of 80 percent, these were impressive.

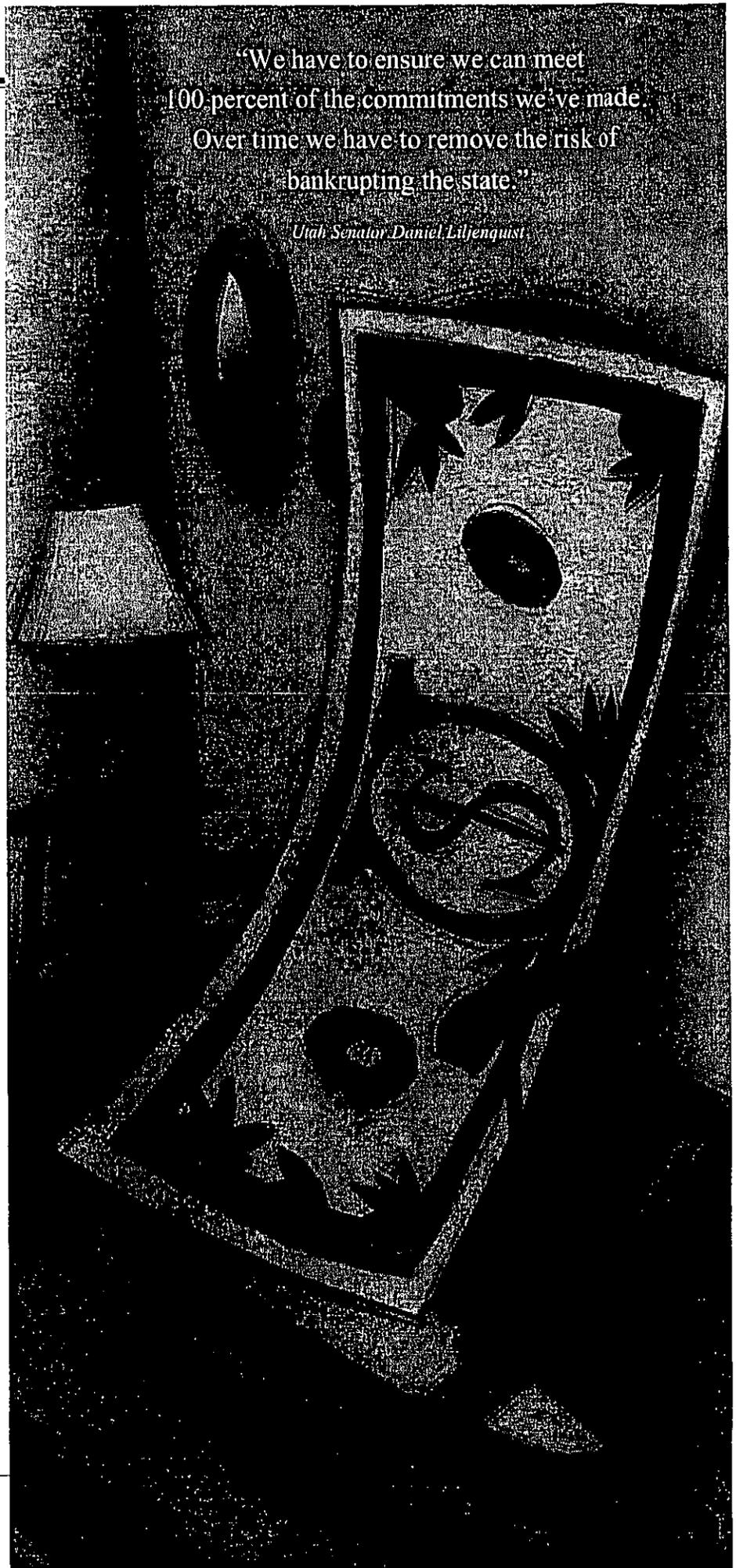
It's unlikely those kind of ratios will be seen again soon. Sixteen of the 31 states that had broken the 100 percent line in 2001 reported ratios above 80 percent in 2009. Only the Delaware Retirement System was close to 100 percent. Two other plans in Indiana and North Carolina were also above 90 percent.

Such dramatic changes have focused a spotlight on public retirement. A 2010 report, "The Trillion Dollar Gap" from the Pew Center on the States, reaped a media harvest when it contended the pension funding crisis began in 2001 and was the result of state neglect over time, as well as the recession of 2007-2009.

Some academic studies assert legislatures and public fund managers have aggravated the problem with unrealistic estimates of what trust funds can earn over time. Others argue defined-benefit

"We have to ensure we can meet 100 percent of the commitments we've made. Over time we have to remove the risk of bankrupting the state."

Utah Senator Daniel Liljenquist



ensions are outmoded, overly generous and too expensive, and should be replaced with retirement policy closer to the private sector model—these days, predominantly individual retirement accounts on the lines of a 401(k).

STATE ACTION

By NCSL's count, 18 states changed retirement plans from 2005 through 2009 by:

- ◆ Increasing employee contributions.
- ◆ Determining retirement benefits by calculating salaries over a longer period of time.
- ◆ Increasing the age or service requirement, or both, for eligibility.
- ◆ Adding an anti-spiking provision.
- ◆ Reducing or controlling post-retirement cost-of-living adjustments.

Returns on investments are not the only problem retirement plans face. Earlier retirement ages, the greater longevity of the population, ill-conceived early retirement incentive plans, and contribution holidays all have hurt. If plan managers failed to keep longevity and mortality statistics up to date, that hurt as well. The shocks brought by the recession of 2001-2002 and demographic changes account for the pension plan changes between 2005 and 2009.

Alaska, Georgia and Utah have had different reasons for moving from defined benefit plans to alternatives. According to the Alaska Division of Retirement and Benefits, serious discussion of change began in 2002 over concerns about the huge liabilities—\$4.2 billion—the state bore in the early years of this century for its public employees' and teachers' plans. Actuaries at the time recommended increasing employer contributions from less than 7 percent to almost 25 percent of salaries, and to 35 percent for the teachers' plan. The risk and volatility associated with funding a defined benefit plan appeared no longer sustainable.

This year, Utah lawmakers also saw the liabilities of defined benefit plans as too challenging to sustain.

"Risk containment was very much on our minds," says Liljenquist, sponsor of the legislation that reshaped Utah's retirement plan. "With investment losses, our costs would have gone from \$400 million to \$800 million a year. We had to look at what we could afford, and what it could buy."

Lawmakers decided Utah could afford a contribution of 10 percent of employees' salaries, which buys a choice for new employees. They can pick a defined contribution plan to which their employers will contribute the



SENATOR
BILL HEATH
GEORGIA

"We had difficulties in attracting and retaining the best and brightest employees. The emerging workforce focuses on current cash flow. We were high on benefits but low on salary."

Georgia Senator Bill Heath

10 percent a year, or they can pick a reduced defined benefit plan to which employees will have to contribute if the state's contribution turns out to be inadequate. With the second option, employees also gain an individual account in which the employer deposits any amount of the 10 percent contribution not needed for the defined benefit portion.

"Ten years from now," says Liljenquist, "we should be able to absorb any economic hit. We'll be in great shape in 20 years, and in 30, we'll have removed any risk of state bankruptcy."

EMPLOYEE CONTRIBUTIONS INCREASE

Georgia ended its defined benefit plan for state employees in 2008 in favor of a plan that resembles the second choice in Utah, but for very different reasons.

"We had difficulties in attracting and retaining the best and brightest employees" with the traditional retirement plan, says Senator Bill Heath, who sponsored the legislation in 2007. "The emerging workforce focuses on current cash flow. We were high on benefits but low on salary."

That led to a nearly 21 percent turnover among workers in their first five years in state government. At the time the plan was adopted, fiscal concerns were minimal: Georgia's retirement plans have long been among the best-funded. The new plan reduces pen-



REPRESENTATIVE
MARK FERRANDINO
COLORADO

sion costs for the state, but Heath emphasizes the change was to attract young workers to state employment.

While most states have stayed with traditional retirement plans, Georgia has moved to substantially more cost-sharing with employees. At least seven states have increased employee contributions this year, sometimes for current employees as well as for new ones. Utah's restructuring, too, places more responsibility on employees. Measures that delay benefits until a later age, provide lower benefits as a percent of salary, or cap post-retirement cost-of-living adjustments also shift responsibility to members by eventually providing a smaller benefit than current laws do.

"We've made difficult choices to deal with these shortfalls," says Colorado Representative Mark Ferrandino, a member of the Joint Budget Committee. "Colorado's changes were a bipartisan effort to ensure that the pension fund is actuarially sound. This effort took shared sacrifices from retirees, current and future employees."

Colorado's legislation reduces the post-retirement cost-of-living adjustments for all retirees from the percentages previously promised, reduces benefits for people who retire in the future, and increases contributions from the salary of current members.

These measures are not expected to solve all the funding problems of pension systems. States with large unfunded liabilities still have to deal with them. But there's a lot to be said for controlling costs going forward. Not least of which is the way legislatures demonstrate the seriousness of their approach to broad state fiscal issues.

"As we grapple with unprecedented deficits, we have to look at how we run government," says Illinois' Trotter. "Pension reform is a significant part of how we do business going forward."

CHECK OUT more about legislation to address public pensions from the 2010 sessions.



The False Obstacles to Pension Reform

October 05, 2010

By Josh Barro

State and local government pension plans have become a lot more expensive for taxpayers over the last few years. This is because public pensions are largely "defined benefit" plans: workers are guaranteed a specific benefit amount regardless of the performance of the assets in which pension plans are invested. When the market underperforms expectations (as it has recently, in spades) it is taxpayers rather than pensioners who bear the loss.

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Across the country, pension actuaries are coming to state legislatures and calling for an increase in pension contribution rates, which is needed to shore up the funds since they have lost so much value. For example, New York City's pension costs have risen over the last decade from approximately \$1 billion per year to \$8 billion, and will soon reach \$10 billion. In response, many states are acting to reduce costs, by trimming future benefits and requiring employees to pay more. 16 states enacted pension reforms in 2008 and 2009, and at least five more have followed in 2010.

Yet, with the key exception of Utah, states have shied away from following private firms' lead and abandoning defined benefit. (84% of state and local employees retain defined benefit coverage, compared to 21% of private sector workers.) Even in New Jersey, where Governor Chris Christie is proposing reforms that are sweeping relative to what is being done in most other states, the proposed reform package maintains the essential defined-benefit nature of employee retirement benefits.

This is a concern, because the problems with defined-benefit pensions aren't a one-time fluke caused by a bad recession and a stock market crash. Their flaw, especially in the public sector, is structural: they involve lawmakers making promises today about payments the state will make decades from now. There is a strong incentive to offer extra retirement benefits instead of extra cash compensation, because the cost can be pushed off into the future. And because the actuarial math is so complicated and subjective, analysts and legislators have trouble figuring out how much pension benefits really cost.

These structural issues have led to a pattern in pension benefits. When times get tough, states cut back pension benefits, but usually only for new hires. The existing employees get their full benefits, and taxpayers kick in extra cash to offset poor performance by assets held by pension plans. (A handful of states have touched benefits for active employees in the last two years, but the vast majority of reforms apply only to future employees -- and reforms affecting active employees or retirees may be blocked by courts in some states.)

But when the stock market soars and pension plans become overfunded, states sweeten pension benefits. New York, New Jersey and California are among the states that sweetened pension benefits as a result of the tech bubble, and are now regretting that choice. And unlike the cutbacks, which usually apply only to new hires, sweeteners usually provide retroactive benefits to existing employees and even retirees. For public workers, pension fund investments are a heads-we-win, tails-you-lose proposition.

There is a reason that New York State's most recent pension reform, enacted last year, is called "Tier V" and not "Tier II." It's that New York has been down this road several times before: creating new, less expensive pension "tiers" for new employees while maintaining rich benefits for existing workers. But later, once the stock market rebounds, state lawmakers go back and re-sweeten benefits to about where they used to be.

Consider how odd this would seem in the context of a defined-contribution retirement plan. Companies change the generosity of their 401(k) match terms often. But if a company raises its 401(k) match rate from 50% to 100%, nobody would expect them to go back and retroactively increase the matches paid in past years to active employees, let alone retirees.

Yet this is standard practice when states increase pension benefit generosity; for example, New Jersey awarded an across-the-board pension increase of 9% to all pension beneficiaries in 2001, active and retired. This move cannot be defended as useful for attracting a talented workforce; you raise prospective compensation to do that. It was a pure giveaway to public workers, and one that was not uncommon around the country.

I therefore worry that reforms like Colorado's and New Jersey's, which are supposed to produce large savings over time, will again be undone when the economy looks a bit better and the legislature a bit more favorable to unions. A move to defined-contribution plans would alleviate this concern.

Why aren't states adopting a model that would stop such abuses for good? We're starting to hear one reason around the country -- and it's not a very good one. North Dakota legislators, for example, have been looking at a move to a 401(k) system, but are

being warned that such a move will impose transition costs, and therefore be more costly for taxpayers than staying the course.

You may be familiar with the concept of transition costs from the debate over Social Security reform. Moving to private accounts would require a shift from a pay-as-you-go benefit to a pre-funded benefit. During the transition period, you have to tax workers both to pay current retirees and to fund their own accounts, which would make the program temporarily more expensive. This is a serious concern with Social Security reform.

But the same issue is not present with pensions, because these benefits are already designed to be pre-funded. Most public employee pensions are not fully pre-funded today because of poor recent stock market performance, but taxpayers are expected to close that gap over time, whether or not you transition to a new system. The need to close this gap is not created by the transition.

However, there are some aspects of a move to defined-contribution that look, at first glance, like a transition cost. Here are three, none of which is a true transition cost.

1. If a pension plan is underfunded, that funding gap must be closed over time. Closing the plan to new participants shrinks the plan's "covered payroll" -- wages paid to active employees in the plan -- and therefore closing the funding gap will require that states contribute a greater percentage of covered payroll than if the plan were kept open. This is true. But the flip side is that new employees are participating in a plan with no funding gap to close at all. The government's contribution rate for those employees is lower than if the plan had been kept open.

Subject to points 2 and 3 below, these effects should wash. A pension contribution consists of two parts: the cost of benefits accrued by employees in the current year ("normal cost") and a payment toward closing whatever unfunded liability exists. If the old and new plans have equal normal costs, and the starting unfunded liability is the same, switching to a new plan is no more expensive than keeping the old plan.

2. When you close a pension fund to new participants, the average time from today when plan benefits will be paid starts shrinking. When this happens, plans shift to less risky investments to be assured of having cash to cover payouts due soon. Therefore, their expected returns fall and taxpayers must put in extra cash to make up the difference. This is the key concern in North Dakota.

This is a false concern for two reasons. One is that it assumes the higher average return of risky investments is free; it's not, as it increases the likelihood that taxpayers will have to come up with added dollars to cover below-target returns when the economy is weakest. The added certainty of returns is valuable to taxpayers; as demonstrated by Andrew Biggs of AEI, that value is equal to the price taxpayers would pay for a stock option covering any losses on risky investments.

The other reason is that actuaries offer guidance, but cannot force a plan to adopt a particular investment strategy. If lawmakers prefer to have taxpayers take a flier on the stock market instead of investing in safe bonds (something, I would note, they have already elected to have taxpayers do in pension funds all over the country) that's their prerogative; and it would eliminate (on average) the need for taxpayers to come up with any extra money to pay for transition.

3. The employer contribution to a defined-contribution plan might have to exceed the current "normal cost" of the defined benefit plan. This is a purely political question. Consider a pension plan with a target investment return of 8% per year, which is the most common return target among state and local retirement plans. If you take that plan's "normal cost" and turn it into an employer contribution into a 401(k), you get a retirement account that will on average be equal in value to the old defined benefit, assuming the employee invests his 401(k) in a portfolio with an expected return of 8% per year.

That might sound like a bad deal to you. You would probably prefer to get a guaranteed \$100,000 in ten years rather than \$46,319 today (which is enough, on average, to generate \$100,000 in ten years at 8% annual returns). But just as that guarantee is valuable to public employees, it is costly to taxpayers, as they must provide the insurance that public workers receive. So, an increase in contribution rates above the normal cost to compensate for the loss of that insurance isn't an added cost; it is just the conversion of a hidden cost to an overt one.

Additionally, I would not be quick to assume that it is necessary to compensate public employees for the added risk they will bear in a defined contribution system. Political incentives and opaque costs have driven employee retirement benefits to a level that is likely in excess of what is necessary to attract quality talent, making a real reduction in benefits (at least for new workers) appropriate. One form that reduction can take is a shift of risk from taxpayers to employees.

Some workers will even prefer a 401(k) system. Pension benefits are rich only for workers who spend a full career inside the same retirement system; since half of public school teachers leave the profession in less than five years, some public workers would actually be advantaged by a shift away from DB plans.

The financial issues here are complex and unfortunately are not exactly what many state lawmakers signed up for when they first ran for office. In that light, it's nice to see one state getting its pension reform pretty much exactly right: Utah, which will move all new employees into a new pension system starting July 2011.

Utah employees will have a choice: a 401(k) plan with employer contribution, or a "hybrid" pension plan with many defined-

Benefit characteristics. The key difference is that the state's contribution to the fund will be capped at 10% of covered payroll -- if asset underperformance requires additional contributions to shore up the fund, employees will be required to come up with the money. Benefit sweeteners will be prohibited until the state has fully closed its pension funding gap.

State Senator Dan Liljenquist, who chairs the Retirement Committee, has been speaking around the country explaining how that state's reform will save money, not impose transition costs. Other states, many of which face pension funding shortfalls much more dire than Utah's, would do well to follow their lead.

Original Source: http://www.realclearmarkets.com/articles/2010/10/05/the_false_obstacles_to_pension_reform_98702.html

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Utah Retirement Systems Reform – Frequently Asked Questions

(1) What is the current situation of URS' Defined Benefit pension system?

The financial crisis of 2008 has opened up a \$6.5 Billion unfunded liability in the Utah Retirement System. Instead of earning the expected rate of return of 7.75% on the portfolio in 2008, the pension fund lost 22.3%. The net result is that the pension fund is 30% lower than we need it to be to meet our obligations.

The pension system did not recover from 2008 losses in 2009. The pension system earned a 13% return in 2009. While 13% is an exceptional rate of return, 7.75% went to cover the expected rate of return and the remaining 5.25% barely covered the interest we were expected to earn on the missing \$6.5 Billion. In short, the 2009 pension returns did little to close the \$6.5 Billion gap.

To grow our way out of the pension problem, we would need to average double digit returns each year for over 20 years, far above our expected return rate of 7.75%. We cannot grow our way out of this problem – instead, we will need to increase contribution rates to pay off the \$6.5 Billion gap (and the compounding interest we needed to earn on that amount).

Current modeling from URS' independent actuaries projects ongoing funding of \$400 Million (plus 4% annual growth) for 25 years to pay for the \$6.5 Billion unfunded liability. For fiscal year 2011, employer contribution rates to the pension system are increasing significantly (2.1% for the State & School system; this equates to ongoing funding of \$75 Million). According to Robert Newman, URS' Executive Director, "contribution rates for all retirement systems will continue to increase over the next 3 to 5 years and will remain at historically high levels for the next 20 to 25 years." (see Letter dated January 26, 2010)

The 2008 market collapse will strain State budgets for years to come. To put \$400 Million ongoing funding in perspective, it equates to:

- 8% to 10% of all State & School payroll for 25 years
- Approximately 8,000 teachers kept out of classrooms for 25 years
- Public education growth for the next five years
- 19% of current State Public Education funding
- 57% of current State Higher Education funding (general fund)
- 68% of current State Health & Human Services funding (general fund)
- 75% of current State Medicaid funding (general fund)
- 100% of current State Transportation budget

(2) Why is pension reform important?

Another market collapse, similar to the 2008 financial crisis, could bankrupt the State, making it impossible to both operate and meet its Defined Benefit commitments.

For example, a 6% return over the next 25 years instead of a 7.75% return would lead to a \$14.4 Billion unfunded liability (see November 10, 2009 letter from Gabriel Roeder Smith & Company; Exhibit 2), nearly 2.5 times our current general fund budget.

(3) What are the goals of pension reform?

The #1 goal of pension reform is to ensure that the State & Local governments can meet 100% of their pension obligations to their current and retired employees.

(4) What are the key elements of pension reform?

Post-retirement reemployment – We need to address our post-retirement reemployment (double dipping) rules to ensure that we have a true “Retirement” system, not a “supplemental income” system.

New system for future employees – We need to alter and reduce retirement benefits for new employees so we can, over time, (1) reduce risk to the current Defined Benefit system, and (2) free up revenue to offset the contribution rate increases. We should not make new long-term pension commitments until we are 100% certain we can meet the obligations we have made to our current and retired employees.

Changes for Current Employees – We need to consider marginal changes to benefits for current employees to free up revenue to offset the contribution rate increases.

(5) What bills are part of the pension reform package?

- a. “New Public Employees’ Tier II Contributory Retirement Systems Act”
 - i. Status – Protected until URS finishes comments; hope to have it numbered by February 5th
 - ii. Overview – All new employees hired after July 1, 2011 will be hired under a new retirement system. New employees will receive 8% of their salary towards retirement, and can choose to spend that 8% on (1) a Defined Contribution Option or (2) a Hybrid Defined Benefit/Defined Contribution Option.
- b. SB 43 – “Post-Retirement Employment Amendments”
 - i. Overview – Retired employees rehired into a full-time position with a URS participating employer after July 1, 2010 will be required to suspend pension payments, but will receive additional service credit to enhance their pension. Retirement service credit caps will be removed for Public Safety and Firefighters systems. 401(k) payments for existing rehired retirees will no longer float with the Defined Benefit contribution rate, but will be capped at the “normal cost” Defined Benefit rate (the originally modeled rate; ~12.5% for the State & School system).

- c. SB 94 – “Supplemental Benefit Amendments for Noncontributory Public Employees”
 - i. Overview – Removes the 1.5% 401(k) payment for State & School employees hired after July 1, 1986. This bill is primarily a financing tool to offset contribution rate increases. It will free up almost \$24 Million ongoing. This move is consistent with recent 401(k) suspension decisions made by Local government employers and the private sector.
- d. SB 42 – “Retirement Eligibility Modifications”
 - i. Overview – Phases in a five year increase in minimum years of service for public employees. Removes early retirement discount for employees who are not yet 65 and who have not met minimum years of service for retirement. This bill is primarily a financing tool to offset contribution rate increases. It will free up almost \$30 Million ongoing.
 - ii. NOTE – We will not need to proceed with SB 42 if we are able to pass SB 43 (post-retirement rules); the actuaries expect SB 43 to generate the same savings over time.

(6) How will current employees be impacted by the proposed legislation?

Current employees should not be affected by the major pieces of pension reform (the “New Public Employees’ Tier II Contributory Retirement Systems Act” and SB 43 “Post-Retirement Employment Amendments”).

Under SB 94, State & School employees hired after July 1, 1986 would no longer receive the 1.5% 401(k) contribution.

Under SB 42, younger employees would be required to work additional years before they could retire while older employees would be unaffected. We will not proceed with SB 42 if we are able to pass SB 43 (post-retirement rules); the actuaries expect SB 43 to generate the same savings over time.

(7) How will retired employees be impacted by the proposed legislation?

Retired employees will not be affected by any of the retirement reforms.

(8) How will retired / rehired employees be impacted by the proposed legislation?

Currently retired / rehired employees will be marginally affected by SB 43 in that they may see a 2% to 3% reduction in their current 401(k) payments.

(9) How will future employees be impacted by the proposed legislation?

Future employees will receive 8% of their salary towards retirement, and can choose to spend that 8% on (1) a Defined Contribution Option or (2) a Hybrid Defined Benefit/Defined Contribution Option.

(10) Common misstatements / misconceptions used to argue against pension reform:

- a. URS says that Utah's pension system is fundamentally sound and should not be changed

URS' independent actuaries from Gabriel Roeder Smith & Company issued a letter on November 10, 2010 demonstrating the issues that face the retirement system, including the \$400 Million ongoing funding that will be required to make the system actuarially sound. Bob Newman, URS' Executive Director, issued a letter on January 26, 2010 supporting the actuaries' assessment of the retirement system.

Many public employees have been confused by statements from Bruce Cundick in URS' 2008 annual report stating that the retirement system is actuarially sound.

- b. The pension system has recovered just like my personal 401(k)

Defined Benefit pension systems are significantly different than 401(k) plans. In 2009, the pension system earned 13% but still made over \$1 Billion in payments to retirees during that same period. Defined Benefit plans do not have the option to stop paying retirees to allow time for the pension system to recover.

Also, the Defined Benefit pension system is a blended portfolio with over 30% of its assets invested outside of the stock market. Many of those investments have not recovered from 2008 losses, including bond portfolios and real estate assets.

- c. The system is 88% funded and is not in trouble

URS' pension rules require losses to be smoothed over a 5 year period. According to Bob Newman, URS' Executive Director, "80% of the 2008 negative return will be recognized over the next four years" (see letter dated January 26, 2010). URS' actuaries project URS' funded ratio to decrease to 70.5% over the next 4 years (see letter dated November 10, 2009; Exhibit 1).

- d. The pension system has been in this situation before and came through just fine

*The pension system has never been in this situation before. According to Bob Newman, URS' Executive Director, contribution rates will increase over the next 3 to 5 years and remain at **historically high levels** for 20 to 25 years (see letter dated January 26, 2010).*

- e. Utah's pension system is in far better shape than other states

This is accurate. Utah's pension system is in far better shape than other states because we are and have been committed to fully funding our system. Governor Herbert's budget wisely funds the 2011 contribution rate increases. The Governor and the Legislature will not "kick the can down the road" like other states have done. But the Governor and Legislature will also not ignore a significant risk to Utah's ability to meet its obligations to its current employees and retirees.

- f. You are hurting public employees

The #1 goal of pension reform is to ensure that the State & Local governments can meet 100% of their pension obligations to their current and retired employees.

- g. You are balancing pension reforms on the backs of future employees

The market crash of 2008 and the structure of our Defined Benefit pension system have already deprived new employees of 8% to 10% of their wages for 20 to 25 years. By changing the pension system for new employees, contribution rates will begin to decrease in the next 5 or 6 years, freeing up funds to better compensate new employees.

(11) Common arguments against prospective system?

- a. 8% towards retirement is not enough

An 8% contribution to retirement is 2 to 4 times higher than comparable private sector retirement benefits. State employees also participate in the Social Security system.

- b. Defined contribution programs don't work

The proposed defined contribution plan will be managed by URS and borrowing against the defined contribution plan will be prohibited. This will help insure against poor personal investment and borrowing decisions.

- c. In the Hybrid DB/DC option, 1% service credit per year is not enough

Employees who select the Hybrid DB/DC option will supplement their 1% DB service credit with additional DC investments.

- d. In the Hybrid DB/DC option, a 35 years is too long to work (especially for Public Safety and Firefighters)

The New Retirement system assumes that public employees will continue to be employed in full-time positions until they reach their 60s, similar to private sector employees. It is

designed to ensure that public employees have retirement resources when they are unable to work in full-time positions.

- e. The system should be studied before legislation is passed

The New Retirement System will go live on July 1, 2011, allowing for (1) an additional independent actuarial study, (2) additional interim study, and (3) an additional Legislative session to adjust and/or change the New Retirement System before it "goes live."

(12) Common arguments against post-retirement reemployment changes?

- a. Utah will lose experienced public employees to retirement

Utah loses experienced public employees every year. The changes to the post-retirement reemployment rules will prevent public employees from "retiring" early only to come back to the same job, collect a pension check and a paycheck.

- b. Early retirement and reemployment actually saves money because retired employees are hired back at a lower wage

Earlier than expected retirement drives up the cost of pension benefits through higher contribution rates for current employees (see Performance Audit of the Cost of Benefits for Reemployed Retirees and Part-time Employees – Number 2009-17).

 AdvisorOne

Utah: One State's Pension Reform Success

Despite dire headlines from New Jersey, Illinois, not all states are having trouble

AdvisorOne | January 19, 2011 | By John Sullivan, AdvisorOne

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As Illinois and New Jersey struggle to reform their broken public pension plans, *The Wall Street Journal* [reports](#) on a recent state success story.

According to the paper, last March Utah replaced **defined-benefit pensions** with a **401(k)-style plan** for new state and municipal workers.

The sponsor of the Utah reform was **Sen. Dan Liljenquist**, who watched in horror during the 2008 stock market **plunge** as the state pension fund lost 22% of its assets. From nearly 100% funded in 2007, it fell to 70% funded by 2009. Utah suddenly faced a long-term \$6.5 billion **funding gap**, and the state would have had to nearly double its annual contributions out of the current budget to make up the shortfall.

The Journal recounts how Liljenquist requested an **analysis** to determine the real and unvarnished financial condition of the pension fund. The state was assuming a 7.75% **annual return** on investment, and actuaries found that if that return fell to only 6% the system would be technically insolvent. The Utah constitution limits total state debt to 1.5% of the value of all **property** in the state, and the unfunded pension liability was one and a half times **over that limit**.

As the paper notes, Utah's constitution bars pension changes for current workers—short of an imminent financial crisis in the fund—so the **legislature** created a **defined-contribution** plan for all new hires starting this year. The state contributes 10% of each worker's salary (12% for public safety workers and firefighters), a generous amount by private company standards. If they wish, new workers can choose a defined-benefit plan, but the state contribution to such a plan is no longer open-ended and is legally capped at 10%.

The reform has **benefits** for taxpayers and public employees, according to the story. Workers own their retirement account and can carry it to another job. They also benefit because politicians can no longer take money from the pension plan to pay for other government spending. As for taxpayers, the reform will eventually **slash state pension liabilities** in half and they no longer bear the risk of having to pay higher taxes if the stock market declines.

Union leaders nonetheless **resisted** the plan, according to the paper, holding public rallies and threatening to defeat any legislator who dared to **vote** for it. But polls found that Utah voters supported reform, recognizing that the changes were **fair** and financially imperative.

From now on in Utah, tax increases or spending cuts for **schools**, parks or roads won't be necessary to make legally required payments to retired state workers, the paper writes. The **contrast** couldn't be sharper with **California**, **New York**, **New Jersey**, **Illinois** and other states in which pension contributions are squeezing out other priorities. *The Journal* said that Montana could be the next state to **adopt** the Utah model, and something like a dozen more are interested in what looks to be a **winner** for taxpayers, workers and state budgets.

About the Author »**John Sullivan, AdvisorOne**

John Sullivan is the editor of *Investment Advisor* magazine and the editor of the Retirement Channel for AdvisorOne.com. Sullivan is the former editor of *Boomer Market Advisor* and *Bank Advisor* magazines, and has a background in the insurance and investment industries in addition to his journalism roots.

Utah leads the way on pension reform

Posted by **Thomas Mitchell**

Wednesday, Jan. 19, 2011 at 07:17 AM

As the 2011 Nevada legislative session nears, we look east to Utah for guidance on what is possible if our lawmakers can find a little fortitude.

According to a **Wall Street Journal editorial** today, the Utah lawmakers, in the face of huge public protests and threats of political repercussions, have changed their pension plan from a defined-benefit program to a 401(k)-style defined-contribution plan for newly hired state and municipal employees.

"Union leaders nonetheless resisted the plan," the WSJ reports, "holding public rallies and threatening to defeat any legislator who dared to vote for it. But polls found that Utah voters supported reform, recognizing that the changes were fair and financially imperative. Not a single Republican who voted for the reforms lost, and the GOP picked up seats in 2010."

The Utah reform also includes an element not mentioned in the editorial that Nevada should consider. Retirees may not be rehired. In a **document** used to argue for the change in plans it was stated, "We need to address our post-retirement reemployment (double dipping) rules to ensure that we have a true 'Retirement' system, not a 'supplemental income' system."

Nevada already has an unfunded pension liability in **excess of \$9 billion**. Without change, that figure is likely to grow.

Find this article at:

http://www.lvrj.com/blogs/mitchell/Utah_leads_the_way_on_pension_reform.html

Check the box to include the list of links referenced in the article.

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Attachment 2
1228

**TESTIMONY OF
SPARB COLLINS ON
HOUSE BILL 1228**

Madame Chair, members of the committee, my name is Sparb Collins. I am the Executive Director of the North Dakota Public Employees Retirement System or PERS. Our agency is responsible for administering about 10 different retirement plans for the state and participating political subdivisions. The bill before you today affects two of those plans. These plans are the PERS Main system which is a Hybrid or modified defined benefit plan and our defined contribution plan. I appear before you today on behalf of the PERS Board and in a neutral position on the bill. However, the Board did want me to share with you:

1. Background information on our defined contribution plan,
2. The effect of this bill on the Main Plan, and
3. Benefit observations/implications that we shared with the interim committee.

Background information on our defined contribution plan

In 1999 the legislature passed HB 1257 which allowed nonclassified state employees the opportunity to elect to withdraw from the PERS Main plan and move to a defined contribution plan. PERS set up this plan which included establishing the plan document, preparing informational material for the members, counseling them on the existing plan and the new plan, determining the investment options and monitoring those options and selecting a vendor. After preparing a bid, soliciting responses and evaluating those responses PERS selected Fidelity.

In our administration of the plan, we utilize a bundled provider/vendor approach. That is our vendor/provider not only provides recordkeeping but also the investment options. I have attached for your information the list of funds offered to the members of the plan. Each quarter the PERS investment committee meets with Fidelity to review the funds and if adjustments in the line up of funds need to be made due to performance issues,

style creep or other reasons we will drop a the fund in question and add a new one. Our plan also has an investment window. That is, member can, after signing the appropriate papers, add about 300 additional funds for their consideration.

The present DC plan is an option available to nonclassified employees. The following is information on the number offered the plan and those selecting the plan:

| Year | Contacts | Transfers |
|-------|----------|-----------|
| 2001 | 98 | 20 |
| 2002 | 48 | 6 |
| 2003 | 48 | 6 |
| 2004 | 46 | 4 |
| 2005 | 61 | 5 |
| 2006 | 100 | 12 |
| 2007* | | |
| 2008 | 82 | 6 |
| 2009 | 50 | 6 |

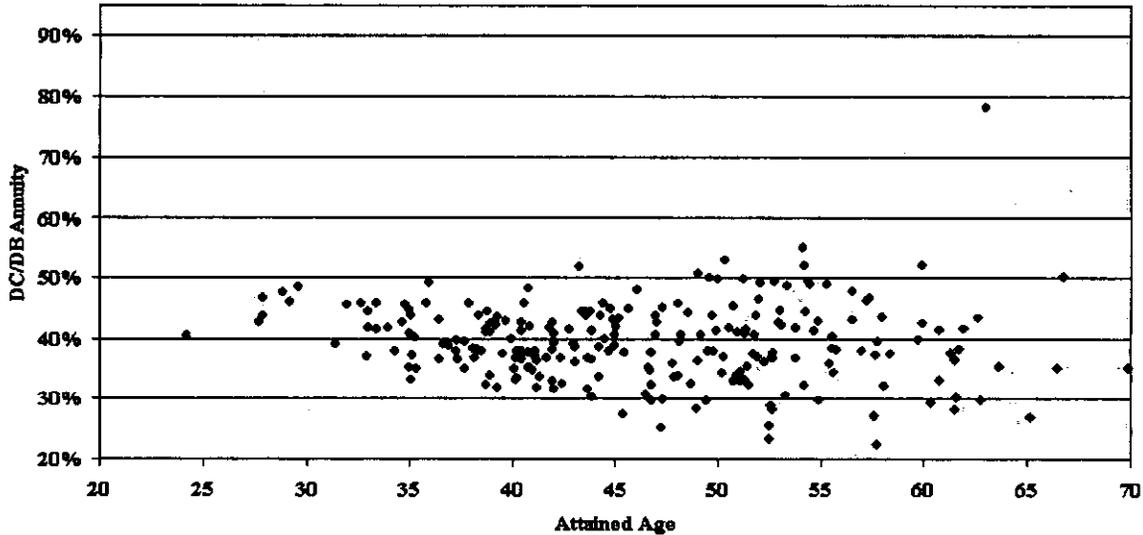
2008 figure includes both 2007 and 2008 eligibles.

When the plan was first offered about 38% of the member elected to participate. This last year about 10% selected the plan.

Contributions to the DC plan are the same as the Main Plan. Presently 8.12% of salary is contributed to the plan.

This DC plan just like the Main plan has been hit hard by the recent downturn in the financial markets. This last interim the Board had a study done projecting what benefit these members may get at retirement and benchmarked that to members of the Main Plan. For this plan we asked the actuary to project for participants in the DC plan what their benefit would be utilizing their existing fund balance and the assumptions used in the Main plan and compare that to what they would have received from the Main Plan. The following table is that information:

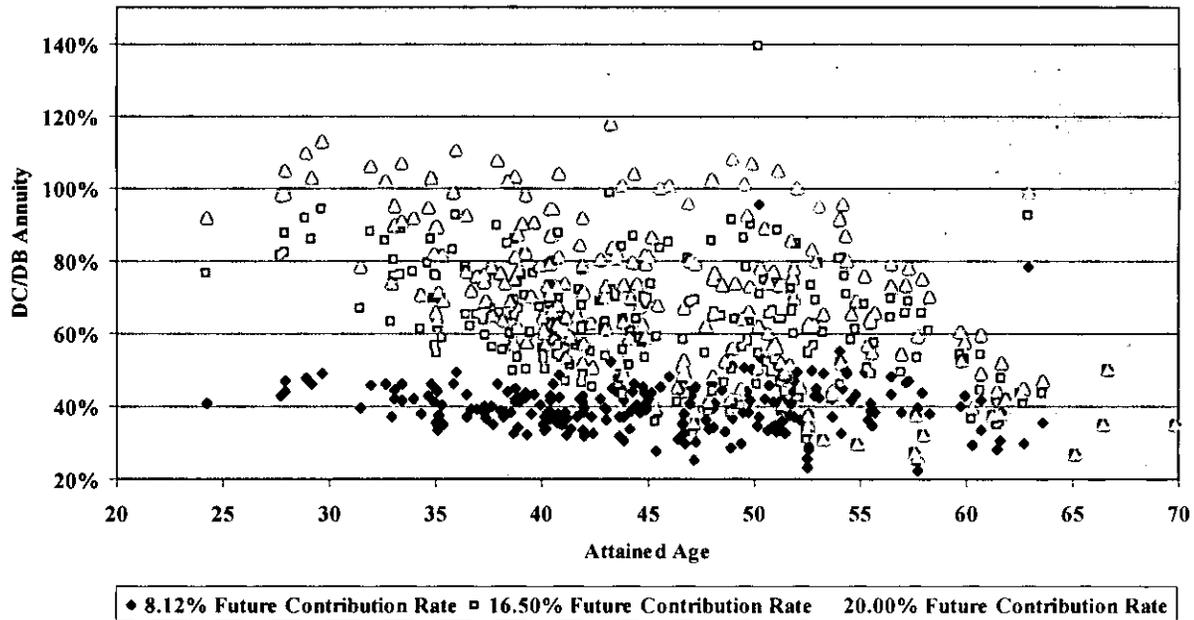
Exhibit III
Ratio of Projected DC Account (Converted to an Annuity) to DB Benefit
by Attained Age as of July 1, 2010
With 8.12% Future Contribution Rate



As the above table shows, these individuals will be getting less than half what they would have received. This shows the challenge facing them and the effect the downturn in the markets have had on them. Our DC plan has a challenge that is as dramatic as our hybrid plan or defined benefit plan.

We also had our actuary run a table assuming contributions would increase to 16.5% or 20%. The table shows the results:

Exhibit IV
Ratio of Projected DC Account (Converted to an Annuity) to DB Benefit
by Attained Age as of July 1, 2010



We see the increase in contributions does help them. As a result we proposed in SB 2108 an increase in contributions for our defined contribution plan members to the same level as that proposed for the main plan which would be to 16.12%. Both plans have a significant challenge if they are to provide the necessary retirement benefits. This increase was included in the executive budget.

If the increase in SB 2108 is approved for the PERS DC plan and if both PERS and TFFR are to be defined contributions, they will have approximately the same level of contributions or benefit as they do today (both have a multiplier of 2 in the present plan). If this increase is not provided, the benefit differential would be dramatic between the two systems since benefits in a DC plan are based upon contributions and earnings.

The effect of the bill on the Main Plan

If HB 1228 passes, it would also have an affect on the Main PERS Plan. During the interim, the Legislative Employee Benefits Committee studied the bill and as part of that study the actuary did an analysis of the bill. Our actuary is the Segal Company and

along with me today is the actuary who did the study, Mr. Brad Ramirez who is available to answer your questions. Segal determined that the required actuary rate if this bill would pass for the Main system should be a total of 23.91%. As mentioned earlier in my testimony, our total rate today is 8.12%. However, the effect of this bill is not the difference between 23.91% and 8.12% because part of that increase includes the cost of getting the main plan back to 100% funded status and addressing the funding issue mentioned above for the existing DC plan. SB 2108 sets forth a strategy to get the retirement plans back on a path to recovery as a result of the recent downturn in the financial markets. A separate actuarial study was done and after consideration by many parties. That proposal (in SB 2108) requests contributions to increase to 16.12%. Consequently, the cost of this bill would be the amount required in addition to the 16.12% and that is 7.79% (23.91%-16.12).

| | Total Rate | Rate Change |
|----------------------|------------|-------------|
| HB 1228 ² | 23.91 | 7.79% |
| SB 2108 ¹ | 16.12 | 8% |
| Present Rate | 8.12 | |

1. Is the rate increase in SB 2108 to get the main plan back to 100% funded status
2. Is the additional cost of having new members go to the DC plan instead of staying in the DB plan

Why the increase? It is not that it will cost more to pay off the unfunded liability. The affect is that there will be less members to pay it off. In fact, the following table from our actuary shows how this will work for the next several years:

| Plan year beginning | Total Payroll | Active Count in Main Plan |
|---------------------|---------------|---------------------------|
| 07/01/2011 | \$460,954,194 | 10,610 |
| 07/01/2012 | 446,907,274 | 9,684 |
| 07/01/2013 | 433,864,385 | 8,900 |
| 07/01/2014 | 421,129,833 | 8,206 |
| 07/01/2015 | 408,507,025 | 7,576 |
| 07/01/2016 | 395,054,545 | 7,002 |

You can see from the above that by 07/01/2016 the main plan will have approximately 3,000 less members. These individuals will all be in the defined contribution plan if HB 2128 is passed. The total covered payroll decreases due to the smaller number of members. Since contributions are a percent of covered payroll, the total contributions to the main plan will decrease as well. Since the size of the unfunded liability does not diminish by an equal amount, then we need a higher contribution to raise the same amount of money to pay it off due to the smaller membership.

An analogy would be a family of 2 brothers and 2 sisters that decide to buy a second home together. Let's say the cost is around \$240,000. They get a variable rate loan at 4.5% for 30 years. Their payment would be about \$1,200 per month or about \$300 each ($\$1,200/4$). Our unfunded liability in the main plan is like the mortgage that needs to be paid off. Now assume after a couple of years that one of the brothers decides he is going to buy a second home of his own since prices have come down so much. He leaves the arrangement. However, the cost of the mortgage for the remaining 3 does not change due to his departure; however, the number of individuals paying on it does. With the one brother's departure there is 3 people left to pay it. So their monthly payment increases from \$300 to \$400 ($\$1,200/3$). In concept this is what is happening here to the Main retirement plan. Members who were counted on to help pay this cost out into the future are not going to be in the plan. The result is an increase in cost to the remaining members. If everyone stayed, the cost would not need to increase.

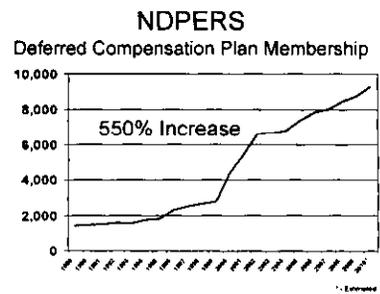
The fiscal note shows the cost of the change. The fiscal note only shows projected expenditures that will be incurred if the HB 1228 is passed not including the transfer provision for existing members. However, you will note there is no appropriation to pay this projected additional cost. Consequently, I have attached to my testimony an amendment to the bill to increase the contributions for those remaining effective July 1, 2011 and an appropriation to each state agency to pay the additional cost. As mentioned in the fiscal note, "If contributions are not increased and funds are not appropriated to pay the additional contribution for the remaining members and the actuarial assumptions are met, this cost will continue to accrue and roll over into future bienniums for payment".

Benefit observations/implications that we shared with the interim committee

The following are some observations and implications that were shared with the Legislative Employee Benefits Committee when this change is viewed from a total benefits perspective. Please note these are not a direct affect of HB 1228 but only considerations that could arise in the future

| Benefit | Description | Considerations | Cost Estimate³ |
|--------------------------------|--|--|----------------------------------|
| <i>Survivor Benefit</i> | The DB plan provides for survivor benefits. Four options are provided including a lifetime benefit of 50% of the accrued benefit payable to the spouse for the remainder of their life. The DC spouse benefit is the account balance. Consequently the DC plan does not provide as sound of a benefit for spouses for employees without a significant account balance. For many employers that is offset since they provide their employees employer paid life insurance that will help the spouse. In North Dakota we provide \$1,300 in coverage but since the DB plan had a sound spouse benefit this was not as critical | An alternative to providing survivor benefits in the retirement plan could be to expand the employer provided life insurance coverage from the existing \$1,300 to a higher amount such as \$50,000. | \$3.5 Million ¹ |
| <i>Disability</i> | The PERS DB plan has a disability retirement benefit of 25% of final average salary. The DC plan's only benefit is that account balance which for many members unless | An alternative to providing this in the DB plan would be to add an employer paid disability insurance as a benefit for state employees to offset the reduction in the disability retirement benefit | \$1.6 Million ¹ |

| Benefit | Description | Considerations | Cost Estimate ³ |
|---------------------------|---|--|--|
| | they are older with many years of service would not be adequate. Some employers have employer paid disability that insures against this contingency | | |
| Investor Education | In a DC plan the individual member is responsible for setting up their investment plan. In the DB plan that responsibility is with the PERS Board and the SIB. In the DC plan the member's ability to retire and the type of retirement they can afford is directly related to how effective they are in establishing and maintaining their investment strategy in an age appropriate manner. | To provide DC member the resources to manage their investments consideration could be given to allowing each members up to 4 hours per year of employer work time to meet with their investment advisor, participate in investment education meetings and view on line education video's | \$1.9 Million ² (this is a soft dollar cost) |
| Savings Incentive | The PERS plan added the PEP program to its plan design in the late 90's. This provision enhances the portability of the plan and also provides an incentive for members to engage in supplemental retirement savings in the deferred comp program by matching their contribution in the DB plan with increased vesting in the employer contribution. This program has been very successful and since its initiation supplemental retirement savings has increased. The proposed DC plan does not have a | Since the DC plan does not have a similar incentive an alternative would be to provide a direct match to employees participating in supplemental retirement savings | \$37 Million ¹ |



| Benefit | Description | Considerations | Cost Estimate ³ |
|---------------------------------------|--|--|--|
| | similar incentive. | | |
| Retiree Increases | <p>The state's present process for providing retiree increases is by Ad Hoc adjustments. That is if the fund can support an increase it is considered by the Legislature and Governor and if passed will then take effect. Given the retirement plan's existing funded status it is unlikely that it will be able to support any increases for many years. However, if new employees are moved to a DC Plan it will insure that the fund will likely never to able to give a retiree increase due to the continued decline in covered payroll.</p> | <p>If the DC plan is passed a new method for considering and funding retiree increases may need to be considered. One option would be set up a separate funding mechanism. An example would be to put a 1% contribution of all covered payroll into the plan for such increases (this would need a study to determine what would be appropriate)</p> | \$9.3 Million |
| Administration and plan design | <ol style="list-style-type: none"> 1. The PERS Business system will need to be modified to provide for the different eligibility procedures 2. The implementation may be a challenge 3. Not clear what should happen to a member of the DB plan who returns to service as a new employee after the DC bill would be implemented | <ol style="list-style-type: none"> 1. Update the business system code 2. Later date is helpful but we have already modified our RFP that is now in the marketplace 3. Have a returning member stay in the Hybrid Plan to maintain continuity of retirement plan | <ol style="list-style-type: none"> 1. We will draw on contingency for these costs (\$20 to \$40,000) 2. No Cost 3. Minimal cost |

Assumptions: 10,800 PERS State FTE & \$926,151,000 biennium payroll

1. Assumes the benefit is provided to all PERS employees at the same time, except for the life insurance which assumes all state employees including Higher Education. If only applied to DC plan members it would start lower and then grow as more members joined the plan.
2. Would be the full cost at full implementation. That is when all employees are in the DC system.
3. All cost estimates are very preliminary and are only provided to give a very general estimate. Full cost is shown so it can be factored down based upon estimated participation.

My comments on this bill do not include the transfer provision since it is my understanding that it may be removed. If this provision remained, we would have additional comments and the cost would be different. That provision was not considered during the interim and therefore no cost study has been done on these implications. Madame Chair, members of the committee, this concludes my testimony.

INVESTMENT OPTIONS

| Fund/Ticker Symbol | Type of Investment | Objective | Annual Expense | Other Fees (Y/N) | Return | Net Historical Performance | | | |
|--|--------------------|------------|----------------|------------------|----------------------------|----------------------------|-------|-------|-------|
| | | | | | 6 Mos. Ended June 30, 2010 | As of December 31, 2009 | | | |
| | | | | | 1 | 3 | 5 | 10 | |
| | | | | | Year | Years | Years | Years | |
| Managed Income Portfolio | Stable Value | Income | 0.55 | N | 0.60 | 1.65 | 3.25 | 3.22 | 4.50 |
| PIMCO Total Return Fund - PTRAX | Mutual Fund | Bond | 0.59 | Y | 5.67 | 13.55 | 8.91 | 6.75 | 7.58 |
| Fidelity Puritan - FPIBFX | Balanced | Bond/Stock | 0.67 | N | 21.49 | 26.69 | -1.60 | 3.74 | 4.15 |
| Fidelity Equity-Income - FEQIX | Mutual Fund | Large Cap | 0.74 | N | -0.91 | 29.54 | -8.45 | -6.50 | 1.83 |
| Mutual Shares A - TESIX | Mutual Fund | Large Cap | 1.20 | Y | -4.02 | 27.84 | 0.60 | 1.12 | 4.91 |
| Fidelity Dividend Growth - FDGIX | Mutual Fund | Large Cap | 0.82 | N | -5.99 | 51.00 | -4.50 | 0.66 | 1.59 |
| Spartan 500 Index Fund - PLSEIX | Mutual Fund | Large Cap | 0.10 | N | 6.58 | 25.51 | 6.65 | 0.98 | 1.64 |
| Fidelity Blue Chip Growth - FBGIX | Mutual Fund | Large Cap | 0.76 | N | -7.30 | 44.96 | -0.16 | 1.70 | 2.11 |
| Fidelity Growth Company - FICRX | Mutual Fund | Large Cap | 0.93 | N | -6.16 | 41.15 | 0.01 | 4.46 | 4.85 |
| Goldman Sachs Mid-Cap Value A - GUMAX | Mutual Fund | Mid Cap | 1.19 | N | -3.42 | 32.70 | -4.75 | 2.35 | 5.05 |
| Dreyfus Mid-Cap Index - PDSIX | Mutual Fund | Mid Cap | 0.51 | Y | -1.64 | 37.64 | -2.15 | 2.80 | 5.89 |
| Spartan Extended Market Index - PSEMX | Mutual Fund | Mid Cap | 0.10 | Y | -1.06 | 36.65 | -3.94 | 2.88 | 1.75 |
| Fidelity Mid-Cap Stock - FMCSX | Mutual Fund | Mid Cap | 0.65 | N | -4.15 | 50.39 | -4.19 | 3.22 | 3.57 |
| Aliazan NEI Small Cap Value Admin - PVADX | Mutual Fund | Small Cap | 1.14 | N | 1.51 | 24.12 | -0.95 | 4.97 | 11.64 |
| Dreyfus Small Cap Stock Index - DISSX | Mutual Fund | Small Cap | 0.51 | N | -1.07 | 25.22 | -4.85 | 1.18 | 1.69 |
| MSF Small Company Growth Class B - MSSMX | Mutual Fund | Small Cap | 1.32 | Y | -6.50 | -7.41 | -4.19 | 2.15 | 1.86 |
| Fidelity Diversified International - FDIVX | Mutual Fund | Foreign | 1.01 | Y | -3.21 | 31.78 | -5.79 | 3.77 | 2.94 |
| Spartan International Index - FSIIX | Mutual Fund | Foreign | 0.20 | Y | -14.07 | 28.48 | -5.90 | 3.63 | 1.69 |

| Fund/Ticker Symbol | Type of Investment | Objective | Annual Expense | Other Fees (Y/N) | Return | Net Historical Performance | | | |
|----------------------------------|--------------------|------------|----------------|------------------|----------------------------|----------------------------|-------|-------|------|
| | | | | | 6 Mos. Ended June 30, 2010 | As of December 31, 2009 | | | |
| | | | | | 1 | 3 | 5 | 10 | |
| | | | | | Year | Years | Years | Years | |
| Lifecycle/Lifestyle Funds | | | | | | | | | |
| Fidelity Freedom Income - FFTAX | Mutual Fund | Life-Cycle | 0.50 | N | 1.02 | 16.12 | 2.27 | 3.98 | 3.82 |
| Fidelity Freedom 2000 - FFPBX | Mutual Fund | Life-Cycle | 0.51 | N | 0.79 | 16.46 | 1.81 | 3.22 | 3.15 |
| Fidelity Freedom 2005 - FFPVX | Mutual Fund | Life-Cycle | 0.64 | N | -1.56 | 23.40 | 0.00 | 2.91 | N/A |
| Fidelity Freedom 2010 - FPFIX | Mutual Fund | Life-Cycle | 0.67 | N | -2.17 | 34.82 | 0.04 | 3.03 | 2.72 |
| Fidelity Freedom 2015 - FPFVX | Mutual Fund | Life-Cycle | 0.68 | N | -2.27 | 25.02 | -0.45 | 3.16 | N/A |
| Fidelity Freedom 2020 - PPFIX | Mutual Fund | Life Cycle | 0.71 | N | 2.57 | 29.80 | 1.75 | 2.69 | 1.74 |
| Fidelity Freedom 2025 - FPFVX | Mutual Fund | Life Cycle | 0.76 | N | -1.50 | 39.03 | -2.11 | 2.55 | N/A |
| Fidelity Freedom 2030 - FPFIX | Mutual Fund | Life-Cycle | 0.70 | N | -5.19 | 30.57 | -3.16 | 2.03 | 0.84 |
| Fidelity Freedom 2035 - FPFIX | Mutual Fund | Life-Cycle | 0.81 | N | -0.07 | 31.26 | -3.71 | 1.91 | N/A |
| Fidelity Freedom 2040 - FPFIX | Mutual Fund | Life-Cycle | 0.81 | N | -6.25 | 31.65 | -4.15 | 1.71 | N/A |
| Fidelity Freedom 2045 - FPFIX | Mutual Fund | Life-Cycle | 0.82 | N | -6.52 | 32.04 | -4.18 | N/A | N/A |
| Fidelity Freedom 2050 - FPFIX | Mutual Fund | Life-Cycle | 0.84 | N | -7.10 | 32.47 | -4.77 | N/A | N/A |

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1228

Page 1, line 3, after "Act" Insert "to create and enact a new section to chapter 54-52 of the North Dakota Century Code, relating to additional retirement contributions by a state agency."

Page 9, after line 2, insert:

"SECTION 7. A new section to chapter 54-52 of the North Dakota Century Code is created and enacted as follows:

Additional contribution by state agency – Employer contribution. Contributions to be paid by a governmental unit increase an additional seven and seventy-nine hundredths percent of the monthly salary or wage beginning July 1, 2011, in addition to the employer contribution required to be paid in section 54-52-06. For purposes of this section, "governmental unit" means any state agency required to make an employer contribution under section 54-52-06."

"SECTION 8. APPROPRIATION. The funds provided in this section, or so much as may be necessary, are appropriated out of any moneys in the general fund in the state treasury, not otherwise appropriated, and from special funds derived from federal funds and other income, to the following departments for the purpose of defraying the cost of the additional employer retirement contributions necessary to pay the cost for the provisions of this bill for the biennium beginning July 1, 2011 and ending June 30, 2013, as follows:

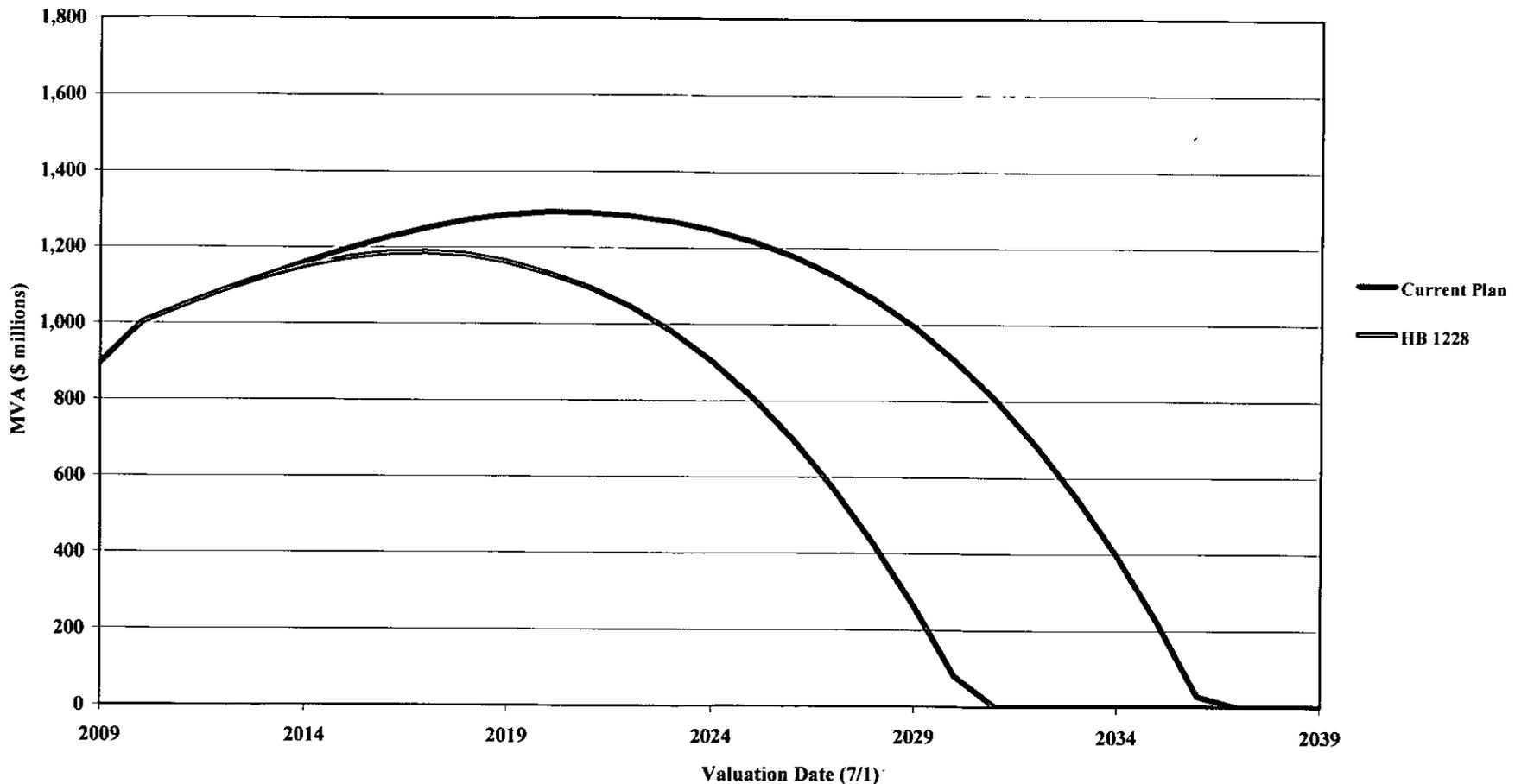
| Department | General | Other |
|---|-------------|-------------|
| 101 Office of the Governor | \$152,116 | \$0 |
| 108 Office of the Secretary of State | \$175,037 | \$6,779 |
| 110 Office of Management and Budget | \$706,315 | \$139,184 |
| 112 Information Technology Department | \$586,784 | \$2,588,724 |
| 117 Office of the State Auditor | \$377,944 | \$113,705 |
| 120 Office of the State Treasurer | \$39,972 | \$0 |
| 125 Office of the Attorney General | \$1,015,775 | \$266,360 |
| 127 Office of the Sate Tax Commissioner | \$1,023,858 | \$0 |
| 140 Office of Administrative Hearings | \$0 | \$57,090 |
| 160 Legislative Council | \$289,411 | \$0 |
| 180 Judicial Branch | \$2,670,229 | \$0 |
| 188 Legal Counsel of Indigents | \$263,184 | \$8,419 |
| 190 Retirement and Investment Office | \$0 | \$186,586 |
| 192 Public Employees Retirement System | \$0 | \$253,144 |
| 201 Department of Public Instruction | \$243,869 | \$527,370 |
| 215 North Dakota University System Office | \$72,330 | \$7,241 |
| 226 State Land Department | \$0 | \$194,325 |
| 227 Bismarck State College | \$345,827 | \$149,055 |
| 228 Lake Region State College | \$149,955 | \$81,270 |
| 229 Williston State College | \$103,616 | \$41,644 |
| 230 University of North Dakota UND School of Medicine and Health | \$2,229,247 | \$3,458,736 |
| 232 Services | \$452,560 | \$311,132 |
| 235 North Dakota State University | \$1,995,132 | \$1,880,386 |
| 238 North Dakota State College of Science | \$525,562 | \$241,606 |
| 239 Dickinson State University | \$315,702 | \$62,096 |
| 240 Mayville State University | \$128,302 | \$230,614 |
| 241 Minot State University | \$456,231 | \$182,880 |
| 242 Valley City State University | \$210,254 | \$36,684 |

| | | | |
|-----|---|--------------|--------------|
| 243 | Bottineau College | \$88,060 | \$38,701 |
| 244 | North Dakota Forest Service | \$61,488 | \$4,417 |
| 250 | State Library | \$154,716 | \$22,782 |
| 252 | School for the Deaf | \$297,170 | \$15,666 |
| 253 | N.D. Vision Services | \$168,547 | \$30,369 |
| 270 | Dept of Career and Technical Ed | \$255,177 | \$0 |
| 301 | North Dakota Department of Health | \$1,270,123 | \$1,361,982 |
| 305 | Tobacco Prevention | \$0 | \$32,229 |
| 313 | Veterans Home | \$641,347 | \$28 |
| 316 | Indian Affairs Commission | \$33,462 | \$0 |
| 321 | Department of Veterans Affairs | \$42,724 | \$0 |
| 325 | Department of Human Services | \$10,335,272 | \$4,553,787 |
| 360 | Protection and Advocacy Project | \$229,559 | \$0 |
| 380 | Job Service North Dakota | \$10,925 | \$1,869,991 |
| 401 | Office of the Insurance Commissioner | \$0 | \$365,400 |
| 405 | Industrial Commission | \$595,669 | \$44,438 |
| 406 | Office of the Labor Commissioner | \$74,034 | \$0 |
| 408 | Public Service Commission | \$250,145 | \$137,207 |
| 412 | Aeronautics Commission | \$0 | \$57,480 |
| 413 | Department of Financial Institutions | \$0 | \$312,349 |
| 414 | Office of the Securities Commissioner | \$73,540 | \$0 |
| 471 | Bank of North Dakota | \$0 | \$1,329,293 |
| 473 | North Dakota Housing Finance Agency | \$0 | \$355,227 |
| 475 | North Dakota Mill & Elevator Association | \$0 | \$880,869 |
| 485 | Workforce Safety & Insurance | \$0 | \$1,070,918 |
| 504 | Highway Patrol | \$344,875 | \$93,682 |
| 530 | Department of Corrections and Rehabilitation | \$5,028,900 | \$320,592 |
| 540 | Adjutant General | \$472,512 | \$954,828 |
| 601 | Department of Commerce | \$360,554 | \$111,827 |
| 602 | Department of Agriculture | \$338,924 | \$227,488 |
| 616 | State Seed Department | \$0 | \$195,217 |
| 627 | Upper Great Plains Transportation Institute | \$74,749 | \$592,165 |
| 628 | Branch Research Centers | \$579,390 | \$161,515 |
| 630 | NDSU Extension Service | \$1,500,944 | \$725,694 |
| 638 | Northern Crops Institute | \$89,328 | \$14,597 |
| 640 | NDSU Main Research Center | \$2,576,587 | \$633,223 |
| 649 | Agronomy Seed Farm | \$0 | \$27,721 |
| 670 | Racing Commission | \$17,828 | \$0 |
| 701 | State Historical Society | \$411,188 | \$50,673 |
| 709 | Council on the Arts | \$40,146 | \$1 |
| 720 | Game & Fish Department | \$0 | \$1,363,143 |
| 750 | Department of Parks & Recreation | \$391,724 | \$14,550 |
| 770 | State Water Commission | \$704,823 | \$109,251 |
| 801 | Department Of Transportation | \$0 | \$8,448,031 |
| | State Total | \$41,971,310 | \$37,556,460 |

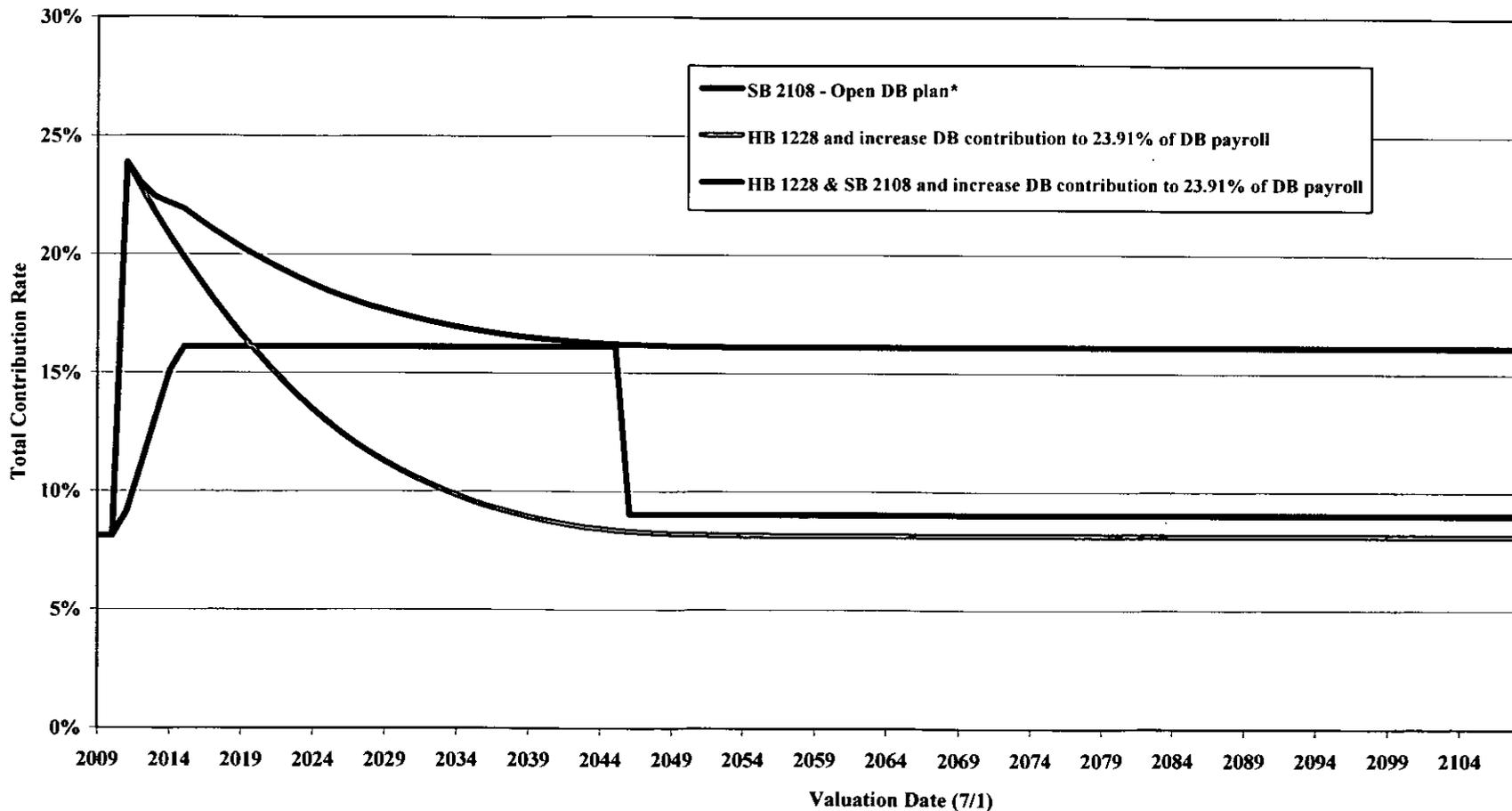
Attachment 3
12 28



Chart 1
North Dakota Main System State Employees
Market Value of Assets
Based on July 1, 2010 Data and 8% Market Return Thereafter



**North Dakota Main System State Employees
Projected Contribution Rates Under Various Legislative Proposals
Based on July 1, 2010 Valuation Data and Assets**



* Under this scenario contributions are expected to increase according to SB 2108 but decrease to Normal Cost (approximately 9%) when the plan achieves full funding

Attachment 4
1228

Testimony on House Bills 1258 and 1228
House Government and Veterans Affairs Committee
January 21, 2011

Presented by Marlowe Kro
Associate State Director, AARP North Dakota

Chairwoman Grande and Members of the Committee:

AARP appreciates the opportunity to present written testimony discussing the important issues surrounding the North Dakota Public Employees and Teachers Pension Systems.

AARP is the largest nonprofit, nonpartisan organization representing the interests of Americans age 50 and older and their families in the State of North Dakota. Nearly half of our members are employed full or part-time and AARP is greatly concerned about their retirement security.

All workers need access to a retirement plan that supplements Social Security's foundation; for those employees who do not participate in Social Security, their retirement plan becomes their main source of income during retirement.

AARP believes that North Dakota public employees and teachers should continue to have access to defined benefit plans. Defined benefit plans provide a predictable monthly retirement benefit to employees, low fees, and professional management of retirement assets. Defined benefit plans are also more efficient – that is, they cost less to achieve a particular level of retirement income than defined contribution plans.

In contrast, defined contribution plans force employees to bear the investment risk, inflation risk, and the risk of outliving one's retirement nest egg. Unfortunately, many individuals are simply not prepared to handle these risks and responsibilities. If defined contribution plan members retire in a down market, their account balances may not be adequate for retirement. While defined contribution-type plans can be an effective savings vehicle for retirement -- especially if individuals take all the right actions and markets achieve historical rates of return -- in practice this is not the case, and many people make mistakes at every step along the way, as evidenced by generally less than adequate defined contribution account balances.

Transitioning to a defined contribution plan raises significant issues that are not addressed in House Bills 1258 and 1228. Any changes should not harm the funding or undermine the State's ability to meet the benefit promises it has made to those employees who remain under the current defined benefit plans. Because the current defined benefit plans will be closed to new hires, their investments will need to be more liquid, potentially lowering investment returns and increasing necessary contributions by the State and/or current employees. Finally, the defined benefit plans will still need to be administered for current retirees and all members who elect to stay in the defined benefit plans, the State will continue to incur the costs for running the current defined benefit plans.

Thank you for the opportunity to present our views to ensure the retirement security of North Dakota teachers and public servants.



NORTH DAKOTA
PUBLIC EMPLOYEES ASSOCIATION

3333 EAST BROADWAY AVE, SUITE 1220
BISMARCK, NORTH DAKOTA 58501-3396

701-223-1964
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AMERICAN FEDERATION
OF TEACHERS LOCAL 4660 AFL-CIO

EMAIL: comments@ndpea.org
WEBSITE: www.ndpea.org

Attachment 5
1228

Testimony Regarding House Bill 1228
Before the Government and Veterans Affairs Committee
Stuart Savelkoul, Executive Director, NDPEA
January 21, 2011

Good morning Chairman Grande and members of the committee. My name is Stuart Savelkoul and I am the Executive Director of the North Dakota Public Employee Association. I am here today representing the interests of public employees across the state of North Dakota including the 2,300 members of NDPEA. This bill seeks to place all newly hired state employees into a defined contribution plan rather than the defined benefit plan that presently exists for most state employees. NDPEA has a clear position on this subject and it is one that dictates our strong opposition to House Bill 1228. There are both philosophical and fiscal reasons to oppose this shift.

Defined contribution plans provide a lesser benefit to the employee. The recent debate about retirement security seems to grant that point over and over. The question of the day seems to revolve around the question of fairness. The question of the day seems to ask, "What is fair for the taxpayer? What is fair for the public employee?"

During the legislative interim, the Government Services committee worked with the Hay Group to evaluate how our state employees are compensated in relation to the market. The study concluded that our state employees are presently compensated at 10%-12% behind market. Is that fair? Consider the following facts:

The state is struggling to recruit workers.

The state is struggling to retain workers.

The state has a high percentage of employees who are currently eligible to retire.

Passing this bill will compound those problems.

If we accept the premise it is a lesser benefit, clearly it will make it even harder to recruit employees.

The fiscal note on this bill is significant and diverts money away from salaries. With the prospect for future salary increases greatly reduced, the incentive to remain an active employee in state service will be greatly reduced. The passage of this bill will make it even more difficult to retain our quality employees in state government and that will lead to a negative impact on the quality services that the citizens of our state have come to expect. Is that fair?

While I am certain that this bill was drafted with the best of intentions, the bottom line is that it robs future state employees of the kind of retirement security that a person who has dedicated a career to public service deserves. NDPEA supports SB 2108 which makes the necessary contribution increases required to shore up the NDPERS defined benefit plan. The responsibility for these contribution increases will be shared by both the state and the employee. It is a sensible plan that received unanimous committee endorsement during the interim and is included in the Governor's budget.

NDPEA is sensitive to the fact that many in the private sector are not afforded defined benefit retirement plans. However, that does not mean that the state of North Dakota ought to engage in a race to the bottom. A defined benefit plan provides proven security to the quality people of our state employee workforce who provide us with quality services. Thank you for your time, and I will now stand for any questions that you might have.

Quality Services from Quality People

Testimony

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1228

Testimony

House Bill 1228 – Bill Kalanek, Association For Public Employees

House Government and Veterans Affairs Committee

Representative Grande, Chairman

January 21, 2011

Madame Chair and members of the Committee, my name is Bill Kalanek and I am here representing the Association For Public Employees (AFPE). AFPE is a state association comprised of active and retired state employees living in communities throughout ND. I am here to testify in opposition to House Bill 1228.

AFPE serves active and retired state employees by advocating to: 1) strengthen and maintain the existing defined benefit retirement plan 2) advocate for annuity adjustments for retirees if the financial environment allows and 3) work with the state government to improve compensation and benefits for active state employees.

Throughout the interim, AFPE was involved in discussions to develop options to improve the funded level of PERS. This past summer and fall we visited with our membership and discussed the options being considered by PERS to improve the financial health of the retirement fund. Overwhelmingly, our members commented on these areas: 1) They are very appreciative for the current defined benefit plan and their retirement annuity; 2) They are very thankful for the supplemental payments approved by the Legislature in 2005 and 2007; 3) They understand the current economic environment and the need to make changes to improve the status of the retirement fund; 4) They understand the fund has the resources to pay current annuities and that it is necessary to makes changes so that retirement obligations will continue to be met well into the future and; 5) The likelihood of near-term annuity adjustments or supplemental payments from investment margin is slim.

AFPE believes the bill before this committee is an unnecessary attempt at dismantling a retirement system that has been better managed and is in better shape than almost all pension funds public and private. Closing the PERS plan to future employees will only serve to exacerbate the current funding issues and delay recovery, resulting in a much greater liability down the road. We would ask that the committee consider the other factors when looking at this piece of legislation: Increased administrative costs, employee life insurance, disability benefits, investment consulting, retiree increases, employee retention and recruitment. The true costs of this bill are not measured by its fiscal note.

The active, retired and future members of AFPE respectfully request that you consider all costs when you deliberate on HB 1228 and give it a Do Not Pass recommendation.

Thank you Madame Chair and members of the committee for the opportunity to testify before you this morning. I'd be happy to answer any questions.

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Attachment 7
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TESTIMONY BEFORE THE GOVERNMENT AND VETERAN'S AFFAIRS COMMITTEE

HB 1228

Presented by Gordy L. Smith, CPA

Good morning Madam Chair and members of the Government and Veteran's Affairs committee. I am here to testify in opposition to HB 1228.

State government has difficulty in hiring and retaining individuals to fill certain positions. The State Auditor's Office Bismarck office has experienced a 30% turnover in auditors in our state agency and performance audit divisions this biennium. One of the tools that the Auditor's Office has to hire and retain qualified applicants is the retirement plan.

One of the best features of the retirement plan is that it is a defined benefit plan and a long term employee is able to rely on a specified level of benefits once they meet the rule of 85 and retire. This bill changes that for newly hired employees and thus will make it more difficult to attract and retain qualified people. In fact an independent assessment of the legislation by the Segal Company indicated "The proposed changes could motivate job mobility and increase turnover."

It appears that this bill is in response to the losses the retirement fund experienced as a result of the national recession. The independent analysis conducted by the Segal Company provides evidence that this bill doesn't resolve the funding shortfall in the state retirement fund. In fact the analysis indicates it will worsen the situation. The bill's intent of reducing participation in the defined benefit program actually results in a negative financial impact on the retirement fund.

The results from Segal state "If the Statutory Contribution Rate is not adjusted, the projected date that the Main System's assets that are allocated to State employees will be exhausted is projected to be earlier under the proposed legislation...." The results of the independent assessment also state "If the Statutory Contribution Rate were to be adjusted to achieve full funding, the increase would be higher under the proposed legislation than it would be under the current plan."

The Segal analysis of the effects of this legislation also states "However it does not match the designs of many larger private sector employers and most public sector employers that have continued to maintain a combination plan structure—a core defined benefit plan with a supplemental set of defined contribution and/or profit sharing arrangements." While the type of

change proposed may be a trend among smaller private sector employers it is not a course of action taken by other larger private and public sector employers.

As a result of the potential to increase turnover and indications the proposed legislation would not successfully address the long term viability of the state retirement fund the Auditor's Office asks that this legislation be given a "do not pass" recommendation.

Madam Chair that would conclude my testimony.