99396

Prepared by the North Dakota Legislative Council staff for the Employee Benefits Programs Committee
October 1998

PUBLIC EMPLOYEES RETIREMENT PROGRAMS - HISTORY

This memorandum reviews the rationale for establishing a public employees retirement plan, the reasons for converting the plan from a defined contribution plan to a defined benefit plan, changes that were made in the defined contribution plan between 1966 and 1977, and benefit enhancements added to the defined benefit plan since 1977. The memorandum is the result of a question raised by a member of the Employee Benefits Programs Committee at the committee's February 2, 1998, committee meeting concerning the rationale for changing from a money purchase or defined contribution plan to a defined benefit plan in 1977.

DEFINED CONTRIBUTION RETIREMENT PLAN 1966-77

The 1965 Legislative Assembly established a defined contribution or money purchase plan for public employees. The Public Employees Retirement System commenced on July 1, 1966. This system was established to provide a member with a lump sum payment upon retirement.

As noted in the Retirement Portability Study submitted to the Legislative Council's Employee Benefits Programs Committee by the Public Employees Retirement System and Office of Management and Budget, a general characteristic of a money purchase plan is that the costs of participating employers and employees are fixed, though individual benefits will vary. Pursuant to the plan adopted by the Legislative Assembly in 1965, individual retirement accounts were established to receive employer and employee contributions. A participating full-time employee contributed four percent of that person's base salary and the employer contributed four percent of the employee's salary, up to a maximum of $300. These moneys were distributed into three funds--the employee contribution went into the employee fund, three dollars of every four dollars the employer contributed went into a vesting fund, and the remaining one dollar went to the administrative expense and benefit fund. When an employee left state employment, for any reason, that person was entitled to receive 100 percent of the amount contributed from that person's salary plus earnings on that amount. In addition, the employee could receive up to 100 percent of the employer contribution in the vesting fund, plus a percentage of the interest thereon, if the employee retired at age 65 after any length of service, became permanently and totally disabled at any age, or died at any age. If the employee left state employment voluntarily or involuntarily for any reason except these, the employee was entitled to the total employee contribution, the vested portion of the employer account, and earnings thereon. The employee gained a vested interest in the vesting fund based upon a vesting schedule beginning with 20 percent plus 20 percent credited earnings after three years of service with full vesting plus 100 percent of credited earnings after 20 years of service, or 15 years of service after 1975. Within these parameters, the member's accumulated retirement moneys were payable upon termination. If the employee's account balance was significantly large enough to provide a minimum of $100 per month annuity, the employee was able to purchase an annuity through a vendor who was under contract with the retirement board.

The Public Employees Retirement System was created by 1965 Senate Bill No. 164. The bill provided that the Act was designed to provide for the general welfare of state employees and that the retirement system was designed to provide for the payment of benefits to state employees or to their beneficiaries thereby enabling the employees to care for themselves and their dependents. The bill also stated that the retirement plan would improve state employment, reduce excessive personnel turnover, and offer career employment to high-grade men and women.

At the Senate Industry, Business and Labor Committee hearing on the bill, the prime sponsor testified that the legislation would give public employees an "opportunity to plan for their retirement and when they do retire they would have a sufficient amount of money to live and be a part of their community and reside in their home and not have to go on welfare as so many of our older people do." An agency director noted that a retirement plan would reduce personnel turnover as state employment "has been a training ground for those people and they do not stay long in our state and either go to an outlying state or join the government service." Finally, a representative of a private pension company noted that the plan would be of "great advantage to the state from a financial point of view."

In testimony before the House Labor Committee, proponents noted that the bill "awards employees for their years of service," "will attract and retain skilled employees," "attract better employees," "will help retain them in the state," "will aid in recruiting trained personnel," "the individual can contribute to the retirement himself," and will provide "incentives so these people will stay a long time."

A North Dakota State Employees Association newsletter entitled *A Report on Retirement Program* noted that "retirement planning has two sides and many objectives. The two sides are the employee's interest and the state or employer's interest. The state's interest is an assistance in recruitment, orderly removal of aged and disabled employees from the payroll, and improvement in employee morale. The employee's interest is to increase the opportunities for advancement of younger workers and have a systematic planned approach to their retirement needs." The newsletter stressed that "it was not intended, nor was any attempt made, to provide a pension or equal retirement benefits for all employees at time of retirement. Only in credit for prior service is an exception made and then only to a limited extent." Thus, based upon this language, it does not appear that the Legislative Assembly considered a defined benefit plan at this time.

SIGNIFICANT CHANGES IN THE DEFINED CONTRIBUTION RETIREMENT PLAN 1965-77

In 1969 the Legislative Assembly expanded the Public Employees Retirement System to include employees of political subdivisions. The bill increased the ceiling on the employer's matching contribution from $300 to $500 per year. The 1969 Legislative Assembly also extended membership in the Public Employees Retirement System to noncertified school district employees.

In 1971 the Legislative Assembly extended the Public Employees Retirement System to cover employees of the Garrison Diversion Conservancy District and district health units. In 1973 the Legislative Assembly extended membership in the Public Employees Retirement System to supreme and district court judges and closed the then current retirement system for supreme and district court judges to new members.

In 1975 the Legislative Assembly increased the matching of the four percent of a participating member's salary from $500 to $600 annually. The Legislative Assembly also revised the vesting schedule at this time. It is interesting to note that a representative of the North Dakota State Employees Association testified that North Dakota was the last state that had a money-purchase plan, and the only state that did not have a benefit formula.

The 1975 Legislative Assembly also adopted a resolution to study the Public Employees Retirement System for the purpose of determining the feasibility of a change in the Public Employees Retirement System from a money purchase plan for receiving retirement benefits to a benefit formula plan. The resolution noted that a money purchase retirement benefit plan is subject to cyclical and irregular shifts in the stock and corporate bond markets which can act to the detriment of public employees through reduction in retirement benefits available. The resolution noted that every state in the nation has a public employees retirement program with a benefit formula plan for the receipt of retirement benefits except North Dakota. The resolution also noted that a benefit formula plan offers retirement benefits to employees that are not based upon cyclical and irregular shifts in the stock and corporate bond markets. There are no standing committee minutes for the resolution, but the legislative history does contain a letter from then Governor Link to Senator Kent Jones who was chairman of the Senate State and Federal Government Committee at the time. In his letter the Governor noted that:

> After working with the model personnel system this past year and after witnessing the problems in implementing the deferred compensation program enacted by the past session, I became acutely aware of the inadequacy of the numerous retirement programs for state employees. To provide state employees with deserved and adequate retirement income, and to improve employee retention rates, it is necessary to enact sound retirement programs. The Legislative Assembly should study both the possibility of incorporating the benefit-formula plan into the North Dakota Retirement Program, and it should study the entire retirement program for the possibility of integrating the numerous existing programs into one comprehensive state system.

1975-76 PUBLIC EMPLOYEES RETIREMENT SYSTEM STUDY

Following adoption of 1975 Senate Concurrent Resolution No. 4025, the Legislative Council assigned a study of the Public Employees Retirement System to the State and Federal Government Committee. The committee compared money purchase and benefit-formula type plans, reviewed the current law, and proposed a final average salary plan.

The report of the State and Federal Government Committee noted that there are several significant differences between a money purchase type plan and a benefit-formula type retirement plan. Under a money purchase plan, the employer's and employee's cost is fixed while benefits vary. Under a final average salary plan, the benefits are fixed by formula, the employee's cost is fixed by statute, and the employer becomes responsible to see that sufficient funds are made available to provide the benefits. Under the money purchase type plan, upon buying an annuity, the employee's monthly lifetime benefit payments are determined by the value of the fund at the time, and only at the time, when that employee leaves state or political subdivision employment.

Since retirement benefits available to employees are subject to change because of fluctuations in the stock and corporate bond markets, employees are uncertain of their retirement benefits. Under a benefit-formula type plan, benefits are not directly affected by the fluctuation in the stock and corporate bond markets. Under a final average salary benefit-formula plan, the benefit produced is the product of a percentage factor applied to the member's years of service and the salary basis specified in the benefit-formula. Percentage factors generally range from one to two percent. A final average salary plan recognizes salary increases over the working life of the employee and thus relates benefits to economic conditions at the time of retirement. In addition, final average salary benefit-formulas reward employees who realize steep progression in salary and may thereby encourage long-term service and provide incentive for improved performance. Thus, the report indicated that one of the reasons for converting the defined contribution plan to a defined benefit plan was to encourage career employees to remain in state employment.

An assistant attorney general assigned to the retirement board testified that the defined benefit plan was a fairer method, and one of the purposes of the state retirement program is to encourage longevity of state employment. A representative of the North Dakota State Employees Association testified that the present plan was insufficient and contained no recognition of long-term employees. He noted that a good retirement plan should be a tool for encouraging people to stay in the service of the state. The State Health Officer testified that the defined benefit plan is an investment by the Legislative Assembly in good quality government and good quality state employees. He said it is a program that over the years will improve the quality of state government and state services. He said the quality of the people working for the state is outstanding, and there will be greater demands for employees in the state in the private sector with the development that is going on. He said the state is competing with the private industry for good people who will stay with the government over a period of time. He said salary and long-term benefits are what employees look at, and the bill would be able to keep the employees who have become trained by the departments instead of having them hired away.

The personnel director for the State Department of Health testified at the Senate State and Federal Government Committee hearing that the department was having difficulty in getting professional people, and a good retirement system could be a determining factor in helping to get these people. He said the department would like to maintain the good employees it has instead of training them and then having them look elsewhere for jobs. The superintendent of the Grafton State School and San Haven State Hospital testified that the current money purchase plan made it difficult to hire career employees. However, the Williston city assessor testified that a retirement system does not encourage employees to make a career of service to the state. A member of the retirement board alluded to the problems with the defined contribution plan when he testified that if the defined benefit bill failed the types of investments allowed under the current plan should be restricted. A representative of the Martin E. Segal Company, the actuary retained by the retirement board, testified that the defined benefit bill would create a retirement program while the money purchase plan in effect at the time was not a retirement program. He said the object is to reward those who make a career of state service and not to reward short-termers. He said the object of the defined benefit plan was to allow state employees to retire and maintain the same standard of living to which they were accustomed. He said the best way to do that was to relate the retirement income to the employee's earnings close to the time of retirement. He said the current money purchase plan did not relate to the employee's standard of living and that made the two difficult to compare. Another representative of the Martin E. Segal Company noted that the new defined benefit plan was designed to reduce turnover while the current defined contribution plan encouraged turnover because it was a source of funds when employees needed them.

The president of the North Dakota State Employees Association testified at the House State and Federal Government Committee hearing on 1977 Senate Bill No. 2068 that the present retirement plan encouraged turnover in state employment by allowing for early withdrawal of the employer's contribution towards retirement. He said it is a gamble for those retiring in that the level of benefits received by the retiring employee is a direct corollary of the market value of the fund. Thus, he said, if the stock market is depressed at the point in time that an individual retires, the retiring employee bears the brunt of that reversal. Because of the uncertain nature of the anticipated benefit, individual employees cannot adequately plan for their retirement years, he said. Also, he said, if an employee becomes permanently disabled before retirement, the employee only has one lump sum payment to look forward to as a hedge against future expenses. He said among those most harmed by the present inequities of the money purchase plan are those who are now retiring or are slated to retire in the near future. Because the present plan has been in effect a scant ten years, he said, it limits the amount of employer contributions, and there are a number of individual retirees who will experience only the most meager retirement incomes. He said monthly retirement benefits of from $30 to $50 per month or less are not uncommon among currently retired or retiring employees. He said it was not the State Employees Association's intent that state employees retire from the state service so that the state can pay for them on the state's relief roles. Yet, he said, for many retiring state employees such a possibility is not all that remote. He said that the State Employees Association believes that conversion of the present plan to a benefit-formula plan would have the net long-term effect of reducing turnover in state employment. He said that the manner in which benefits are provided for under the bill would encourage employees to make a career of state employment. He testified that the proposed new retirement plan would prove to be an incentive for attracting qualified talent to the state service and for retaining such individuals.

He summarized the position of the North Dakota State Employees Association that the proposed new retirement plan (1) would accomplish a decent retirement income for retiring individuals free from the vagaries and uncertainties of the stock market and allow employees to plan adequately for their retirement; (2) would allow those employees currently retiring or retiring in the next ten years to retire with a sense of dignity and with a retirement income that is a form of recognition of their dedicated service to the state; and (3) would promote career employment in the state service and serve to attract qualified young talent into the state's service.

BENEFIT ENHANCEMENTS UNDER THE DEFINED BENEFIT RETIREMENT PLAN 1977-97

Date	Benefit Multiplier
7/1/77	1.04
7/1/83	1.20
7/1/85	1.30 (Benefits increased by 8.33 percent for retirees) (Rule of 90 implemented)
7/1/87	1.50 (Benefits increased by 15.4 percent for retirees)
7/1/89	1.65 (Benefits increased by 15.76 percent for retirees) (Vesting reduced from 10 years to 5 years or age 65)
7/1/91	1.69 (Benefits increased by 2.42 percent for retirees)
8/1/93	1.725 (Benefits increased by 2 percent for retirees) (Rule of 88 implemented)
1/1/94	1.74 (Benefits increased by 1 percent for retirees)
8/1/97	1.77 (Benefits increased by 5 percent for retirees) (Rule of 85 implemented)

These benefit increases or enhancements have been funded from the positive investment results of the Public Employees Retirement System fund or other positive experience results. The Legislative Assembly has not increased employer or employee contributions to fund benefits and in fact reduced the employer contribution from 5.12 percent of salary to 4.12 percent of salary in 1989. The one percent reduction in the employer contribution to the Public Employees Retirement System fund was used to fund the retiree health benefits fund.