Good morning, Mr. Chairman, and members of the Appropriations Committee.

House Bill 1040 may be the most important piece of legislation of this session and this decade.

HB 1040 closes the Main **PERS** defined benefit (**DB**) plan for new hires effective January 1, 2025, and opens a defined contribution (DC) plan to new hires after that date.

This bill comes to you after being thoroughly vetted by the interim Retirement Committee, the Employee Benefits Committee and the GVA committee for nearly a year and a half where we heard from experts and stakeholders from a variety of source.

To be clear, this pension reform bill does **not** impact any current State employee. They will receive their **full pension** benefit as contracted with the State of North Dakota.

Why is pension reform needed? It's because this **PERS** plan is in serious debt.

Our unfunded liability has climbed to **$1.8 billion dollars**.

The **PERS** plan has lost more than **two billion dollars** over the last 20 years.

This despite changing the rule of **85 to 90** in 2016 and lowering the multiplier for members from **2% percent to 1.75%** in 2019.

Still, we **drown** in debt and that debt is on the backs of taxpayers.

To be clear, **HB 1040** does **not** affect the:

- **Judges retirement plan.**
- **Public Safety plans.**
- **Highway Patrol retirement plan.**
- **Higher education retirement plan; or**
- **Job Service retirement plan.**

This closure affects all other **future** state employees, including appointed and elected officials and temporary employees, and the **374** political subdivisions that have elected to participate in the **PERS DB plan.**

The state and political subdivision employees participating in the plan will continue in the **DB plan**.

As mentioned, effective **Jan. 1, 2025, new** state and participating political subdivision employees will be routed in the **DC** plan.

HB 1040 would allocate a **one-time cash infusion** of $240 million from the **SIIF fund**.

In code, the **legacy streams** will forward **$48.2 million** to the **PERS DB** plan on July 1st of this year.

Additionally, in the **Legacy Streams II** legislation being discussed, there is a stream which allocates another **$70 million** per biennium into the DB plan.

The goal is to forward nearly **$370 million** to the **DB** plan.

Yes, a big ask. However, the sooner we can invest these dollars, the sooner we get that money working to get a **return** for the plan.

Of the assets raised for the plan, about **50%** will come from employer and employee contributions and the remaining **50%** from returns on those investments.

The state is required to pay an actuarially determined contribution rate that is calculated based on a closed period of 20 and a half years.

Some of the unfunded liability comes from the political subdivisions involved in the plan.

The political subs will be assessed an additional **one percent** employer contribution.

We are very mindful of not forcing political subs into higher property rates as it was the State running the **PERS** retirement program, not them.

We are working with **TIAA**, the largest **defined contribution** plan in the country, that has successfully managed our University System DC Plan for 50 years, as well as the **Reason Foundation** on a "best practices" **DC** plan.

It would include a contribution rate of **14%**; 7% employer and paying another 4% of the employee contribution which is currently being done in our **DB** plan.

We will continue to fund our **DB** plan until the last retiree has drawn the last check. That is a promise to our employees.

However, the time has come to stop making minimum payments on a credit card that carries a **$1.8 billion** dollar debt.

Mr. Chairman, committee members, **HB 1040** may not have all the answers, but it has one: This is the right vehicle to drive us out of a mountain of debt and into **retirement stability** that is affordable and honoring to our state employees.

Jenn Clark and Leader Lefor are here to answer questions you may on **HB 1040**. I must complement both for the outstanding job they've done and others in getting this plan together.

It has taken several years of hard work with a lot of obstacles to overcome, but they got the job done.

We hope you agree Mr. Chairman and committee members.

North Dakota House Bill 1040: NDPERS Reform

HB 1040 Background

- Today, NDPERS is estimated to be $1.9 billion underfunded.
- According to a recent report from the National Conference on Public Employee Retirement Systems (NCPERS), an organization that represents and advocates for defined benefit public pension plans, North Dakota is one of just five states that has an unsustainable public pension debt trajectory.
- Without HB 1040, NDPERS will continue to accrue unfunded liabilities, ultimately exhausting its assets in approximately 80 years under a best-case scenario. If market conditions worsen, the fund will run out of money much sooner.
- HB 1040 addresses many of the challenges facing NDPERS, helping turn it away from a path of perpetual underfunding, and setting it on a course to pay off the existing debt in the next 20 years.

Solving the Unfunded Liability Problem

- HB 1040 fixes the systematic underfunding that has existed for NDPERS over the past two decades by swapping from contribution rates set in statute to an "actuarially determined rate," or "ADEC" rate for short.
- ADEC is a calculation performed during the annual pension valuation process that shows what contribution rates are needed to be to pay for both benefits and debt servicing costs.
- The pension benefits promised to members of NDPERS are ultimately the responsibility of the state, local governments, and taxpayers.
- Adopting an ADEC funding policy is a crucial first step in getting North Dakota on the path to fully paying for its pension obligations.
- To assist that paydown, sponsors have added other cash infusions into this bill, beginning with $240 million in year one and another $70 million per biennium until the plan reaches 90% funded.
- Our modeling forecasts show that these added funds, coupled with the swap to a proper actuarial funding method, **would save North Dakota $1.1 billion dollars over the next 20 years relative to the status quo** and finally put NDPERS back on proper financial footing.

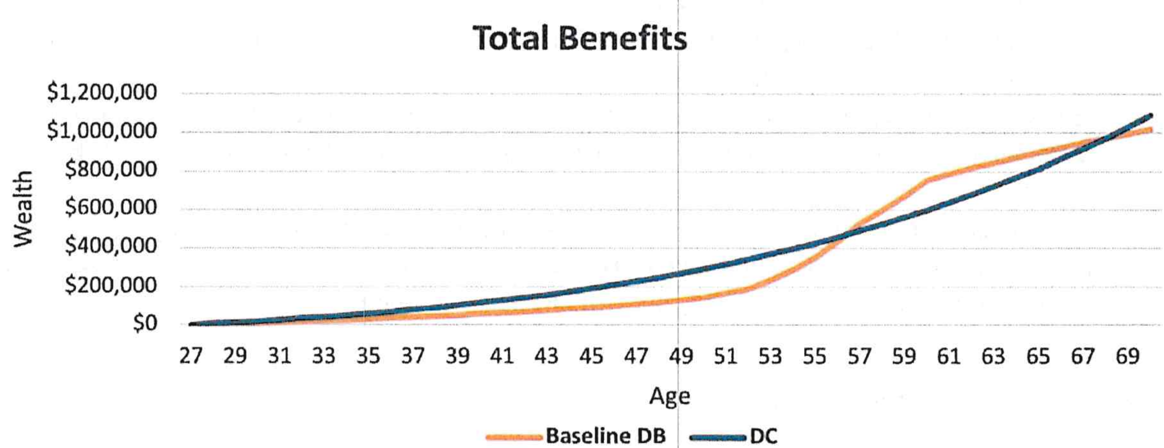
Solving the Prospective Risk Problem

- HB 1040 closes the current structurally underfunded defined benefit plan to all future new hires and instead offers them a new defined contribution retirement plan that our analysis finds meets the high standards of best practices in retirement system design.
- The cost of the current defined benefit is saddled by years of stifled contributions and a high interest rate (historically around 8%) on the pension system's accruing debt.
- The proposed reform would ensure that government employers avoid the accrual of new unfunded liabilities related to future hires.

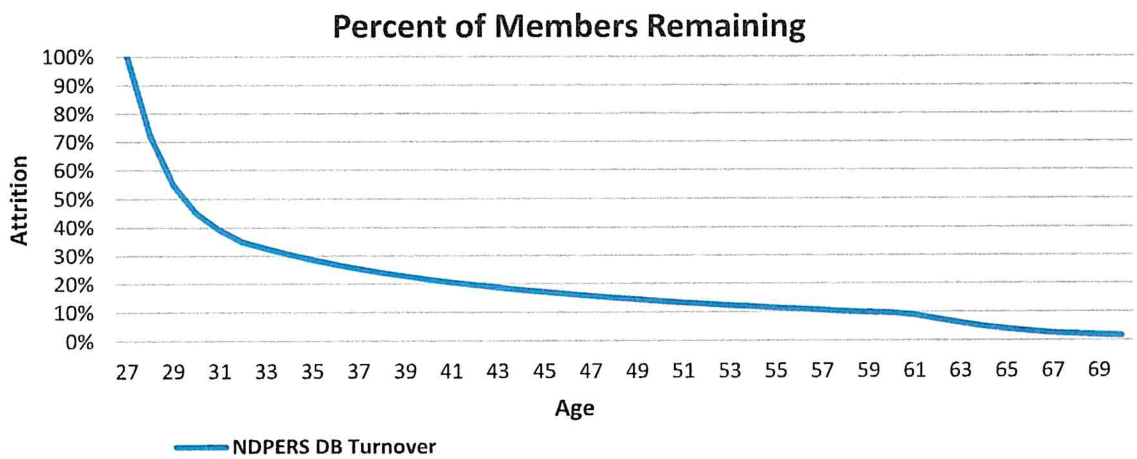
- Our analysis, along with research from the Teachers Insurance and Annuity Association (TIAA), showed the interim committee that for almost any age an employee begins work, the proposed defined contribution plan's benefits would be more generous and advantageous to public workers than the current NDPERS pension plan's benefits.
- This is due to the extremely low multiplier of 1.75% that the NDPERS pension uses for calculating benefits and the high rate of employee turnover in the plan.

Solving the Poor Benefit Problem

- The level of benefits offered in the NDPERS DB is the worst in the country.
- For an average entrant into NDPERS, the proposed defined contribution plan's benefits would be better than the current NDPERS defined benefit plan's benefits.
- Only once a member reaches 29 years of service does the DB benefit become more valuable.
- Only around 9% of new members will reach 29 years of service.
- Due to the high turnover, most members leave NDPERS-covered employment with only a refund of their own pension contributions, plus interest earned. They forfeit all employer contributions made and are not eligible for any pension benefit.
- This chart compares the projected benefit accrual for the current DB plan to the proposed DC plan in HB 1040. The assumptions used in this analysis are the following:
    - Member hired at age 27
    - 6.5% return for both DB and DC plans
    - 1.75% DB multiplier – current NDPERS benefit
    - DC rates are 7% from employee and 7.12% from employer



- This chart shows NDPERS' projected turnover rates. This uses current NDPERS DB turnover experience and assumption and assumes no change from the swap to a DC plan.
    - NDPERS currently has one of the higher turnover rates in the country.
    - 55% of new employees leave before they reach three years of service.



HB 1040 Myths

- NDPERS administrators have said that closing the defined benefit pension plan to new entrants could result in cash flow issues decades from now, and therefore recommends lowering the assumed rate of investment return and discount rate on liabilities to 4.5%, down from the current 6.5% assumption. This logic needlessly inserts billions in previously unrecognized unfunded liabilities and higher costs into their fiscal note calculations.
- There are no legal, financial, or professional requirements or mandates that the discount rate be immediately changed when closing a defined benefit plan or opening a new benefit tier.
- **States like Texas, Oklahoma, Florida, Michigan, and Arizona have all recently enacted plan design and funding policy reforms similar to those in House Bill 1040 and none of these states significantly lowered their assumed investment return or discount rate as part of reform.**
- None of those reforms have created any cash flow issues, and all have seen significant funding progress to their pension systems.
- The risk associated with future negative cash flow exists with or without reform, and if the state wanted to address it, it would not be standard practice nor recommended to immediately lower the discount rate.
- Instead, the state could make up the difference between cash inflows and outflows decades from now, when liabilities are just a fraction of their current amount, through supplemental amortization payments in the event they are actually needed.

Conclusion

- To visualize the thought process behind this bill, think of NDPERS' unfunded liabilities as an oil spill. The two most urgent actions are: (1) to cap the spill and (2) to clean up the oil that's spilled already.
- The transition to the defined contribution plan for future hires caps the spill because no new hire would ever bring the risk of an unfunded liability attached to them in the future.
- The second course of action is to clean up the oil already spilled, which is what the shift to proper actuarial funding reflects.
- Together these actions address the state's growing pension problem.

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