Testimony on North Dakota House Bill 1040: NDPERS Reform

Prepared for: North Dakota House Government and Veterans Affairs Committee

Prepared by: Ryan Frost, Senior Policy Analyst

Date: January 13, 2023

Good afternoon,

My name is Ryan Frost, and I am a senior policy analyst with the Pension Integrity Project at Reason Foundation. Our pension team has played a key technical assistance role on dozens of bipartisan pension reforms across 10 states over the past several years, including major efforts to overhaul and restore the solvency of major state pension systems in Texas, Michigan, Florida, Colorado, New Mexico, Arizona and South Carolina. Prior to joining Reason in 2019, I spent seven years as the research and policy manager for the Law Enforcement Officers and Firefighters Pension System, or LEOFF 2 for short, in Washington state. LEOFF 2 has been one of the top-three best-funded public pension plans since its inception in the mid-1970s, and that's primarily been accomplished by keeping up to date with best practices in pension funding design. Thank you for inviting me to provide our technical analysis of House Bill 1040 based on our experience evaluating pension solvency and design quality nationally, as well as answer any questions the committee may have.

We operated as pro-bono technical assistants during the interim committee process that led to this bill, building an actuarial model for the North Dakota Public Employees Retirement System (NDPERS) to help inform the process. We've thoroughly examined the details of this legislation, as well as the funding history of NDPERS. I have provided several supplemental materials to the committee that I hope are helpful in your consideration of this bill.

The context for the current discussion is the looming insolvency of NDPERS. Today, NDPERS is estimated to be about $1.8 billion underfunded. Even according to a recent report from the National Conference on Public Employee Retirement Systems, 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 any changes, NDPERS will continue to accrue unfunded liabilities, ultimately exhausting its assets in approximately 80 years. HB 1040 would meaningfully address many of the longstanding challenges facing NDPERS, help turn it away from a path of perpetual underfunding and set it on a course to be fully paid off in the next 20 years.

First and most importantly, HB 1040 fixes the systematic underfunding that NDPERS has undergone over the past two decades by swapping from contribution rates set in statute to an "actuarially determined rate," or ADEC for short. ADEC is a calculation performed during the pension valuation process that shows what plan contribution rates need to be to pay for both benefits and debt service costs. The pension benefits promised to members of NDPERS are ultimately the responsibility of the state, local governments, and taxpayers. Continuing to fall short of fully funding these pension promises unfairly passes on the cost of today's public services to future generations. Adopting an ADEC funding policy is a crucial first step in getting North Dakota on the path to living up to its pension obligations.

Second, this bill closes the current structurally underfunded defined benefit plan to all future new hires and instead offers them a defined contribution retirement plan that our analysis finds meets the high standards of best practices in retirement system design. The proposed reform would avoid the accrual of new unfunded liabilities related to future hires and would, in most cases, offer a more generous benefit than the current NDPERS pension.

Our analysis, along with research from the Teachers Insurance and Annuity Association (TIAA), a Fortune 100 financial services organization, presented to the interim committee, showed that for almost any age an employee begins work, the proposed defined contribution plan's benefits would be more generous than the current NDPERS defined benefit plan's benefits. This is due to the extremely low multiplier of 1.75% that the NDPERS defined benefit uses for calculating benefits and the high rate of turnover in the plan. I'm unaware of any other full defined benefit pension plan with that low of a benefit multiplier.

While the cost of offering the current defined benefit should be low, it is saddled by years of underpaying contributions and the high interest rate on the pension system's accruing debt. Those are the two main factors that have moved NDPERS from being overfunded in 2000 to being $1.8 billion in debt.

To help you 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 have 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 does. Over the next 20 years, the state and, on a smaller scale, its local governments would be able to pay off the pension system's $1.8 billion in debt by making full actuarial contributions to the NDPERS defined benefit plan.

To assist that paydown, the state has also put other cash infusions into this bill, beginning with $250 million in year one and another $70 million per biennium until the plan reaches full funding. 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.

Lastly, I'd like to make it clear to this committee that if you hear discussions about the the costs associated with this bill, those costs are not the inevitable consequence of shifting to a defined contribution plan for future hires. Instead, the costs reflect the state needing to make an overdue commitment to fully pay for the retirement benefits it has already promised generations of public workers and retirees of North Dakota, who understandably expect to have the pensions promised to them adequately funded.

Swapping to a different retirement plan design has a negligible impact on the overall costs of any pension reform bill. No new workers are needed to "fund" previously granted benefits; pensions do not operate as Ponzi schemes and should not be treated as such. The cleanup of years of underfunding is where the costs of this bill—and most pension reform bills across the country—come from.

Thank you very much for your time, and I welcome any questions.