LEGISLATIVE EMPLOYEE BENEFITS PROGRAMS COMMITTEE
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TFFR Legislative Proposal – Bill No. 54

The TFFR Board has submitted Bill No. 54 for study. As fiduciaries of the trust fund, the Board is proposing changes designed to keep TFFR financially strong and sustainable for past, present, and future ND educators. TFFR's funding situation has been reviewed with this Committee at previous meetings, most recently in October 2009 when the actuary presented TFFR's 2009 annual actuarial valuation report and future funding projections. I will briefly highlight TFFR's funding challenge and study of funding improvement options as background for TFFR's legislative proposals.

TFFR's Funding Challenge and Funding Improvement Study

TFFR faces a significant funding challenge as a result of the 2008-09 financial market down turn. As explained previously, sharp drops in global investment markets resulted in significant losses for all investors, large and small. Markets had this kind of effect on retirement plans around the country (individual, corporate, and public plans). Without action, TFFR's funded level is expected to decline from its 2009 level of 78% to about 50% within the next 5 years, and steadily deteriorate in the future.

Assuming variable investment returns for the 2009-10 fiscal year, plus 8% returns in the future, Chart 1 shows projected TFFR funding levels if no changes are made. At this time, current estimated fiscal year to date investment performance is over 20%. As you can see from Chart 1, even with a 16% - 24% return this year, and 8% returns every year in the future, TFFR funding levels are projected to decline to unacceptable levels. So while current market recovery is very good news, it still will not change TFFR's long term funding projections much.

TFFR's challenge then is to stop this downward trend, stabilize funding, and over the long-term, improve funding levels.

The TFFR Board, along with representatives from the ND Education Association (NDEA), ND Council of Educational Leaders (NDCEL), ND School Boards Association (NDSBA), and ND Retired Teachers Association (NDRTA), have spent the last year studying numerous options to offset investment losses and address declining funding levels. Options considered include: (1) investment performance over 8% assumed return; (2) increasing contributions; (3) reducing benefits; (4) state general fund; (5) and a combined approach.

The Study Group discussed in depth the advantages and disadvantages of various alternatives, analyzed actuarial, legal, financial, and policy issues, and seriously considered the impact on members, employers, and the State. The Group focused on developing proposals which would reflect the following core principles:

- Restore the financial health of the TFFR plan.
- Maintain adequate retirement security for ND educators.
- Share responsibility for funding improvement with employees, employers, and the State.
- Phase changes over time.
- Protect benefits of those employees closest to retirement.

Additionally, during 2009, the TFFR Board's actuarial consultant conducted an Experience Study to review actuarial assumptions and methods being used. This study is done every 5 years. As a result of the study, the Board approved changes to certain assumptions to reflect more recent plan experience, primarily those assumptions related to mortality rates, retirement rates, and salary increase rates. The total impact of these changes amounted to an increase of about $65 million to TFFR's unfunded liability which will be reflected in the 2010 actuarial report.

Bill No. 54 - Base Funding Improvements

In general, changes included in Bill No. 54 are designed to improve TFFR funding levels over the long-term by increasing employee, employer, and re-employed retiree contributions. It also reduces future liabilities by raising the retirement age for unreduced benefits and increasing the early retirement reduction factor for reduced benefits for nonretired employees who are more than 10 years away from retirement under special grandfathering criteria.

I will review each section of Bill No. 54, but would like to begin with Section 2, as Sections 1, 3, and 4 are closely related and should be discussed together.

SECTION 2. NDCC 15-39.1-09 Membership in fund and assessments

Under current statutes, employee contribution rates are 7.75% of salary and employer contribution rates are 8.75% (effective 7/1/10). Bill No. 54 would increase contribution rates for all employees and employers a total of 8%, shared equally between employees (4%) and employers (4%). The rate increases would be phased in over two bienniums as follows:

	Current 7/1/10	**Proposed 7/1/12**	**Proposed 7/1/14**
Employee	7.75%	9.75%	11.75%
Employer	8.75%	10.75%	12.75%

Under this proposal, employee and employer contribution rates would be effective until TFFR reaches 90% funded level on an actuarial basis at which time employee and employer contribution rates would be reduced to 7.75% each. These were the rates in effect prior to 7/1/07.

In dollar terms, employee and employer contribution increases are estimated to increase TFFR revenues more than $40 million each year after rate increases are phased in ($20 million employee + $20 million employer). Contribution amounts are estimated at $5 million for every 1% increase in TFFR contribution rates and based on current total employee salaries; total contribution amounts will differ based on actual total employee salaries for any given year.

SECTION 1. NDCC 15-39.1-04 (14 and 15) Definitions:

TFFR currently has two tiers of participating members. Tier 1 employees are those who were members of the system prior to 6/30/08. Tier 2 employees are those who began TFFR participation after 6/30/08. The differences in the two tiers relate to their eligibility for and calculation of retirement benefits. Tier 1 employees can retire when they reach the Rule of 85, 3 year vesting, and 3 year final average salary calculation. Tier 2 employees can retire when they reach the Rule of 90, 5 year vesting, and 5 year final average salary calculation. Both membership tiers use the multiplier of 2.0% X years of service credit X final average salary in calculating retirement benefits.

Section 1 creates two new definitions for grandfathered and non-grandfathered Tier 1 members. The intent is to "grandfather" or protect those Tier 1 members who are within 10 years of retirement eligibility and allow them to remain under current retirement eligibility provisions. Approximately 3,500 employees would be grandfathered, and would therefore not be affected by unreduced and reduced retirement benefit eligibility changes described in sections 3 and 4. Non-grandfathered Tier 1 members, Tier 2 employees, and future employees would be affected by such changes. To identify which employees are within 10 years of retirement eligibility, grandfathering criteria would be established as follows:

> 14. A Tier 1 grandfathered member is one who, as of 6/30/13, is vested (3 years of service credit) and (a) is at least 55 years of age, OR (b) has a combined total of years of service and age which is 65 or greater.
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> 15. A Tier 1 non-grandfathered member is one who does not qualify as a Tier 1 grandfathered member (i.e. is not vested, is younger than age 55, and has less than Rule of 65 on 6/30/13).

Examples:

1) Tier 1 employee is age 57 with 4 years of service credit.
   Yes, employee is grandfathered since vested and over age 55.

2) Tier 1 employee is age 45 with 20 years of service credit.
   45 + 20 = 65   Yes, employee is grandfathered since total is 65 or over.

3) Tier 1 employee is age 40 with 15 years of service credit.
   40 + 15 = 55   No, employee is not grandfathered since total is less than 65.

In determining eligibility for grandfathering provisions, the employee's actual age and service credit (including any purchased service credit made before 6/30/13) would be calculated to the nearest thousandth (0.000) according to information on file at TFFR.

	Grandfathered Employee Eligibility – Tier 1 vested member					
	TFFR Service Credit on 6/30/2013					
Member age on 6/30/2013	**5**	**10**	**15**	**20**	**25**	**30+**
25	No	NA	NA	NA	NA	NA
30	No	No	NA	NA	NA	NA
35	No	No	No	NA	NA	NA
40	No	No	No	No	NA	NA
45	No	No	No	Yes	Yes	NA
50	No	No	Yes	Yes	Yes	Yes
55+	Yes	Yes	Yes	Yes	Yes	Yes

SECTION 3. NDCC 15-39.1-10. Eligibility for normal unreduced retirement benefits.

Under current law, all vested employees can retire with full unreduced benefits at age 65, or earlier if they reach the Rule of 85 (Tier 1) or Rule of 90 (Tier 2). There are no minimum retirement ages. The changes in Bill No. 54 refer to whether employees can retire earlier than age 65 based on their age and service.

Bill No. 54 allows Tier 1 grandfathered employees (those within 10 years of retirement) to remain under current provisions (i.e. Rule of 85) to qualify for unreduced retirement benefits. Non-grandfathered Tier 1 employees, Tier 2 employees, and all future employees would be required to work longer in order to qualify for unreduced retirement benefits. Effective 7/1/13, non-grandfathered employees would need to work until a minimum of 60 years of age, and could then retire with unreduced benefits if they have the Rule of 90. If, however, they do not have the Rule of 90, they would need to continue working, or defer drawing benefits until they reach the Rule of 90/minimum age 60, or until age 65. Note that the employee must work until age 60 to receive unreduced benefits, even if they reach the Rule of 90 at an earlier age.

Examples:

1) Grandfathered Tier 1 employee, age 50 @ 25 yrs service credit on 6/30/13.
   Current: Elig Rule 85 @ age 55 + 30 yrs (R85) in 2018
   Proposed: Elig Rule 85 @ age 55 + 30 yrs (R85) in 2018 No change

2) Non-grandfathered Tier 1 employee, age 40 @ 15 yrs service credit on 6/30/13.
   Current: Elig Rule 85 @ age 55 + 30 yrs (R85) in 2028
   Proposed: Elig Age 60 + 35 yrs (R95) in 2033 + 5 yr diff
   (*Reached R90 @ age 58 + 33 = R91)

3) Non-grandfathered Tier 2 employee, age 32 @ 6 years service credit on 6/30/13.
   Current: Elig Rule 90 @ age 58 + 32 years (R 90) in 2039
   Proposed: Elig Age 60 +34 yrs (R94) in 2041 + 2 yr diff

4) Non-grandfathered Tier 1 employees at various age/service combinations after 6/30/13.

   Age 60 + 30 years service or more
   Age 61 + 29 years service
   Age 62 + 28 years service
   Age 63 + 27 years service
   Age 64 + 26 years service
   Age 65 + vested (3 years service or more)

SECTION 4. NDCC 15-39.1-12. Early reduced retirement benefits.

Current statutes also allow a vested member to be eligible to retire before normal retirement age and receive reduced retirement benefits if the employee is age 55 or older. Early retirement benefits are reduced by 6% per year from the earlier of age 65 or the Rule of 85 (Tier 1) or Rule of 90 (Tier 2).

Bill No. 54 does not change the minimum age 55 eligibility requirement for receiving reduced benefits, but it does increase the 6% per year reduction to 8% per year reduction from the proposed unreduced retirement ages outlined in Section 3. That is, effective 7/1/13, a non-grandfathered member's benefits would be reduced by 8% from the earlier of age 65 OR the later of either age 60 or Rule of 90.

Example: Non-grandfathered Tier 1 employee, age 55 @ 19 years of service, FAMS $3,000

Current: Age 65-55 = 10 x 6% = 60% reduction
$3,000 x 19 yrs x 2% = 1140 x 40% = $456 per month at age 55

Proposed Age 65-55 = 10 x 8% = 80% reduction
$3,000 x 19 yrs x 2% = 1140 x 20% = $228 per month at age 55
Difference -$228 month

SECTION 5. NDCC 15-39.1-18. Disability retirements.

Under current law, members are eligible for disability benefits if they have at least one year of service and qualify for total disability as determined by the Board. If approved, the amount of the disability benefit is calculated based on a minimum of 20 years of service credit, for a minimum disability benefit of 40% of final average salary.

Bill No. 54 increases the vesting requirement from 1 year to 5 years, and changes the benefit calculation to using actual service credit earned instead of the 20 year minimum. This change would be effective 7/1/13 for all nonretired Tier 1 and Tier 2 employees.

Example: Teacher age 40 @ 15 years service credit, FAMS $3,000

Current:	$3,000 X 20 X 2.0% = $1,200 mo.	
Proposed:	$3,000 X 15 X 2.0% = $ 900 mo.	
Difference		-$300 month

SECTION 6. NDCC 15-39.1-19.1 Retired teachers return to active service - Annuities discontinued on resumption of teaching over annual hour limit

Current law allows public school teachers and administrators to return to work after retirement and continue receiving their TFFR benefits under certain employment limitations. The limits apply to TFFR covered employment, but do not apply to non contracted substitute teaching, teaching in a public college, university, or private school employment outside of education, or employment outside of ND.

The maximum annual hour limit is based on length of contract duties: 9 month contract = 700 hours; 10 month contract = 800 hours; 11 month contract = 900 hours; 12 month contract = 1,000 hours. If the retiree exceeds the annual hour limit, their monthly retirement is suspended and they are then treated like an active employee with their benefit possibly recalculated upon subsequent retirement if they meet certain conditions outlined in state law. The employer is required to pay employer contributions on the salary paid to the retiree.

During the 2009-10 year, there are 297 re-employed retirees. Of the total, 270 are working under the annual hour limit, 20 are working full time under critical shortage area exemption (see section 7), and 7 are working full time under the benefit suspension and recalculation option.

Bill No. 54 would require all re-employed retirees to pay employee contributions on the salary earned from the school district beginning 7/1/12. This is estimated to bring in approximately $600,000 of additional contributions per year based on current contribution rates. The re-employed retiree's pension benefit would not increase as a result of the additional contributions being paid (unless their benefit was suspended because they exceeded the annual hour limit). However, the employee contributions would be included in the retiree's guaranteed account value.

SECTION 7. NDCC 15-39.1-19.2 Retired teachers return to active service – Critical shortage areas and disciplines.

Current law also allows retirees to return to TFFR covered employment in an approved critical shortage area and exceed the annual hour limitation (work full time) without losing retirement benefits. A one-year waiting period is required. Critical shortage areas are determined each year by the Education Standards and Practices Board (ESPB). For the 2009-10 school years, ESPB has designated all areas except for elementary education and physical education as critical shortage areas. The employer is required to pay employer contributions on the salary paid to the retiree.

Bill No. 54 would require the re-employed retiree to pay the employee contributions on the salary earned from the school district beginning 7/1/12. The re-employed retiree's pension benefit would not increase as a result of the additional contributions being paid.

SECTION 8. EFFECTIVE DATES

Requiring re-employed retiree contribution (sections 6 and 7) would be effective 7/1/12. The changes relating to unreduced retirement, reduced retirement, and disability benefits (sections 3, 4, and 5) would be effective 7/1/13. The effective dates for the employee and employer contribution rate increases (section 2) are included in the bill's language and become effective 7/1/12 and 7/1/14.

FINANCIAL IMPACT

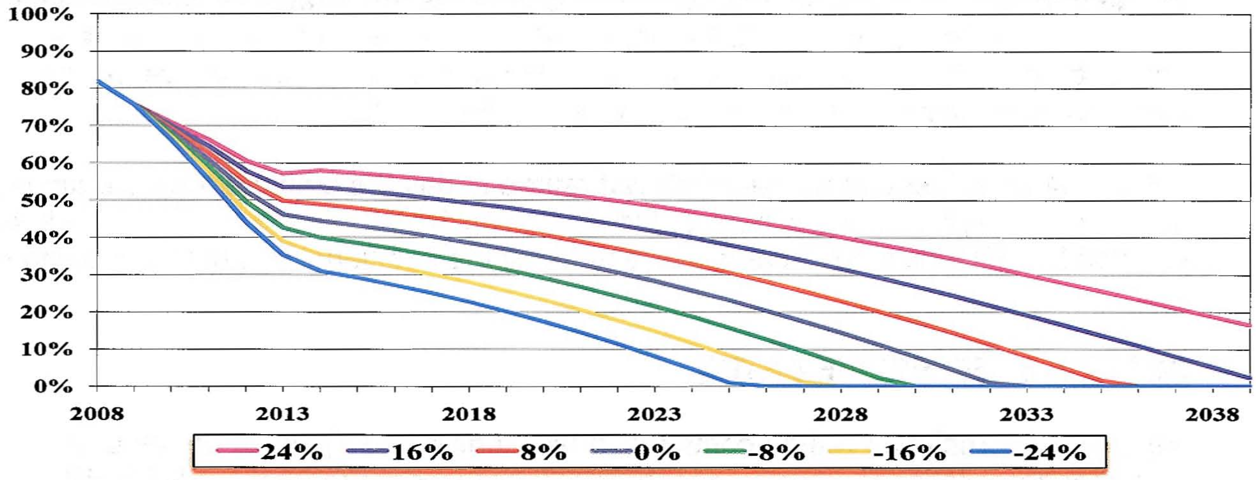
Chart 2 shows the actuarial impact of the changes outlined in Bill No. 54 under variable investment return rates for the 2009-10 fiscal year. As you can see, if TFFR earns at least 16% this year, plus 8% returns in the future, funding levels are projected to reach nearly 80% at the end of the 30-year projection period. A 24% return this year, plus 8% returns in the future, would bring funding levels to 90% in 30 years. These charts are actuarial projections based on the 2009 actuarial valuation, adjusted for assumption changes made in the 2009 Experience Study. Once the 2010 actuarial report is completed (October 2010), the fund's actuary can recalculate the actuarial impact of Bill No. 54 and provide additional actuarial details.

SUMMARY

The TFFR Board believes that in addition to future positive investment growth, other revenue sources are also needed to contribute to TFFR's funding solution. Bill No. 54 reflects shared responsibility from both employees and employers so that pension benefits for ND educators will be financially secure now and into the future.

Chart 1

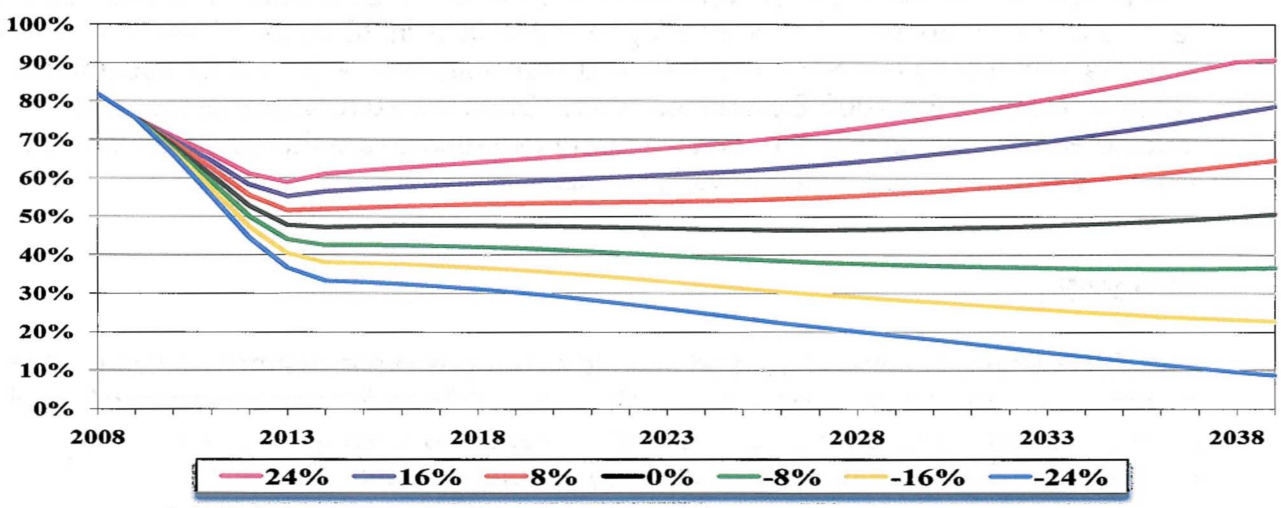
Projected TFFR Funded Ratios (AVA)
Current Plan - No Changes



Note: Projections assume variable market returns for FY 2010, and 8% returns in 2011 and all years thereafter.

Chart 2

Projected TFFR Funding Ratio (AVA)
Bill No. 54 – Contribution Increases and Benefit Changes



Note: Projections assume variable market returns for FY 2010, and 8% returns in all years thereafter.