Testimony in Opposition to House Bill No. 1040

Scott Miller, Executive Director

NORTH DAKOTA
PUBLIC EMPLOYEES
RETIREMENT SYSTEM

$4.6 Billion More Expensive

- This is the present value of how much MORE expensive over the next 23 years it will be to close the Defined Benefit plan and have all new employees go into the new Defined Contribution plan, rather than maintain the current DB plan
- Unfortunately, you cannot require future Legislatures to maintain adequate funding
- We do not yet know the cost of the Weisz amendment

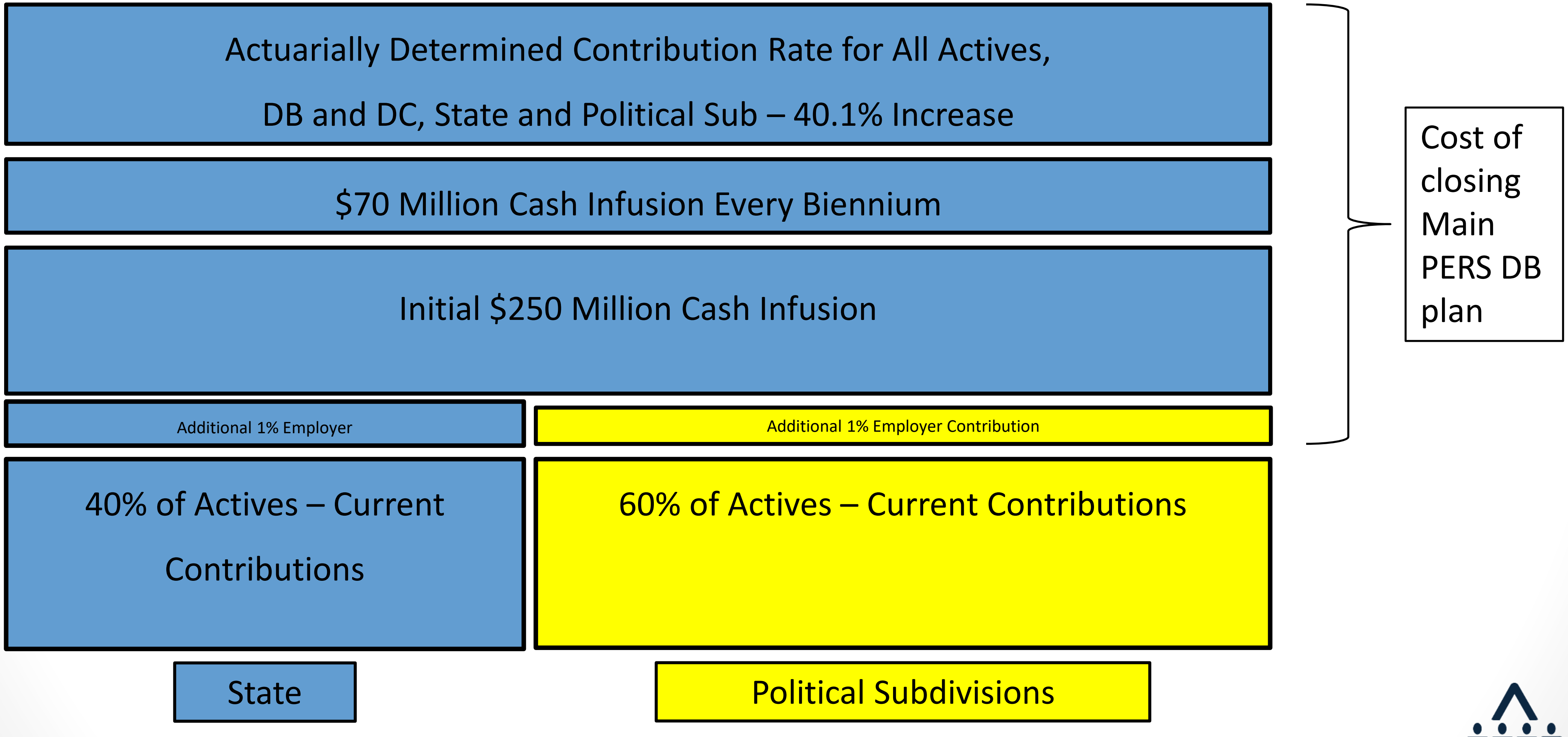
Contributions to the DB Plan and DC Plan			
	Present Value of Total Employer Contributions for 2023 to 2046[1]	Difference from Baseline	Difference from Baseline - ADEC Funding
Baseline	$1,681,415,635		
Baseline - ADEC Funding	$2,489,470,983	$808,055,347	
Bill 280 - 6.50% Investment Return	$3,287,166,589	$1,605,750,953	$ 797,695,606
Bill 280 - 5.50% Investment Return	$4,560,649,023	$2,879,233,388	$ 2,071,178,041
Bill 280 - 4.50% Investment Return	$6,257,016,726	$4,575,601,091	$ 3,767,545,744

Massive Future Contributions

- The total of additional State and Political Subdivision contributions for the 2023-25 biennium, including the $240 million and $70 million infusions, is $330 million
- Next biennium the additional contributions will be $526 million
- On January 1, 2026, the State Employer contribution increases 40.1%, to 48.36% of compensation (this amount may change based on the 7/1/24 valuation)
- Agencies with federally-funded positions will need to find alternate funding sources for new DC member contributions to the DB plan

Bill 1040 - 2025 Closure Date:		
	2023-2025 Biennium	2025 - 2027 Biennium
State Agencies (1% increase in 2023-205, 40.1% increase in 2025 - 2027)	$ 11,047,957	$ 443,023,074
Counties (1% increase)	2,907,174	3,876,232
Cities (1% increase)	1,894,105	2,525,474
School Districts (1% increase)	3,913,549	5,218,065
Other Political Subs (1% increase)	748,125	997,500
Lump Sum Deposits	310,000,000	70,000,000
Total	$ 330,510,910	$ 525,640,345

Exorbitant Costs



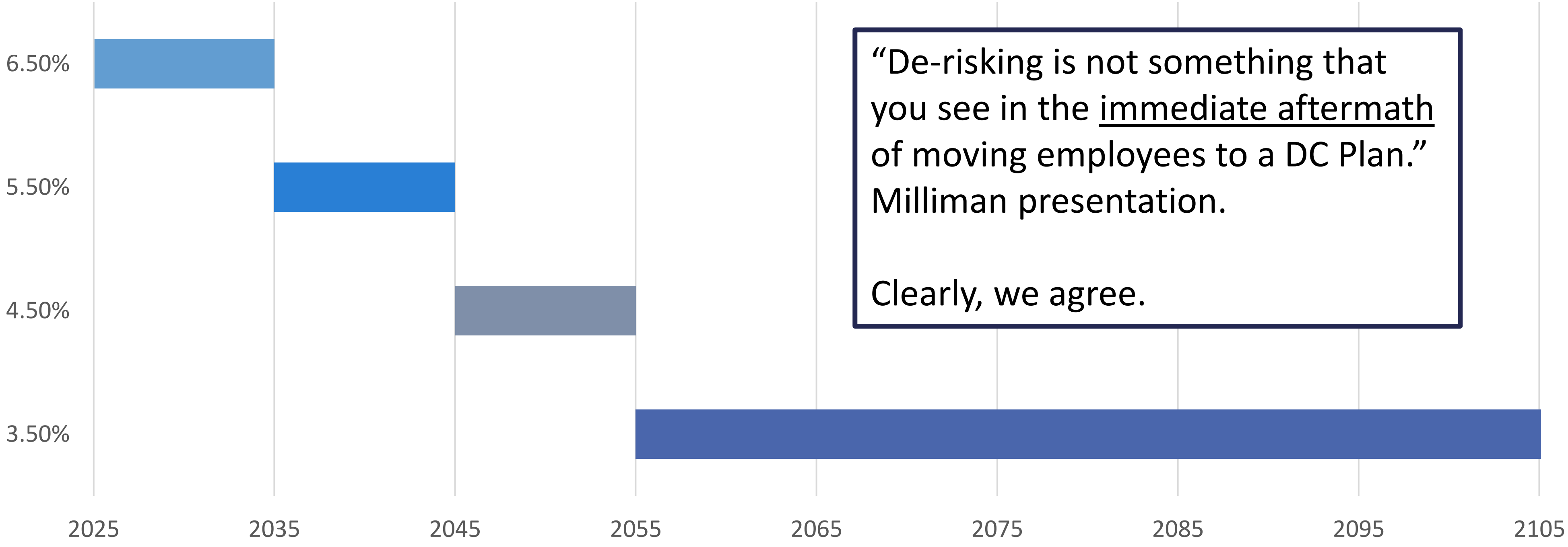
Credentialed Actuaries

"The Board shall cause a ***qualified, competent actuary*** to be retained on a consulting basis." NDCC section 54-52-04(4).
"As determined ***by actuarial valuations***, each state governmental unit shall contribute" the Actuarially Determined Contribution Rate. HB 1040.

- NDCC section 54-52-04(4), above, requires the NDPERS Board to retain and use a credentialed actuary to do these analyses.
- The Retirement Committee did not have Milliman, its actuary, analyze HB 1040.
- Any alternative numbers you may have seen are not from a credentialed actuary.
  - The Reason Foundation does not have actuaries on staff, and do not have our data
- The NDPERS Board could not rely on anyone other than a credentialed actuary to do these analyses, both from a statutory perspective and a fiduciary responsibility perspective. Why is anyone listening to any other numbers?

De-risking Doesn't Happen Tomorrow

Glidepath to a 4.5% Blended Discount Rate



"De-risking is not something that you see in the immediate aftermath of moving employees to a DC Plan." Milliman presentation.

Clearly, we agree.

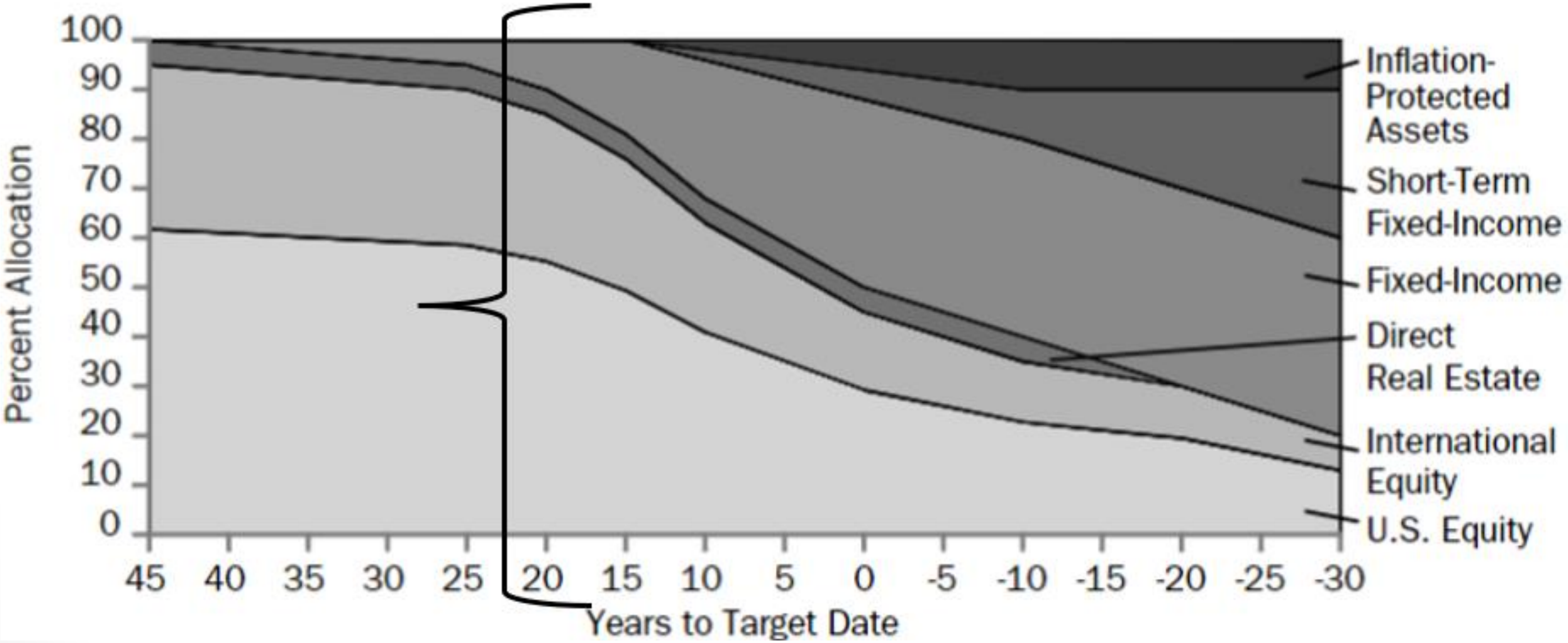
Interestingly, the Reason Foundation has historically argued that open public pension plans should never discount their liabilities by more than about 4.5%, but in this case argue that 6.5% is acceptable. For a closed plan.

De-Risking ***IS*** the Norm

- Our own experience - the NDPERS Board has de-risked the Job Service Plan asset allocation to below 3%
- "The Impact of Closing the Defined Benefit Plan at CalPERS", March 2011
  - The California PERS plan is the largest in the country
- "Legislative Analysis: Close MPSERS Hybrid Pension Plan and Replace with Defined Contribution", May 24, 2017 (Michigan)
- Cavanaugh Macdonald analysis of a proposal to close the Kentucky Teachers' Retirement System, November 8, 2017
- "Costs of Switching from Pensions to Individual Accounts", National Retired Teachers Association and the National Institute on Retirement Security, undated
- Rep. Steven Johnson, Chair of the Kansas House Pension Committee, told the Retirement Committee at its October 2021 meeting that if KS had gone to a DC plan, they would have had huge costs due to de-risking
- Private pension plans run by corporations HAVE to de-risk when they close a plan

De-Risking ***IS*** the Norm

- TIAA target date fund glidepath:



DB Transfer Amendment

- Introduced in the House Appropriations Committee
- State employee DB plan members with less than 5 years of service credit as of 1/1/25 have the option to “transfer to the defined contribution plan under this chapter”
  - Approximately 4,000 employees
  - It is not clear whether this means the current DC plan or the HB 1040 DC plan
- PERS will transfer 100% of the member’s “actuarial present value of the eligible employee's accumulated benefit obligation”
  - Given that the Main PERS Plan is only 65% funded, the plan will lose 35% with every transfer
- State will contribute an extra $3,333 per year for three years to each transferee’s DC account – potentially $40 million in total
- Waiting on the actuarial analysis to determine the total cost of this amendment
- Tax counsel has stated that giving current DB plan members the option to join the new DC plan and elect a contribution rate is a violation of the Internal Revenue Code

Tax Dollar Efficiency

Traditional defined benefit plans - advantages

- Efficient use of taxpayer dollars

- The Retirement Committee’s own actuarial expert called Defined Benefit plans an “efficient use of taxpayer dollars”
  - Milliman Presentation to Retirement Committee, slide 16, April 11, 2022
- Milliman cited a study from 2022 that showed that employees receive about twice the retirement benefit in a DB plan for the same cost as a DC plan

Traditional defined contribution plans - disadvantages

- Inefficient use of taxpayer money

“Best Practice” DC Plan?

- The current DC plan has a mandatory contribution rate for new employees of 15.26%: 7% employee and 8.26% employer
- The new DC plan only has a mandatory contribution rate of 9.26%: 4% employee and 5.26% employer
  - Employee must elect to contribute more, up to 7% employee and 8.26% employer
  - In Oklahoma, which has a similar, if somewhat better, DC plan, only 43% of employees elect to contribute more than the minimum
- A recent study by the consulting firm Aon and the National Institute on Retirement Security found that a contribution rate of 17% of compensation is necessary for someone to retire at age 67, and 23% to retire at age 62
  - “The Real Deal for the Public Sector: Retirement Income Adequacy Among U.S. Public Sector Employees”, Eric Atwater, Tyler Bond, Dan Doonan, Emily Swickard (Dec. 2022).

"Best Practice" DC Plan?

- "The qualified default investment alternative must include an in-plan annuity."
- We know of only one qualifying product, from TIAA
  - A complex product participants may not understand
  - Requires the selection of a named fund manager in addition to the underlying investments
  - Moving to a different provider may be difficult, making procurement problematic
  - Likely markedly more expensive than a typical target date fund
- Note this also places the fiduciary responsibility for setting this default with the Legislative Assembly rather than the Board
  - Investment costs are a primary source of fiduciary litigation
- This requirement basically creates a poor cash balance plan, not a DC plan
- Yet this is the reason that TIAA gives when it says the proposed DC plan is "best practice" – because it provides a ***defined benefit-like benefit***

$14,700 vs. $3,944-7,640

- The average benefit in the DB plan under the Main 2020 Plan versus the average projected benefit under the new DC plan ***if the member elects the full 15.26% contribution***
  - Using average retiree numbers from 2021 valuation (21 years of service, final average salary of $40,000), a 1.75% multiplier, and a DC plan return of 6% compounded annually
  - Depending on the final account balance and whether the individual takes out 3.4% or 4.0% per year
- DC plans are especially difficult for public safety personnel
  - Limited disability and early retirement funds
- PERS must make financial counseling available to new DC plan participants
  - Any additional cost for this requirement will come out of DC participant accounts

Vesting/Portability

- The vesting schedule for employer contributions to the DC plan:
  - Under two years of service, 0%
  - Two years of service, 50%
  - Three years of service, 75%
  - Four years of service, 100%
- Always 100% vested in employee contributions

- Defined Benefit Plan – three-year vesting in a guaranteed lifetime income
- Always 100% vested in employee contributions, plus guaranteed interest
- If participate in the 457 deferred compensation plan, can vest in up to 4% of the 8.26% employer contribution over 4 years
- For employees who only stay less than two years, the DB plan is better

2.87%

- The percent of new employees that elected to join the DC plan from 2013-2017 when it was open and available to all new state employees
- **<u>Only 2.36% of 20-somethings</u>** elected to join the DC plan at that time
- Current state employees also strongly prefer a DB plan:

Based on the information provided, I prefer to have a defined contribution (DC) retirement plan rather than a defined benefit (DB) retirement plan.* *As stated earlier in this survey a DC plan is similar to the well-known 401(k) and a DB plan is commonly referred to as a pension.	3840	2.18	3%
Based on the information provide, I prefer to have a Defined benefit (DB) Retirement Plan rather than a Defined Contribution (DC) Retirement Plan.* *As defined earlier in this survey a DB is commonly referred to as a pension and a DC is similar to the well-known 401(k).	3858	3.95	42%

Source: 2022 HRMS Survey of Current State Employees

Percent that "Strongly Agree"

Average Rating

75%

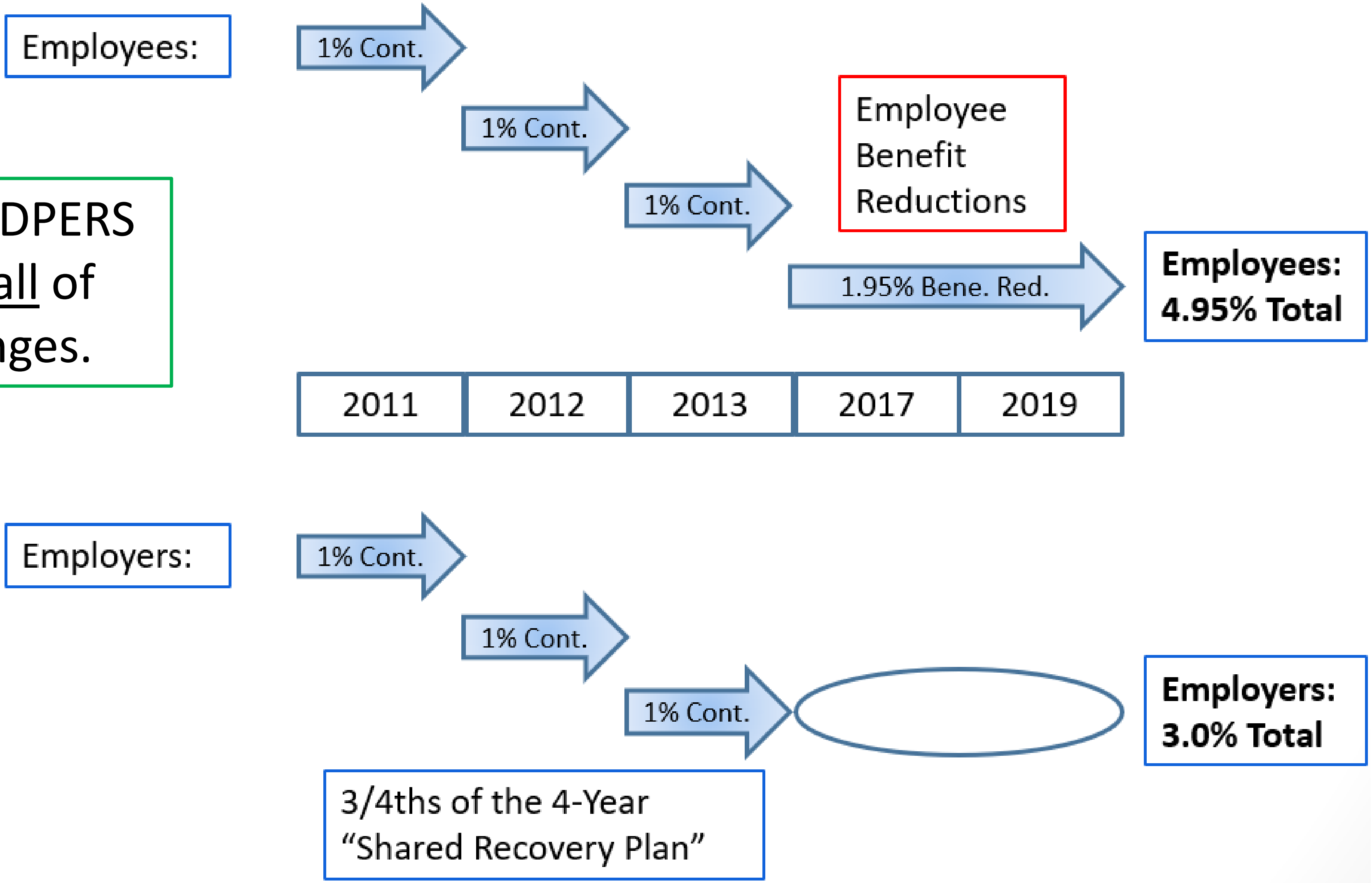
- The percent of DC plan members who ***elected to go back*** to the DB plan when given the opportunity to do so
- Those members agreed to pay ***an extra 2% of employee compensation*** to go back to the DB plan

Other States' Experience

- West Virginia – DB closure was far too expensive, and re-opened the DB plan
- Michigan – Closed the DB plan when it was 109% funded, with a $734 million surplus; in September 2019 it was 65% funded with a $6.6 Billion unfunded liability
- Alaska – closed the DB plan in 2005 and has paid billions of dollars more than anticipated; recruitment and retention issues for teachers and public safety have led to significant pressure to re-open the DB plan, including a new legislative proposal
- Oklahoma – closed the DB plan in 2018 and created a new DC plan that is better than this DC plan, and has already had two legislative efforts to re-open the DB plan
  - Employer contribution is 16.5% spread over both DB and DC employees
  - Costing the state more than if they had maintained the DB plan
  - Only 43% of new employees elect to contribute above the minimum
  - 87% of members who leave employment take a direct distribution rather than roll-over
  - Recruitment and retention has become a "major issue that is being discussed"

Employees Did Their Part

Notably, NDPERS proposed all of these changes.



Conclusion: An Unreasonable Decision

- $4.6 billion more expensive over the next 20 years
  - Future Legislatures cannot be required to adequately fund this decision
- DB Transfer Amendment causes IRC problems and significant cost
- DC plans are an "inefficient use of taxpayer money"; DB plans are "efficient"
- DC plans provide half the benefit for the same cost as a DB plan
- The new DC plan will result in significantly lower savings than the existing DC plan
- Employees who leave before completing 2 years of service will not take any of the employer contribution with them
- Neither new employees nor current employees have shown a desire for a DC plan
- Recruitment and retention may become major issues for the state and political subs
- Why would you throw away a good DB plan in favor of a DC plan the sole benefit of which is that it provides a ***worse defined benefit-like benefit?!?***

Questions?

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