NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

EMPLOYEE BENEFITS PROGRAMS COMMITTEE

Thursday, January 12, 2012
Harvest Room, State Capitol
Bismarck, North Dakota

Senator Dick Dever, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators Dick Dever, Ralph L. Kilzer, Karen K. Krebsbach, Carolyn C. Nelson, Ronald Sorvaag; Representatives Randy Boehning, Roger Brabandt, Bette Grande, Ron Guggisberg, Scott Louser, Ralph Metcalf, John D. Wall

Member absent: Senator Ray Holmberg

Others present: Representative Jerry Kelsh, member of the Legislative Management, was also in attendance.

See Appendix A for additional persons present.

It was moved by Senator Nelson, seconded by Representative Grande, and carried on a voice vote that the minutes of the September 20, 2011, meeting be approved as distributed.

At the request of Chairman Dever, committee counsel distributed a copy of the October 2011 "Your Vested Interest" newsletter published by the State Investment Board (on file in the Legislative Council office).

ACTUARIAL VALUATIONS OF THE TEACHERS' FUND FOR RETIREMENT AND PUBLIC EMPLOYEES RETIREMENT SYSTEM

Chairman Dever recognized Ms. Kim Nicholl, FSA, MAAA, FCA, EA, Senior Vice President and National Public Sector Retirement Practice Leader, The Segal Company, Chicago, Illinois, who presented an overview (Appendix B) of the Teachers' Fund for Retirement (TFFR) and Public Employees Retirement System (PERS) valuation process. She said the purposes of the actuarial valuation are to report the fund's assets, estimate the fund's liabilities, determine the annual contribution for fiscal year 2012, provide information for annual financial statements, and identify emerging trends. Over the life of a pension system, she said, benefits plus expenses must equal contributions plus investment return or contributions must equal benefits plus expenses less investment return. Concerning actuarial assumptions, she said, there are two types--demographic and economic. She said demographic actuarial assumptions include retirement, disability, death in active service, withdrawal, and death after retirement. She said economic actuarial assumptions include inflation, interest rate or return on assets, salary increases, and payroll growth. She said actuaries make assumptions as to when and why a member will leave active service and estimate the amount and duration of the pension benefits paid.

Ms. Nicholl presented the actuarial valuation and review of TFFR as of July 1, 2011. A copy of the valuation report is on file in the Legislative Council office. She said the valuation reflects plan changes as a result of enactment of 2011 House Bill No. 1134. She noted the legislation increased contribution rates by 4 percent for both members and employers over the next two bienniums. She said these increases will revert to 7.75 percent for both members and employers once the funded ratio for TFFR reaches 90 percent as measured using the actuarial value of assets. She said the market value of assets returned 23.5 percent for the year ending June 30, 2011. She said the actuarial value of assets gradually recognizes deferred losses resulting in a 1.4 percent return on actuarial assets. She said unrecognized investment losses represent approximately 6 percent of market assets. She said the funded ratio decreased from 69.8 percent as of July 1, 2010, to 66.3 percent as of July 1, 2011. She said recognition of the changes contained in House Bill No. 1134 alone resulted in an increase of .6 percent in the funded ratio. She said the annual required contribution calculation increased from 12.79 percent of payroll to 13.16 percent of payroll, and that based upon an employer contribution rate for fiscal year 2012 of 8.75 percent, there is a contribution deficiency of 4.41 percent of payroll. She said contribution rate increases contained in House Bill No. 1134 will begin to address this deficiency.

Concerning assets, Ms. Nicholl said the market value of assets increased from $1.438 billion as of June 30, 2010, to $1.726 billion as of June 30, 2011. The actuarial value of assets, she said, which smooths investment gains and losses over five years, decreased from $1.842 billion as of June 30, 2010, to $1.823 billion as of June 30, 2011. She said based upon the market value of assets the investment return was 23.5 percent, while the investment return based upon the actuarial return was 1.4 percent. She said the actuarial value of assets, is 105.6 percent of the market value of assets, and there is a total of $96 million in deferred investment losses that will be recognized in future years.

Ms. Nicholl said the actuarial accrued liability increased from $2.637 billion as of June 30, 2010, to $2.750 billion as of June 30, 2011. She said the actuarial accrued liability includes a decrease of $24 million due to reflecting the retirement eligibility changes contained in House Bill No. 1134. She said the unfunded actuarial accrued liability increased from $795 million to $927 million, which is 190 percent of projected active payroll. She said the funded ratio on an actuarial value of assets basis decreased from 70 percent to 66 percent, while the funded ratio increased from 55 percent to 63 percent based on the market value of assets. She said the annual required contribution increased from 12.79 percent of payroll to 13.16 percent of payroll. She said this compares to the 8.75 percent employer contribution which resulted in a contribution shortfall of 4.41 percent. She said the funding period based on an 8.75 percent statutory contribution rate is infinite, while reflecting the full 8 percent increase in the total contribution rate would result in a funding period of 18 years.

Chairman Dever recognized Mr. Brad Ramirez, FSA, MAAA, FCA, EA, Consulting Actuary, The Segal Company, Greenwood Village, Colorado, who presented the July 1, 2011, 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 North Dakota retirement fund. Mr. Ramirez's PowerPoint presentation is contained in Appendix B, and a copy of the actuarial report is on file in the Legislative Council office.

In response to a question from Senator Dever, Mr. Ramirez said both TFFR and PERS funds are invested by the State Investment Board. However, he said, the funds have different investment allocations which account for the slight difference in investment returns.

Mr. Ramirez said the funded ratio of PERS is 70.5 percent, 73.7 percent for the Highway Patrolmen's retirement system, 49.6 percent for the retiree health benefits fund, and 108.7 percent for the Job Service North Dakota retirement plan. He said the market value of assets increased from $1.474 billion to $1.758 billion and the actuarial value of assets increased from $1.622 billion to $1.650 billion. He said the ratio of actuarial value to market value is 93.9 percent, a $108 million differed gain. He said the approximate return based on market value was 21.1 percent, and the approximate return based on the actuarial value of assets was 3.3 percent.

Concerning the main system, Mr. Ramirez said the contribution margin or deficit was a -6.74 percent as of July 1, 2011. He said this compares to a -6.64 percent on July 1, 2010. For the judges' retirement system, he said, the contribution margin or deficit was a -.94 percent on July 1, 2011, compared to .42 percent on July 1, 2010. For the National Guard retirement system, he said, the contribution margin or deficit on July 1, 2011, was a -.58 percent compared to a -.50 percent on July 1, 2010. He said the contribution margin or deficit for the law enforcement with prior main service was a -2.65 percent on July 1, 2011, compared to a -2.49 percent on July 1, 2010. For the law enforcement without prior main service, he said, the contribution margin or deficit on July 1, 2011, was -1.13 percent compared to -1.10 percent on July 1, 2010.

Concerning the Highway Patrolmen's retirement fund, Mr. Ramirez said the market value of assets increased from $44.8 million on July 1, 2010, to $52.7 million on July 1, 2011. He said the actuarial value of assets increased from $49.3 million to $49.9 million during the same period. He said the ratio of the actuarial value of assets to the market value of assets is 94 percent, and there is a $3.2 million deferred gain. He said the return on investment on a market value of assets was approximately 21.2 percent, while the return on the actuarial value of assets was approximately 3.3 percent. He said the contribution margin or deficit declined from -5.84 percent on July 1, 2010, to -9.93 percent on July 1, 2011. He said the funded ratio declined from 80 percent on July 1, 2010, to 74 percent on July 1, 2011.

Concerning the retiree health insurance credit fund, Mr. Ramirez said the market value of assets increased from $45.8 million to $58.7 million, and the actuarial value of assets increased from $48.7 million to $53.7 million. He said the ratio of actuarial value to market value is 91.5 percent, and there is a $5 million deferred gain. He said the contribution margin increased from .25 percent to .26 percent. He said the funded ratio for the retiree health insurance credit fund is 50 percent, an increase from 47 percent on July 1, 2010.

DEFINED BENEFIT, DEFINED CONTRIBUTION, AND HYBRID RETIREMENT SYSTEM ISSUES

At the request of Chairman Dever, Mr. Ramirez and Ms. Nicholl discussed defined benefit, defined contribution, and hybrid plans. A copy of their PowerPoint presentation is contained in Appendix B. Under a defined benefit plan, Mr. Ramirez said the benefit is defined, and the contribution is not. Under a defined contribution plan, he said, the contribution is defined, but the benefit is not. He said both retirement plans have risks, including investment risk, inflation risk, contribution risk, and longevity risk; but the risks are allocated differently under the two types of plans. In a defined benefit plan, he said, the employer usually bears the risks, while in a defined contribution plan, the employee bears the risks. A hybrid plan, he said, is a combination of a defined benefit and a defined contribution plan.

Ms. Nicholl said Alaska, West Virginia, and Michigan, as well as North Dakota, have or have had defined contribution plans. However, she said, the West Virginia defined contribution plan was closed to new members in 2005, and in 2006 members of the defined contribution plan voted to merge with the defined benefit plan. Effective in 2008, she said, members of the defined contribution plan were permitted to elect to transfer back into the closed defined benefit plan, and 80 percent of eligible employees have elected to do so.

Ms. Nicholl said changing from a defined benefit to a defined contribution plan or a hybrid plan raises several transition issues that must be addressed. She said unfunded liabilities are not eliminated by a change to a defined contribution plan or a hybrid plan, and that best practices and accounting standards call for an accelerated funding, driving up short-term costs. In addition, she said, longer-term asset allocation changes may lead to reduced investment return and therefore to higher total costs for the plan sponsor. She said if defined contribution plan investments are participant-directed, employee education is needed and that creating a new defined contribution plan could add administrative complexity and costs. Allowing choice between plans introduces antiselection issues, she said, and adequate death and disability benefits could not be provided by a defined contribution plan. Finally, she said, workforce management is difficult with a defined contribution plan.

STATE INVESTMENT BOARD

Chairman Dever recognized Mr. John Geissinger, Executive Director and Chief Investment Officer, Retirement and Investment Office, who discussed investment returns of the TFFR and PERS retirement funds and the current investment climate (Appendix C). Mr. Geissinger also introduced Mr. Darren Schulz, Deputy Chief Investment Officer. Mr. Geissinger said Mr. Schulz has over 15 years of investment management experience and joins the Retirement and Investment Office from WellPoint, Inc., where he held a position of investment manager and was responsible for oversight of the company's defined benefit, defined contribution, and nonqualified plans and foundation assets totaling approximately $5 billion. Prior to joining WellPoint, he said, Mr. Schulz was in the investment consulting business with Morgan Keegan and Tioga consulting and spent nine years in investment management with the retirement systems of Alabama.

Concerning the annualized rates of return net of fees for TFFR and PERS for the period ending June 30, 2011, Mr. Geissinger said the return for the past year for TFFR was 24.21 percent and 21.43 percent for PERS. However, he said, the estimated fiscal year 2011 returns net of fees through December 31, 2011, were a -6.11 percent for the past year for TFFR and a -5.14 percent for the past year for PERS.

In response to a question from Representative Grande, Mr. Geissinger said the goal of each of the State Investment Board's investment providers is to provide the greatest return possible to the funds under management by those providers. He said investment managers are cognizant of political factors, and he would provide additional information on investments in countries or regions that may be viewed as anti-American.

HUMAN RESOURCE MANAGEMENT SERVICES

Chairman Dever recognized Ms. Laurie Sterioti Hammeren, Director, Human Resource Management Services, Office of Management and Budget, who presented the report on state employee service awards, employer-paid tuition, employer-paid professional organization memberships and service club dues from July 1, 2009, through June 30, 2011. A copy of Ms. Sterioti Hammeren's testimony is attached as Appendix D, and a summary of the report is attached as Appendix E. The complete report is on file in the Legislative Council office. For the biennium, she said, state employee service awards totaled $466,713.63 or approximately $52 per employee per biennium. She said the total employer-paid costs of training or educational courses, including tuition and fees, was $3,083,111.36 or approximately $343 per employee per biennium. For employer-paid professional organization membership and service club dues for individuals, she said, the total was $923,520.65 or approximately $100 per employee per biennium. She said Human Resource Management Services believes that the expenditures are well within expected norms.

Senator Dever requested that Human Resource Management Services includes the number of employees within each agency on the next summary chart.

Representative Grande requested that the next report include the number of individual employees receiving benefits within each category.

In response to a question from Representative Grande, Ms. Sterioti Hammeren distributed a copy (Appendix F) of proposed sick leave rules to become effective January 1, 2012.

STAFF DIRECTIVES

Representative Grande requested that the Legislative Council staff provide additional information on the Utah option for a defined contribution plan and additional information on recent multiplier changes in state public pension plans.

No further business appearing, Chairman Dever adjourned the meeting at 2:00 p.m.

Jeffrey N. Nelson
Committee Counsel

ATTACH:6