

October 22, 2010

Rep. Bette Grande, Chairman  
Employee Benefits Programs Committee  
c/o Jeff Nelson  
ND Legislative Council  
State Capitol  
600 East Boulevard  
Bismarck, ND 58505-0360

**Re: Bill 40 (Tier 3 with 1.88% Multiplier)**

Dear Rep. Grande:

As requested, we have reviewed Bill 40 (Bill 10040.0100). This bill would create a third membership tier for the Teachers' Fund for Retirement (TFFR) with lower benefits.

#### **Provisions of Bill**

Members hired on or after July 1, 2011 would belong to this third tier. They would receive benefits similar to those provided to Tier 2 members, but the multiplier used in their benefit formula would be 1.88% rather than 2.00%. A Tier 3 member who retires from TFFR would receive a benefit 6% smaller than a Tier 2 member.

As a reminder, Tier 1 members are those members who joined TFFR before July 1, 2008, and Tier 2 members are those who joined TFFR on or after that date. Both Tier 1 and Tier 2 members who are eligible for retirement receive a benefit equal to 2.00% of their final average salary for each year of service. For Tier 1 members, the final average salary is a three-year average, while for Tier 2 members it is a five-year average. Tier 1 members are eligible for unreduced retirement after reaching the Rule of 85 (age in years plus years of service equals 85), while Tier 2 members are eligible upon reaching the Rule of 90. Both Tier 1 and Tier 2 members are eligible for unreduced retirement at age 65 if they are vested. Tier 1 and Tier 2 members who are not eligible for an unreduced retirement benefit may take an early (reduced) retirement benefit if they are age 55 and vested. The current reduction is 6% for each year the retirement precedes the earlier of age 65 or attainment of the Rule of 85 (Tier 1) or Rule of 90 (Tier 2). Vesting requires three years of service for a Tier 1 member; five years of service for a Tier 2 member.

Except for the 1.88% formula multiplier, Tier 3 members would have the same benefit provisions as Tier 2 members: a five-year Final Average Salary, unreduced retirement eligibility at the Rule of 90, and five-year vesting.

Member and employer contributions are not changed by the bill.

Under the bill, a Tier 1 or Tier 2 member who terminated service, took a refund, and later rejoined TFFR on or after July 1, 2011 would become a Tier 3 member upon reemployment.

### **Actuarial Analysis**

Here is a comparison of some key actuarial measurements as of July 1, 2010:

Item	Current Law	Bill 40	Difference
Normal cost rate	10.57%	10.06%	-0.51%
UAAL	\$795.2 Million	\$818.2 Million	\$23.0 Million
Funded ratio	69.8%	69.2%	-0.6%
Funding period	Infinite	Infinite	NA
GASB ARC	12.79%	12.57%	-0.22%
GASB ARC (dollars)	\$63.1 Million	\$62.0 Million	-\$1.1 Million

In summary, the total normal cost rate would decrease from 10.57% to 10.06%, the Actuarial Required Contribution (ARC) would decrease from 12.79% to 12.57%, and the funded status would decrease by 0.6% to 69.2%. However, even with the changes proposed in this legislation, the statutory contribution rate of 8.75%, for FY 2011, is still projected to be insufficient to ever fully fund the retirement system.

The measurements shown in the above table and the attached exhibits include:

**Normal cost rate:** The average cost for a new member, expressed as a level contribution over the member's career, based on the provisions applicable to future hires.

**UAAL:** The unfunded actuarial accrued liability, which is the result of subtracting the actuarial value of assets from the actuarial accrued liability.

**Funded Ratio:** The ratio of the actuarial value of assets to the actuarial accrued liability.

**ARC:** The Annual Required Contribution determined in accordance with Government Accounting Standards Board Statement No. 25 (GASB 25).

It should be noted that the UAAL increases under this bill, even though benefits are being reduced. This anomaly is a byproduct of the actuarial cost method used for TFFR (the Ultimate Entry Age Normal method). The normal cost can be thought of as the cost for a new member. It is determined using the benefit provisions that apply to future Tier 3 members. Since the normal cost is reduced by the legislation, and since the present value of future benefits for current members is unchanged, the actuarial accrued liability increases, by definition. (The actuarial accrued liability is defined as the actuarial present value of future benefits for current members, less the present value of future normal costs. When the normal cost decreases, but the present value of future benefits is unchanged, the actuarial accrued liability must increase.) However, the decrease in the plan's funded status is less important than the decrease in the plan's future normal cost. This is why, despite the decrease

in the plan's funded status, the ARC is reduced by 0.22% due to the legislation. By reducing the normal cost, more of the employer contribution rate is available to amortize the unfunded actuarial accrued liability.

### **Technical Comments**

We have not identified any legal, regulatory or compliance issues raised by the bill. We are not aware of any conflicts between federal pension law and the bill.

Adding a third tier does add to the costs and complications of administration and makes communications with members more cumbersome. Schools could have members under four different sets of benefits:

- Tier 1 TFFR members (members joining before July 1, 2008)
- Tier 2 TFFR members (members joining on or after July 1, 2008)
- Tier 3 TFFR members (proposed: members joining on or after July 1, 2011)
- Noncertified support personnel covered under some other plan, in most cases the Public Employees Retirement System

This could make negotiations between the districts and member groups more involved.

### **Basis of Calculations**

The cost analysis was based on the same member and financial data used to prepare the actuarial valuation as of July 1, 2010. There were no changes to any actuarial assumptions or methods from those used to perform the actuarial valuation of the TFFR as of June 30, 2010.

### **General Comments**

In the event that more than one plan change is being considered, it is very important to remember that the results of separate actuarial valuations cannot generally be added together to produce a correct estimate of the combined effect of all of the changes. The total can be considerably greater than the sum of the parts due to the interaction of various plan provisions with each other, and with the assumptions that must be used.

Our calculations are based upon assumptions regarding future events, which may or may not materialize. Please bear in mind that actual results could deviate significantly from our projections, depending on actual plan experience.

Nothing in this letter should be construed as providing legal, investment or tax advice. We certify that the undersigned are members of the American Academy of Actuaries and that we meet all of the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein. No statement in this letter is intended to be interpreted as a recommendation in favor of the change or in opposition to it.

Rep. Bette Grande, Chairman

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If you have any questions, or require any additional or clarifying information, please do not hesitate to contact either one of the undersigned.

Sincerely,

A handwritten signature in cursive script, reading "Daniel J. White".

Daniel J. White, FSA, MAAA, EA  
Senior Consultant

A handwritten signature in cursive script, reading "J. Christian Conradi".

J. Christian Conradi, ASA, MAAA, EA  
Senior Consultant

Enclosure

cc: Ms. Fay Kopp, Deputy Executive Director, ND Retirement and Investment Office

*J:\2039\2010\Leg\Study Bill 40 (Tier 3 1.88%)\Bill40 Impact Analysis.docx*