Legislative Council

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RETIREMENT COMMITTEE - STATUTORY DUTIES AND RESPONSIBILITIES FOR THE 2021-22 INTERIM

STATUTORY DUTIES AND RESPONSIBILITIES

Section 1 of House Bill No. 1209 (2021) directs the Legislative Management to develop a plan for new hires under the Public Employees Retirement System (PERS) main system to participate in the defined contribution plan and to close the defined benefit plan to new entries effective January 1, 2024. Upon approval of the Chairman of the Legislative Management, the study may use the services of a third-party contractor to assist in the study.

HISTORY

Original Main System Defined Contribution Plan

In Senate Bill No. 154 (1965), the Legislative Assembly created PERS, effective July 1, 1966, as a defined contribution plan. In Senate Bill No. 2068 (1977), the Legislative Assembly converted the main system retirement plan to a defined benefit plan.

Main System Defined Benefit Plan

The PERS main system defined benefit plan is funded from employer contributions, employee contributions, and investment earnings. Contributions are calculated based on a percentage of gross pay. From 1977 through 1989, the employer contribution was 5.12 percent of state employee salaries and the employee contribution was 4 percent. In lieu of state employee salary increases in 1983 and 1984, the state began to pay the 4 percent employee contribution. In 1989, the employer contribution was reduced by 1 percent and reallocated for a retiree health benefit credit. In January 2012, January 2013, and January 2014, the employer and employee contributions each increased by 1 percent annually. Senate Bill No. 2046 (2019) reallocated the 1.14 percent employer contribution for the retiree health insurance credit to the main system defined benefit retirement plan for employees hired after December 31, 2019. A history of employer and employee contribution rates for the main system defined benefit plan are shown below.

1989 Through December 31, 2011		Effective January 1, 2012		Effective January 1, 2013		Effective January 1, 2014	
Employer	Employee	Employer	Employee	Employer	Employee	Employer	Employee
4.12%	4.00%[1]	5.12%	5.00%[1]	6.12%	6.00%[1]	7.12%[2]	7.00%[1]

[1]The state pays 4 percent of the employee share of retirement contributions.

[2]Senate Bill No. 2046 (2019) reallocated the 1.14 percent employer contribution for the retiree health insurance credit to the main system defined benefit retirement plan for employees hired after December 31, 2019, resulting in a total employer contribution rate of 8.26 percent for employees hired after December 31, 2019.

Benefit Levels and Recent Changes in Benefit Calculations

Members of the main system retirement plan are eligible for a normal service retirement benefit at age 65. For employees hired prior to January 1, 2016, employees are also eligible for retirement when age plus years of service is equal to 85 (commonly known as the "Rule of 85"). For employees hired on or after January 1, 2016, employees are eligible for retirement when age plus years of service is equal to 90 (commonly known as the "Rule of 90") and the member attains a minimum age of sixty.

Retirement benefits under the defined benefit plan are calculated using the following mathematical formula provided in North Dakota Century Code Section 54-52-17(4):

Final average salary[1] x benefit multiplier[2] x years of service credit[3] = monthly single life retirement benefit.
[1]For employees who retired prior to August 1, 2010, the final average salary was the average of an employee's highest salaries in 36 of the last 120 months worked. For employees who terminate employment on or after August 1, 2010, but before January 1, 2020, it is the average of the employee's highest salaries in 36 of the last 180 months worked. For employees who terminate employment on or after January 1, 2020, it is the average of the employee's highest three 12 consecutive month periods of the last 180 months worked.
[2]The benefit multiplier is the rate at which benefits are earned. For defined benefit members enrolled before January 1, 2020, the benefit multiplier is 2 percent. For members enrolled after December 31, 2019, the benefit multiplier is 1.75 percent.
[3]The service credit is the amount of public service an employee has accumulated under PERS for retirement purposes.

The following is a summary of benefit changes approved by the Legislative Assembly since 1977:

Year	Benefit Multiplier	Change in Retirement Rule Levels
July 1977	1.04%	
July 1983	1.20%	
July 1985	1.30%	Rule of 90 established as an alternative for retirement eligibility
July 1987	1.50%	
July 1989	1.65%	
July 1991	1.69%	
August 1993	1.725%	Rule of 90 changed to Rule of 88
January 1994	1.74%	
August 1997	1.77%	Rule of 88 changed to Rule of 85
August 1999	1.89%	
August 2001	2.00%	
January 2016	2.00%	Rule of 85 changed to Rule of 90 for employees hired after December 31, 2015
January 2020	1.75%	Benefit multiplier of 1.75 percent for members enrolled after December 31, 2019, but remains 2 percent for members enrolled before January 1, 2020

Similar adjustments were made to the benefit calculations of members who retired before the above changes were made. Benefits were increased in amounts that equaled the benefit multiplier changes. In addition, retirees received a 13th check in 2006 and 2008. In 2006 the 13th check was equal to one-half of the retiree's normal monthly check and in 2008 the 13th check was equal to three-fourths of the retiree's normal monthly check.

Funded Ratio

The actuarial funded ratio is the percentage of the retirement fund's actuarial value of assets to its actuarial accrued liabilities. The actuarial value of assets is determined by spreading market appreciation or depreciation over 5 years. This procedure results in recognition of all changes in market value over 5 years.

The schedule below shows the actuarial assets and liabilities of the main system defined benefit plan since 2000.

Fiscal Year	Actuarial Assets	Actuarial Liabilities	Actuarial Surplus or (Unfunded Liability)	Actuarial Funded Ratio
2000	$1,009,744,796	$879,189,877	$130,554,919	114.8%
2001	$1,096,115,648	$993,851,809	$102,263,839	110.3%
2002	$1,129,697,099	$1,087,003,336	$42,693,763	103.9%
2003	$1,145,284,302	$1,170,477,887	($25,193,585)	97.8%
2004	$1,172,258,036	$1,250,849,240	($78,591,204)	93.7%
2005	$1,210,287,848	$1,333,491,341	($123,203,493)	90.8%
2006	$1,286,478,642	$1,450,113,412	($163,634,770)	88.7%
2007	$1,470,367,098	$1,575,666,628	($105,299,530)	93.3%
2008	$1,571,159,912	$1,700,171,588	($129,011,676)	92.4%
2009	$1,577,552,012	$1,861,032,305	($283,480,293)	84.8%
2010	$1,576,794,397	$2,156,560,553	($579,766,156)	73.1%
2011	$1,603,718,656	$2,284,199,019	($680,480,363)	70.2%
2012	$1,579,933,179	$2,442,299,210	($862,366,031)	64.7%
2013	$1,632,915,720	$2,650,525,018	($1,017,609,298)	61.6%
2014	$1,837,902,845	$2,866,511,290	($1,028,608,445)	64.1%
2015	$2,027,476,214	$2,976,071,808	($948,595,594)	68.1%
2016	$2,180,748,616	$3,299,381,100	($1,118,632,484)	66.1%
2017	$2,529,631,008	$3,618,083,973	($1,088,452,965)	69.9%
2018	$2,752,053,305	$3,841,701,179	($1,089,647,874)	71.6%
2019	$2,949,967,049	$4,136,252,987	($1,186,285,938)	71.3%
2020	$3,112,920,033	$4,557,679,020	($1,444,758,987)	68.3%

The actuarial unfunded liability of the main system defined benefit plan as of July 1, 2020, was $1.445 billion. Using the most recent net pension liability data available, it is estimated that the state portion of the unfunded liability is approximately 50.1 percent of the total while 49.9 percent is attributable to political subdivisions. Therefore, the estimated state portion of the unfunded liability is approximately $723.2 million as of July 1, 2020.

Participation of Political Subdivisions

The schedule below shows the number of state agencies and political subdivisions participating in the PERS retirement plan since 2012.

PERS Retirement Participating Employers[1]									
	2012	2013	2014	2015	2016	2017	2018	2019	2020
State agencies	93	93	94	94	95	95	95	94	95
Counties	49	49	49	49	50	50	50	50	52
Cities	81	81	82	85	86	87	87	89	92
School districts	112	114	116	119	119	121	121	123	127
Other[2]	70	73	74	76	77	78	82	83	81
Subdivision subtotal	312	317	321	329	332	336	340	345	352
Total	405	410	415	423	427	431	435	439	447

[1]Data presented in this table is as of January of each year.

[2]Other participating political subdivisions include water districts, park districts, and other similar municipalities.

Government Finance Committee - 2013-14 Interim

Pursuant to Section 16 of House Bill No. 1452 (2013), the 2013-14 interim Government Finance Committee was assigned a study of existing and potential state employee retirement plans, including an analysis of defined benefit and defined contribution plans and the feasibility, desirability, and consequences of transitioning to only a state defined contribution plan.

Projected Costs to Close the Defined Benefit Plan to New State Employees

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

The committee received information in March 2014 from The Segal Company, which was the consulting actuary for PERS. Segal reported that if the defined benefit plan was closed to new employees, the state portion of the plan would be able to pay benefits until the year 2046. There would be a projected contribution shortfall of $3,688,100,000 for future benefits to be paid after 2046. However, a payment of $162.8 million could be made to the retirement plan on July 1, 2015, to fully offset the state portion of the future projected contribution shortfall.

The estimated payment of $162.8 million needed to fully fund the state portion of the plan was based on an 8 percent investment return. However, the committee learned the asset allocation of the plan's investments would need to be adjusted near the projected end of the plan to move to more short-term investments, which would potentially reduce the plan's investment return.

Committee Recommendation

The committee recommended Senate Bill No. 2038 (2015) to provide for changes to the main system defined benefit retirement plan. Under the bill, an eligible employee hired for the first time after December 31, 2015, would have been required to enroll in the defined contribution plan under Chapter 54-52.6, rather than the defined benefit plan. The bill was not approved by the 2015 Legislative Assembly.

CURRENT PROJECTIONS TO CLOSE THE DEFINED BENEFIT PLAN

As of March 2021, an actuarial analysis has not been completed related to the potential cost or cost-savings of closing the main system defined benefit retirement plan to new employees. The Public Employees Retirement System has indicated once the plan is closed and new employees will not be contributing to the defined benefit plan, an estimated total of $3 billion is needed to keep the plan solvent until the last current defined benefit member's benefits are paid (similar to the 2013-14 study estimate referred to above). An actuarial analysis would be necessary to provide the most accurate estimates of the cost or cost-savings of closing the main system defined benefit plan to new state employees.

SELECT STATE FUNDS

This section includes information regarding state funds from which funds may be available for transfer to the PERS retirement fund to reduce the main system unfunded liability based on statutory provisions or future legislative action.

Legacy Fund/Legacy Earnings Fund/Legacy Sinking and Interest Fund

In 2010, the voters of North Dakota approved a constitutional amendment to create the legacy fund (Section 26 of Article X of the Constitution of North Dakota). Pursuant to the measure, 30 percent of oil and gas gross production and oil extraction taxes are deposited in the legacy fund.

The measure restricted the expenditure of principal and earnings until after June 30, 2017. Any expenditure of principal requires a vote of at least two-thirds of the members elected to each house of the Legislative Assembly, and the expenditure of principal may not exceed 15 percent of the principal balance of the legacy fund during a biennium. The Legislative Assembly may transfer funds from any source to the legacy fund which become part of the principal of the fund.

The State Investment Board is responsible for investing the principal of the legacy fund. Investment earnings accruing after June 30, 2017, are transferred to the general fund at the end of each biennium. Section 21-10-12 provides a definition for the earnings of the legacy fund. The earnings include interest, dividends, and realized gains and losses, but exclude unrealized gains and losses.

During the budgeting process for the 2017-19 biennium, the 2017 Legislative Assembly included $200 million of estimated legacy fund earnings in the general fund revenue forecast. The 2019 Legislative Assembly revised the general fund revenue forecast for the 2017-19 biennium to include $300 million of estimated legacy fund earnings, an increase of $100 million compared to the original estimate. The 2017-19 biennium earnings of the legacy fund transferred to the general fund at the end of the biennium were $455.26 million.

For the 2019-21 biennium through February 2021, the investment earnings of the legacy fund that are eligible to be transferred to the general fund at the end of the biennium total $736 million. As a part of the 2019 legislative revenue forecast, the Legislative Assembly budgeted for a transfer of $736 million from the legacy fund to the general fund at the end of the 2019-21 biennium. The Office of Management and Budget has reported a preliminary estimate of $872 million of legacy fund earnings to be transferred to the general fund at the end of the 2019-21 biennium.

The Legislative Assembly approved House Bill No. 1380 (2021) establishing a percent of market value calculation to determine the amount of legacy fund earnings available for spending each biennium and creating a legacy earnings fund. The percent of market value is based on 7 percent of the 5-year average of legacy fund assets. The earnings available for spending will be transferred at the end of each biennium to a legacy earnings fund for allocations to special funds and other purposes designated by the Legislative Assembly. Pursuant to provisions of the bill, the first allocation from the legacy earnings fund is to the legacy sinking and interest fund in an amount of up to $150 million per biennium. Money deposited in the legacy sinking and interest fund is first used to make any payments on bonds issued by the Public Finance Authority pursuant to legislative appropriations. Any funds in the legacy sinking and interest fund in excess of the funds needed for the bond payments may be transferred by the State Treasurer to the PERS main system retirement plan if the actuarial funded ratio of the plan is less than 90 percent. Depending on the amount of legacy fund earnings and the required bond payment amount, funds may be available for transfer to the PERS retirement plan during the 2023-25 biennium.

General Fund

The general fund is the chief operating fund of the state. Revenue deposited in the general fund includes money collected from sales and use tax, motor vehicle excise tax, individual and corporate income taxes, oil and gas taxes, coal conversion tax, insurance premium tax, departmental collections, and other sources. The Legislative Assembly appropriates funding from the general fund to various state agencies for the operations of each agency and to provide services to citizens of North Dakota.

The 2021 legislative revenue forecast includes estimated general fund revenue, including the beginning balance, tax and fee revenues, and transfers, of $5,056.54 million for the 2021-23 biennium. The 2021 Legislative Assembly appropriated $4,992.96 million to state agencies for the 2021-23 biennium, resulting in an estimated general fund balance of $63.58 million on June 30, 2023.

Budget Stabilization Fund

In House Bill No. 1596 (1987), the Legislative Assembly enacted Section 54-27.2-01, which established the budget stabilization fund. The section requires any amount in the general fund at the end of a biennium in excess of $65 million to be transferred to the budget stabilization fund, except that the balance in the budget stabilization fund may not exceed 15 percent of the general fund budget approved by the most recently adjourned Legislative Assembly. The budget stabilization fund is used to offset general fund revenue shortfalls if the Governor orders budget allotments. Revenue deposited in the budget stabilization fund includes investment income, oil and gas tax collections, and transfers from the general fund.

Based on the general fund appropriations of $4,992.96 million approved by the 2021 Legislative Assembly, the 15 percent maximum budget stabilization fund balance is $748.94 million for the 2021-23 biennium. The fund is currently at is maximum balance.

Strategic Investment and Improvements Fund

In House Bill No. 1451 (2011), the Legislative Assembly established Section 15-08.1-08, which established the strategic investment and improvements fund. Revenue deposited in the fund is derived from the sale, lease, and management of mineral interests acquired by the Board of University and School Lands and oil and gas tax revenue allocations.

Allowable expenditures of the strategic investment and improvements fund include one-time expenditures relating to improving state infrastructure or for initiatives to improve the efficiency and effectiveness of state government. Funding in the strategic investment and improvements fund may be appropriated by the Legislative Assembly, but only to the extent the money is estimated to be available at the beginning of the biennium in which the appropriations are authorized.

Based on the 2021 legislative revenue forecast, the June 30, 2023, available balance in the strategic investment and improvements fund is estimated to be $544.5 million.

POTENTIAL OPTIONS TO REDUCE THE MAIN SYSTEM UNFUNDED LIABILITY

The following are proposed options to reduce the main system unfunded liability and increase the main system defined benefit plan funded ratio to 100 percent:

1. Provide a one-time transfer from other funds to the PERS retirement fund.
2. Create a new "retirement stabilization fund" to be included in the oil and gas tax revenue allocation formula until the main system defined benefit plan is 100 percent funded. See the *Oil and Gas Tax Revenue Allocation Flowchart - 2021-23 Biennium* for the current oil and gas tax revenue allocation formula.
3. Provide additional allocations of legacy fund earnings to the PERS retirement fund.
4. Increase employer and employee contributions to the main system retirement plan.

One-Time Transfer Option

The following are preliminary estimated effects of providing a one-time transfer to the PERS retirement fund to reduce the main system unfunded liability if there are no changes to the existing retirement plan:

Transfer Amount	Estimated Time to Become 100 Percent Funded	
	Bienniums	Years
$50 million	22	44
$75 million	20	39
$100 million	18	35
$125 million	16	32
$150 million	15	29
$200 million	13	25
$250 million	11	22
$300 million	10	20
$350 million	9	17
$400 million	8	16

"Retirement Stabilization Fund" Option

The following are preliminary estimated effects of providing ongoing transfers to the PERS retirement fund each biennium to reduce the main system unfunded liability if there are no changes to the existing retirement plan:

Biennial Transfer Amount	Estimated Time to Become 100 Percent Funded		Estimated Total State Funds Transferred
	Bienniums	Years	
$10 million	20	40	$200 million
$20 million	16	31	$320 million
$25 million	14	28	$350 million
$30 million	13	26	$390 million
$40 million	12	23	$480 million
$50 million	10	20	$500 million
$75 million	8	16	$600 million
$100 million	7	13	$700 million

Contribution Increase Option

The Legislative Assembly considered Senate Bill No. 2048 (2019) but did not approve the bill. The bill would have increased the employer and employee retirement contributions by 1 percent, resulting in a total employer contribution of 8.12 percent and total employee contribution of 8 percent, of which 4 percent is paid by the state.

The fiscal note for the introduced bill states if the increased contributions began in January 2020, the total state cost for the 2019-21 biennium would be $9 million, of which $3.9 million would be from the general fund and $5.1 million would be from other funds. The total state cost for the 2021-23 biennium would have been $12 million, of which $5.2 million would be from the general fund and $6.8 million would be from other funds. The cost to political subdivisions was estimated to be $7.8 million in the 2019-21 biennium and $10.3 million in the 2021-23 biennium.

An actuarial analysis (appendix) of the introduced bill was conducted by Gabriel, Roeder, and Smith & Company Holdings, Inc., and presented to the Employee Benefits Programs Committee in October 2018. The analysis stated the increased employer and employee contributions would result in the main system defined benefit plan becoming 100 percent funded in 2057, or 37 years after the January 2020 effective date.

Other Considerations

- The transfer calculations in this document are based on the current main system expected investment return of 7.5 percent, the current unfunded liability of $1.19 billion, and funds being transferred at the beginning of the biennium. The calculations do not consider potential changes in expected investment returns, the unfunded liability, the number of employees contributing to the main system, salaries of contributing employees, or contribution rates. Actuarial services would be needed for a complete analysis of these variables for the proposed options in this document.
- This document contains estimated effects of transferring funding to the PERS retirement fund and the estimated effects of separately increasing contributions to the main system plan. The document does not contain estimated effects of transferring funds while also increasing contributions. Actuarial services would be needed for a complete analysis of implementing one or a combination of these options.
- The current unfunded liability of the main system defined benefit plan is $1.445 billion. Of this amount, approximately 50.1 percent is the state responsibility and approximately 49.9 percent is the responsibility of participating political subdivisions. Any transfer of state funds to the PERS retirement fund to reduce the unfunded liability would also benefit participating political subdivisions.
- Transfers to the PERS retirement fund would include funding solely from state sources, while increases in employer and employee contributions would include funding from both state and nonstate sources, including federal funds received by state agencies and contributions from participating political subdivisions.

LEGAL CONSIDERATIONS

The committee is charged with creating a plan to close the defined benefit plan to new hires and route new hires into the defined contribution plan. In addition to funding issues, there are several preliminary legal questions the committee may wish to address in pursuing this charge.

The PERS main system plan is comprised of both state and political subdivision members. In addressing the closure of the defined benefit plan, the committee will need to consider how to treat political subdivision existing employees and new hires. If the plan is only closed to new state hires, the proposal may include a provision to separate the main system plan into a state plan and a local plan. However, there may be federal provisions that limit the ability of the proposal to carve out the local plan or to keep the plan open for political subdivision new hires while closing the plan to state new hires.

Although the study charge appears to be written to route new state hires into the existing defined contribution plan, the committee may wish to make changes to the existing defined contribution plan. Changes may include revision of whether political subdivision employees may be participating members in the defined contribution plan, the employer and employee contribution levels and whether the goal is to have benefits comparable to the defined benefit plan benefits or whether the goal is to have the defined contribution plan contributions comparable to the defined benefit contribution, whether participation is mandatory, whether to provide a window to allow existing defined benefit members to opt into the defined contribution plan, and how to calculate the value of the amount transferred.

Additional matters the proposed plan may need to address include how the retirement plans should treat members who have both state and local contributions and how to treat members who leave state or local employment and return to the state or local employment at a later date.

PROPOSED ACTION PLAN

The following is a proposed action plan the committee may wish to consider in fulfilling its statutory duties:

1. Receive information regarding actuarial estimates from PERS regarding closing the defined benefit plan to new entries effective January 1, 2024.
2. Contract with a third-party contractor to provide actuarial projections for potential changes to the state employee retirement plan and assistance in developing a plan for new hires under the PERS main system to participate in the defined contribution plan and to close the defined benefit plan to new entries effective January 1, 2024.
3. Receive input from political subdivisions, PERS, the Office of Management and Budget's Human Resource Management Services Division, and other state agencies regarding a plan for new hires under the PERS main system to participate in the defined contribution plan and to close the defined benefit plan to new entries effective January 1, 2024.
4. Receive input from the National Conference of State Legislatures and other interested parties regarding what other states have done to fund retirement programs and the impacts of those changes.
5. Receive input from other organizations such as North Dakota United.
6. Develop a plan, recommendations, and related bill drafts.
7. Prepare the final report for submission to the Legislative Management.

ATTACH:1