THE 14.5 MILLION DOLLAR TRANSFER

The 1977 Legislative Assembly transferred $14.5 million from the General Fund to the Teachers' Fund for Retirement to "bail out" the Fund. Why was this transfer necessary? This question has been asked by many over the last three to four years. The answer given is ". . . loss of money in the equity market." But is that the correct answer to the question? My research has found that the real reason for the transfer was lost in time.

I am sure that investment in the equity market in the early 1970's had some effect on the need for the transfer. I am also sure that investment in low interest-bearing North Dakota municipal bonds in the 1960's had an effect, but in my opinion a very slight effect. The real reason for the need to transfer that amount of money was because of the increasing unfunded liability and decreasing solvency of the Fund. That condition was brought about by a series of benefit increases that were given the members without funding the cost. Benefit increases result in increased cost to a retirement plan. If these rising costs are not funded by increasing contribution rates, appropriation of general fund dollars, or paid from actuarial margins created by positive plan growth, then an unfunded liability is created or increased. This is exactly what happened to the Teachers' Fund for Retirement between 1965 and 1977.

At the conclusion of fiscal year 1965, the Teachers' Insurance and Retirement Fund (old fund) had an unfunded liability (accrued liability that has not been paid in the past) of $8,834,963. At the end of that same year, the Fund was 82.4% solvent (amount of liability covered by the assets). By the end of fiscal year 1975, the Teachers' Fund for Retirement (current fund) had an unfunded liability of $68,296,000 and was 39% solvent. The following table graphicly shows the road to the need for the general fund monies.

Year	Unfunded Liability	Percent of Solvency
1965 *	$ 8,834,963	82.4%
1969 *	$43,512,891	38%
1974 *	$73,902,376	35%
1975 **	$68,296,000	39%

* From Legislative Council background memorandum on the Teachers' Fund for Retirement, July 1975.

** From report on the Teachers' Fund for Retirement, by Martin E. Segal Co., October 1976.

What happened? Why did the unfunded liability get out of control? The answer is simple. Increases were made to benefits without funding the cost of those increases. The increases included the repealing of the code governing the Teachers' Insurance and Retirement Fund and the creation of a new fund, the Teachers' Fund for Retirement. The following review makes clear how the unfunded liability increased out of control and a need to "bail out" the fund was created by the legislature and the proponents of benefit increases.

June 1984

1965

Legislature enacted minimum annuity at $60 per month to all retired teachers. Retired members under this minimum were given a monthly raise to that amount. The cost to the members and the school districts remained the same:

Member	School District
4% first 8 years - maximum $120	Match to maximum $50
5% next 8 years - maximum $180	4% to maximum $120
6% thereafter - maximum $200	4% to maximum $120

1967

Legislature raised the minimum annuity for all retired members age 70 and over to $100 per month. Required monthly increases were given to eligible members. New retirees could not receive less than $60 per month if they had 25 years in the Fund.

The cost to members and school districts was not changed.

1969

The Legislature lowered the age from 70 to 65 for the $100 minimum annuity. The minimum and maximum annuity amounts for new retirees was raised 25%. The legislature also passed legislation that allowed payment of interest on refunds and members with ten years of credit in North Dakota were allowed to receive a reduced annuity at age 55.

Member costs were changed to 3% of salary to a maximum of $225 and the school district cost was changed to 2% of the teachers salary to a maximum of $150.

An actuarial valuation report written by George Stennes and Associates and dated June 30, 1969, stated:

- Interest assumption on investments - 4½% compounded annually.
- Interest earned for year - 5.25%
- Asset growth of only $730,000 for the entire year (increase in benefits were paid from income not margins -- My comment.)
- "The estimated contribution falls short of even the minimum payment . . . However, an increase in the contributions amounting to about 1.2% of the covered payroll . . . would bring the contribution up to the level needed for 40-year funding."

1971

Legislature repealed 15-39, N.D.C.C. and enacted 15-39.1, N.D.C.C. creating the Teachers' Fund for Retirement. Retirement age increased to age 65 and benefits for new retirees were increased by using the following benefit formula:

> Average monthly salary of 1970-71 x 1% x years taught prior to 1970-71 plus 1.5% of average monthly salary for total salary received after July 1, 1971.

The cost to the members was changed to 4% of salary and to the school districts to 4% of the teachers salary to a maximum of $500.

Members who were vested in the old law retained those rights if their claim was greater than under the new law.

1973

The legislature passed HB 1290 which increased benefits for all retired members who retired prior to July 1, 1971. These members were allowed to choose one of the following options:

- Have benefits recalculated under the 1971 Formula by making a one-time payment.
- Have retirement annuity increased by 20%.
- If the member had 17 or more years of credit in the Fund, a minimum benefit of $140 per month was paid.

No changes were made to the cost for the members or the school districts.

An actuarial valuation report written by Brown and Flott and dated June 30, 1974 stated:

- Interest assumption on investments - 5% compounded annually.
- Interest earned for year - 6.4%
- The value of the increases under HB 1290 amounted to $11,428,355. The retired members making an election paid $110,852 in one-time payments. This left $11,371,503 unfunded.
- Recommended an additional $1.8 million in additional support needed each year to pay the unfunded liability in 40 years.

A loop hole in the law was discovered allowing members to retire under the old law (15-39.1-03, rights under prior chapter preserved) and making the election of one of the options listed above.

1975

The legislature passed a bill that allowed college teachers under the Fund retiring after July 1, 1971 to come under the 1971 law. They had previously been frozen under the 1967 law. By making a one-time payment, they would be eligible to a benefit based on the following formula:

> 1/12 last salary x 1% x years of service credit less a TIAA-CREF offset.

The legislature also allowed beneficiaries and continuing annuitants of deceased members to elect one of the first two options allowed by HB 1290 in 1973.

There was no change in the cost to members or the school districts.

An actuarial valuation written by Brown and Flott and dated June 30, 1975 stated:

- Interest assumption - 5% compounded annually.

- Interest earned for year - 6.66%

- $1.3 million additional money would be needed each year to pay the unfunded liability in 40 years.

An actuarial valuation written by Brown and Flott and dated June 30, 1976, stated:

- Interest assumption - 5% compounded annually.

- Interest earned for year - 6.29%

- $1.3 million additional support still needed each year to pay the unfunded liability.

The legislature also passed a resolution for a study of the Teachers' Fund for Retirement to determine the actuarial soundness of the Fund. The Martin E. Segal Co. was retained to conduct the study during the 1975-77 interim.

1977

The legislative study report on the Teachers' Fund for Retirement written by Martin E. Segal Co. showed that the Fund had an unfunded liability of $68,296,000 and a solvency rate of 39%. The Martin E. Segal Co. gave five recommendations to the Legislative Council (see attached) for payment of the unfunded liability.

Legislation passed by the 1977 Legislative Assembly established a minimum benefit formula for all Fund members, transferred $14.5 million from the General Fund to the Trust as a one-time payment toward the unfunded liability, and increased the cost to the members and the school districts in order to pay the balance of the unfunded liability in forty years. The cost to the members was set at 5% of salary and for the school districts a matching amount. The maximum amount paid by the school districts was removed.

A note of interest is that both houses of the Legislature voted overwhelmingly to transfer the $14.5 million to the Fund. The vote was: State Senate 49 yes, 0 no; State House 95 yes, 4 no. It was also interesting to note that legislative committee minutes show that committee members rejected the recommendations of the Fund valuation reports and accepted information from constituents and assumed that the Fund was sound and could tolerate benefit increases without jeopardizing the solvency of the Fund.

In my opinion the evidence is quite clear. The transfer of the $14.5 million was necessary to offset the increasing unfunded liability and decreasing solvency of the Fund caused by benefit increases to members from 1965 to 1975. Benefit increases that were not funded by increased costs or offset by margins in the Trust.

SCOTT ENGMANN
Executive Secretary

June 1984

METHODS AVAILABLE TO REMEDY $38 MILLION UNFUNDED LIABILITY

TEACHERS' FUND FOR RETIREMENT

STATE	SCHOOL DISTRICTS	TEACHERS
(LEGISLATIVE COUNCIL) (1) $14.5 millions One-time appropriation from General Fund	1% of Payroll 40 years	1% of Payroll 40 years
(2) $14.5 Millions (see above) plus $750,000 per year, 40 years All from the General Fund	1% of Payroll 40 years	
(3) $2,783,000 per year, 40 years From the General Fund	NOTE: These calculations include an amount sufficient to fund the minimum benefit floor (based upon $6.00 and $7.50 times number of years taught) proposed in HB 1074.	
(4) $14.5 millions one-time appropriation plus $1,630,000 per year, 40 years All from the General Fund		
(5) $38.5 millions one-time appropriation From the General Fund		

Teachers' Fund for Retirement

Average Yield on Investments

June 30, 1965 - 1976

1965	3.4%
1966	2.3%
1967	3.75%
1968	4.89%
1969	5.25%
1970	5.82%
1971	5.8%
1972	5.3%
1973	6.4%
1974	6.45% (Equities 4.8%; fixed income 7.23%)
1975	6.66% (Equities 3.44%; fixed income 7.427%)
1976	6.29%