NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

EMPLOYEE BENEFITS PROGRAMS COMMITTEE

Wednesday, November 14, 2007
Harvest Room, State Capitol
Bismarck, North Dakota

Representative Bette Grande, Chairman, called the meeting to order at 9:00 a.m.

Members present: Representatives Bette Grande, Eliot Glassheim, Matthew M. Klein, Joe Kroeber; Senators Ralph L. Kilzer, Karen K. Krebsbach, Curtis Olafson, Harvey D. Tallackson

Member absent: Representative Jim Kasper

Others present: See Appendix A

It was moved by Representative Klein, seconded by Representative Glassheim, and carried on a voice vote that the minutes of the August 21, 2007, meeting be approved as distributed.

VALUATIONS OF RETIREMENT, INSURANCE, AND RETIREE HEALTH INSURANCE PROGRAMS

Chairman Grande called on Mr. Chris Conradi, Enrolled Actuary and Senior Consultant, Gabriel, Roeder, Smith and Company, Dallas, Texas, to present the July 1, 2007, actuarial valuation of the Teachers' Fund for Retirement (TFFR). A copy of the slides used by Mr. Conradi in his PowerPoint presentation is attached as Appendix B and a copy of the actuarial valuation report of TFFR is on file in the Legislative Council office.

Mr. Conradi said the actuarial valuation was prepared as of July 1, 2007, using member data, financial data, benefit and contributions provisions, and actuarial assumptions and methods. He said the purposes of an actuarial valuation are to measure the actuarial liabilities of the affected system, determine the adequacy of current statutory contributions, provide other information for GASB No. 25 and comprehensive annual financial reporting requirements, explain changes in the actuarial condition of the system, track changes over time, and warn about possible future problems and issues. He noted that the 2007 Legislative Assembly enacted legislation affecting TFFR. He said the legislation established a new benefit tier for members hired on or after July 1, 2008, with a Rule of 90 for these members. He said the new legislation also establishes a five-year vesting requirement and a five-year averaging requirement for determination of final average salary. He said the employer contribution rate will increase from 7.75 percent to 8.25 percent on July 1, 2008. He said this contribution rate increase will sunset and the contribution rate will return to 7.75 percent when the fund is 90 percent funded. Also, he said, effective July 1, 2007, employer contributions are required for retirees who have returned to work in a covered position.

Concerning membership in TFFR, Mr. Conradi said the number of active members increased from 9,585 on July 1, 2006, to 9,599 on July 1, 2007. He said the payroll for active members increased 2.9 percent, from $390.1 million on July 1, 2006, to $401.3 million on July 1, 2007. He said payroll has increased an average of 3.2 percent per year over the last 10 years. He said the average pay for active members increased 2.7 percent, from $40,703 on July 1, 2006, to $41,810 on July 1, 2007. He said the average age of active members is 44.7, compared to 44.8 last year and 43.4 ten years ago. He said the average years of service is 14.5, compared to 14.6 last year and 14 ten years ago. He said there are also 1,429 inactive vested members and 142 inactive nonvested members.

In response to a question from Representative Klein, Mr. Conradi said the 142 inactive nonvested members are individuals who intend to withdraw but still appeared on the fund records as of July 1, 2007, or are short-term members who intend to return to teaching at a later date.

In response to a question from Representative Glassheim, Mr. Conradi said TFFR would provide information on the census projections showing school-age population over the next 15 to 20 years at a future committee meeting.

Mr. Conradi said the number of retirees increased from 5,893 on July 1, 2006, to 6,077 on July 1, 2007, an increase of 184 or 3.1 percent. He said the average annual retiree benefit is $17,207 and there are 1.6 active members for each retiree.

Concerning assets, Mr. Conradi said the fair market value increased from $1,720,000,000 on June 30, 2006, to $2,030,000,000 on June 30, 2007. He said the net external cashflow, contributions less benefits and refunds, was -$38.3 million or -1.9 percent of market value of assets at the end of the year. He said a negative net external cashflow is not a problem for a mature pension plan such as TFFR and it is expected that benefit payments will exceed contributions in a mature pension plan as investment earnings supplement contributions to pay benefits and refunds. He said the return on the market value of assets was 20.4 percent in fiscal year 2007 as compared to 14.6 percent in fiscal year 2006.

He said the average return for the last 10 years has been 8.5 percent which is above the 8 percent actuarial assumed investment rate of return. He said the 15-year average return has been 9.8 percent. He said although the actuarial consultant calculates a market value, all actuarial calculations, including the funding ratio, the annual contribution requirement, and margin, are based on the actuarial valuation of assets. He said the actuarial value reflects 20 percent of the difference between last year's expected return on market and the actuarial return. He said this phases in the gains over the 8 percent actuarial assumed rate of return or losses below the 8 percent actuarial assumed rate of return over a five-year period. He said the actuarial value is an artificial value but it smoothes out the results over a five-year period. He said the actuarial value of TFFR is $1,750,000,000 as compared to $1,564,000,000 last year. He said the actuarial rate of return for fiscal year 2007 was 14.4 percent as compared to the market value of rate of return of 20.4 percent. He said the actuarial value is 86 percent of fair market value and was 91 percent last year. He said there are $278,600,000 in deferred gains that are not yet recognized in the actuarial value. He said contributions into TFFR were $66,400,000 for the year ending June 30, 2007, as compared to $65,600,000 for the previous year. He said benefits and refunds were $104,700,000 for the year ending June 30, 2007, as compared to $96,000,000 for the previous year. Although the contributions versus benefits and refunds gap appears to be widening, he said, it is still very small and is indicative of a mature pension plan.

Concerning the actuarial results of the July 1, 2007, actuarial valuation of TFFR, Mr. Conradi said the unfunded actuarial accrued liability decreased from $509,900,000 to $459,200,000. He said the funded ratio, the actuarial assets divided by the actuarial accrued liability, increased from 75.4 percent to 79.2 percent. He said the funded ratio using the market value of assets is 91.9 percent, up from 83 percent. He said the unfunded actuarial accrued liability is 114.4 percent of covered payroll, as compared to 130.7 percent last year. He said the annual required contribution level is 10.15 percent and the employer statutory contribution rate is 7.75 percent. Thus, he said, the margin is a negative 2.4 percent. He said this compares to a negative 4.54 percent margin for the previous valuation. He said the funding period based on the 7.75 percent employer contribution rate remains infinite and the 5.24 percent amortization payment is not sufficient.

Concerning next year, Mr. Conradi noted the 8.25 percent employer contribution rate will commence and $280 million in deferred asset gains will be available to be recognized over the next four years, unless needed to offset future investment losses. He said TFFR projections show increases in funded ratios, decreases in unfunded actuarial accrued liability, and a decreasing negative margin that turns positive in 2009.

In response to a question from Representative Klein, Mr. Conradi said the employer contribution rate of 8.25 percent will return to 7.75 percent when the ratio of the actuarial value of assets to the actuarial accrued liability increases to 90 percent based upon the actuarial value of assets.

Comparing TFFR to other public pension plans, Mr. Conradi said the average funded ratio for large public retirement systems is 85.8 percent. He said the funded ratio for TFFR as of July 1, 2007, was 79.2 percent and 75.4 percent on July 1, 2006. He said the fund's 7.75 employee contribution rate is among the highest for public pension plans with those with a higher contribution rate not covered by Social Security. He said the median employee contribution rate for plans covered by Social Security is 5 percent. He said the fund's 7.75 percent or 8.25 percent employer contribution rate is slightly below average with the median for plans covered by Social Security at 8.5 percent. He said TFFR benefits are generally comparable to other statewide teacher plans with a 2 percent multiplier slightly above average. He said the median multiplier for plans covered by Social Security is 1.85 percent. He said the Rule of 85 is mainstream but about three-fourths of statewide plans provide for an automatic cost-of-living adjustment to retirees while TFFR does not.

At the request of Chairman Grande, committee counsel distributed a memorandum from Ms. Fay Kopp, Deputy Executive Director, Retirement and Investment Office and Teachers' Fund for Retirement, summarizing TFFR retirement plan changes since 1979 and a summary of the number of employees who have transferred from TFFR to the Public Employees Retirement System (PERS) under various legislative measures enacted since 1999, a copy of which is attached as Appendix C. Committee counsel also distributed a memorandum from Ms. Kopp concerning the number of special education teachers and student enrollment figures, a copy of which is attached as Appendix D.

Chairman Grande recognized Ms. Janet Welk, Executive Director, Education Standards and Practices Board. A copy of Ms. Welk's written comments and materials is attached as Appendix E. Ms. Welk discussed the determination of the critical shortage areas exception for defining retirees returning to work under TFFR.

Chairman Grande requested that representatives of the Department of Public Instruction be invited to attend a future meeting to discuss distance-learning initiatives developed by the department.

Chairman Grande recognized Mr. Michael Moehle, FSA, MAAA EA, Vice President and Consulting Actuary, The Segel Company, San Francisco, California. Mr. Moehle presented the July 1, 2007, actuarial valuations of the PERS main system, judges' retirement fund, National Guard retirement fund, Highway Patrolmen's retirement fund, retiree health benefits fund, and Job Service retirement plan. A copy of the slides used in his PowerPoint presentation is attached as Appendix F and a copy of the slides used in his PowerPoint presentation concerning 2007 projections for PERS is attached as Appendix G. A copy of the actuarial report is on file in the Legislative Council office.

Mr. Moehle said the judges', National Guard, Highway Patrolmen's, and retiree health insurance credit funds have positive contribution margins. However, he said, the main, law enforcement with prior main service, and law enforcement without prior main service plans have negative contribution margins. He said the funded ratio at actuarial value is above 100 percent for the judges', National Guard, and Job Service plans but below 100 percent at actuarial value for the main, retiree health insurance credit fund, law enforcement with prior main service, law enforcement without prior main service, and the Highway Patrolmen's funds. He said the main PERS plan is over 100 percent funded at market value and that the market value exceeds the actuarial value by $388 million. He said there were no changes in the actuarial assumptions. Other than the investment experience gain, he said, there were no other significant gains or losses and the overall funded position has improved since 2006.

In response to a question from Representative Glassheim, Mr. Sparb Collins, Executive Director, Public Employees Retirement System, said of the approximately 18,000 active members in the PERS main system, approximately 9,000 to 10,000 are state employees and the remainder are political subdivision employees.

Concerning the combined July 1, 2007, actuarial valuation for PERS and the Highway Patrolmen's retirement system, Mr. Moehle said the assets of the systems at market value totaled $1.94 billion. He said the rate of return last year was 19.6 percent. He said the actuarial value of assets totaled $1.55 billion which is 80 percent of market value. He said the rate of return on actuarial value was 15.8 percent which is 7.8 percent higher than the 8 percent assumed rate of return. He said the 10-year average rate of return on an actuarial valuation basis equals 8.79 percent and is 8.89 percent on market value.

Mr. Moehle said the employer statutory contribution rate is 4.12 percent and the calculated employer cost rate is 6.08 percent. Thus, he said, the available margin in the main system is -1.96 percent or 4.12 percent - 6.08 percent = a -1.96 percent.

For the judges' retirement system, Mr. Moehle said the employer statutory contribution rate is 14.52 percent and the calculated employer cost rate is 9.31 percent. Thus, he said, the available margin in the judges' retirement system is 5.21 percent or 14.52 percent - 9.31 percent = 5.21 percent. He said the employer contribution rate for the National Guard retirement system is 6.5 percent while the required employer cost rate is 3.53 percent. Thus, he said, the available margin for the National Guard retirement system is 2.97 percent or 6.5 percent - 3.53 percent = 2.97 percent. He said the employer contribution rate for the law enforcement with prior main service plan is 8.31 percent and the required employer cost rate is 12.39 percent. Thus, he said, the available margin is -4.08 percent or 8.31 percent - 12.39 percent = -4.08 percent. He said the contribution margin for the law enforcement with prior main service plan will be reevaluated following an analysis of transfers from the main system. He said the employer contribution rate for the law enforcement without prior main service system is 6.43 percent and the required employee cost rate is 8.5 percent. Thus, he said, the available contribution margin for the law enforcement without prior main service system is -2.07 percent or 6.43 percent - 8.5 percent = -2.07 percent.

Concerning the funded ratio for the main system, Mr. Moehle said it is 93 percent based on the actuarial value of assets and 117 percent based on the market value of assets. He said the funded ratio for the judges' retirement system is 118 percent based on the actuarial value of assets and 145 percent based on the market value of assets. For the National Guard retirement system, he said, the funded ratio based on the actuarial value of assets is 109 percent while the funded ratio based on market value of assets is 136 percent. He said the funded ratio for the law enforcement with prior main service based on the actuarial value of assets is 43 percent while the funded ratio based on market value of assets is 53 percent. He said the funded ratio for the law enforcement without prior main service plan based upon the actuarial value of assets is 35 percent while based upon market value the funded ratio is 43 percent. He said the combined funded ratio for the main, judges', National Guard, and law enforcement retirement systems taken together is 93 percent based upon the actuarial value of assets and 117 percent based upon the market value of assets.

Concerning the retiree health insurance credit fund, Mr. Moehle said the assets of the system at market value total $45.3 million. He said the value of assets, at actuarial value total $38.9 million, which is 85.9 percent of the market value. He said the market value rate of return was 15.91 percent while the actuarial value rate of return was 10.44 percent. He said the actuarial value rate of return was 2.44 percent more than the 8 percent investment return assumption.

In response to a question from Representative Klein, Mr. Collins said the assets of the retiree health insurance credit fund are invested separately because under federal law this plan is not considered a retirement pension plan. Since this fund is quite a bit smaller than the commingled pension funds, he said, this fund is not able to take advantage of the broad diversification of the large pension funds and is also managed a little more conservatively thus accounting for the lower rate of return last year.

Concerning the contribution margin for the retiree health insurance credit fund, Mr. Moehle said the statutory contribution rate is 1 percent while the required employer cost rate is .95 percent. Thus, he said, the available contribution margin is .05 percent or 1 percent - .95 percent = .05 percent. He said the funded ratio for the retiree health insurance credit fund is 45.6 percent based on the actuarial value of assets and 53 percent based upon the market value of assets.

Concerning the Highway Patrolmen's retirement system, Mr. Moehle said the statutory employer contribution rate is 16.7 percent and the required employer cost rate is 15.08 percent. Thus, he said, the available contribution margin for the Highway Patrolmen's retirement system is 1.62 percent or 16.7 percent - 15.08 percent = 1.62 percent. He said the funded ratio of the Highway Patrolmen's retirement system based upon the actuarial value of assets is 93 percent while the funded ratio based on the market value of assets is 117 percent.

Concerning the actuarial valuation of the Job Service retirement plan, Mr. Moehle said this plan is a frozen plan with declining membership. He said the total number of active members declined from 44 to 40 and the average age of active members increased from 55.1 years to 55.5 years of age. He said the funded ratio of the Job Service retirement plan based upon the actuarial value of assets is 106 percent while the funded ratio based upon the market value of assets is 132 percent.

Concerning projected margins for the PERS main system, Mr. Moehle said if the market return for fiscal year 2008 is 18 percent and the market return after fiscal year 2008 is always 8 percent, the available margin would be a negative .23 percent on June 30, 2008, and a positive 3.24 percent on June 30, 2012. If the market return for fiscal year 2008 is 0 percent and the market return after fiscal year 2008 is always 8 percent, he said, the available margin on June 30, 2008, would be a negative 1.45 percent and a negative .77 percent on June 30, 2012. He said if the market return for fiscal year 2008 is 18 percent and the market return after fiscal year is always 9.3 percent, the margin on June 30, 2008, would be a negative .23 percent and a positive 3.92 percent on June 30, 2012. If the market return for fiscal year 2008, is 0 percent, he said, and the market return after 2008 is always 9.3 percent, the margin on June 30, 2008, will be a negative 1.45 percent and a negative .20 percent on June 30, 2012.

Chairman Grande recognized Mr. Collins who reviewed the provisions of 2007 Senate Bill No. 2044. He said the bill provided for an additional payment equal to 75 percent of the January retirement allowance following the fiscal yearend to each eligible retiree in pay status as of that January, excluding judicial retirees and beneficiaries, but including joint and survivor and term certain beneficiaries if the board determines that the fund has obtained a total return on investments of 9.06 percent or higher for the fiscal years ending June 30, 2007, or June 30, 2008. He said the fund achieved a return of over 18 percent and thus the payment will go into effect in January. Concerning the judges' retirement system, he said, Senate Bill No. 2044 provided a 2 percent increase if the Public Employees Retirement System Board determines there is actuarial margin sufficient to pay the increase. He said the cost of this proposal was approximately 4 percent while the return on the judges' retirement system was 5 percent and thus the 2 percent increase will go into effect.

EMPLOYEE BENEFITS STUDY AND RECRUITMENT AND RETENTION BONUS REPORT

At the request of Chairman Grande, committee counsel distributed a memorandum entitled *Employee Benefits Programs Committee Benefits Survey Results*. Committee counsel also distributed a packet of materials concerning state employee benefits prepared by the National Conference of State Legislatures, which is on file in the Legislative Council office.

Chairman Grande recognized Mr. Ken Purdy, Manager, Classification and Compensation, Human Resource Management Services, Office of Management and Budget, who presented the results of a survey of central states relating to the study of employee benefits provided by public employers which are not specifically authorized by law or if authorized by law are not consistent among agencies, a copy of which is attached as Appendix H.

In response to a question from Senator Olafson, Mr. Purdy said in order to participate in the performance bonus program, an agency must have a performance appraisal program in place for at least one year prior to granting bonuses. He said this should not be an issue for agencies because an administrative rule has required agencies to conduct annual performance reviews since 1996. Also, he said, agencies are required to file performance bonus policies with Human Resource Management Services to ensure that there is an established policy in effect on the part of the agency. He said bonuses are limited to $1,000 per employee per biennium and no more than 25 percent of an agency's employees may receive a bonus. He said the performance bonus program is not widely used by state agencies.

In response to a question from Representative Klein, Mr. Purdy said very few employees purchase air time under North Dakota Century Code Section 54-52-29 or Section 54-52.6-09.2. However, he said, many employees make use of the sick leave repurchase provisions under Section 54-52-27.

Mr. Purdy also presented the recruitment and retention bonus report (Appendix I).

Chairman Grande recognized Ms. Laurie Sterioti Hammeren, Director, Human Resource Management Services, Office of Management and Budget. She said the office of Human Resource Management Services has adopted a number of administrative rules that deal with issues identified by the committee in its study of employee benefits provided by public employers which are not specifically authorized by law or if authorized by law are not consistent among agencies. Concerning tuition reimbursement, she said, agencies have internal policy guidelines that govern tuition reimbursement. She said the current system works well in that it provides flexibility for each agency to meet its identified needs and the policies are consistently applied within each agency.

In response to a question from Senator Krebsbach, Ms. Sterioti Hammeren said most of the items contained in the employee survey are covered by administrative rule. She said tuition reimbursement and dues and memberships are not. Thus, she said, the office of Human Resource Management Services may consider adopting a rule that agencies may adopt tuition and dues and membership policies under rules adopted by Human Resource Management Services and file copies of the policies with that agency.

Chairman Grande recognized Ms. Jodee Buhr, Executive Director, North Dakota Public Employees Association. Ms. Buhr said state agencies and employees understand that state agencies have the authority to implement the benefits identified in the survey of employee benefits provided by public employers which are not specifically authorized by law or if authorized by law are not consistent among agencies. She said the ability of state agencies to provide tuition and employee memberships and dues is critical in the retention of state employees. She said the Legislative Assembly should not add additional reporting requirements. She said agencies report on their policies and the Legislative Assembly has oversight of these polices in the state budgeting process and the budget of each state agency must be approved by the Legislative Assembly. Also, she said, state agencies are subject to audit by the State Auditor's office and the Auditor's office would note any noncompliance with state law or rules.

In response to a question from Senator Olafson, Ms. Buhr said she has not received any complaints from state employees that one state employee may be receiving a benefit that another employee is not. She said the North Dakota Public Employees Association encourages agencies to implement recognition, tuition, and bonus programs and make them available to all employees. The one area where she hears complaints, she said, is from tenured employees who see entry-level employees receiving high salaries to attract them to the job. She said tenured employees believe they should be compensated for their years of service and loyalty to the state. She said high salaries to attract new employees leads to competition among state agencies for employees.

STAFF DIRECTIVES

Representative Glassheim requested that representatives of Human Resource Management Services be invited to discuss the issue of flexible programs to retain older workers in the state system at a future committee meeting.

No further business appearing, Chairman Grande adjourned the meeting at 2:30 p.m.

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Jeffrey N. Nelson
Committee Counsel

ATTACH:9