North Dakota Public Employees Retirement System (NDPERS)

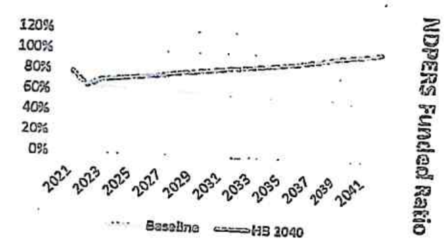
REFORM ALERT:

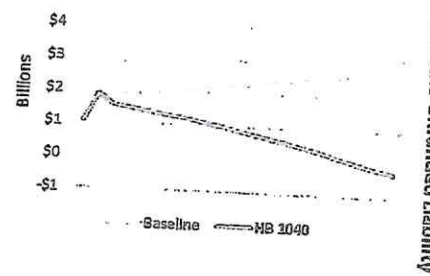
The Benefits of House Bill 1040

Commits the State to Fully Funding All NDPERS Retirement Benefits

- NDPERS currently holds $1.8 billion in unfunded pension promises and expects to be insolvent in 80 years absent reform, largely due to insufficient funding and the growing interest costs from the state's accumulating debt.

- HB 1040 would shift NDPERS to an industry standard and actuarially sound method of funding, ensuring the state can deliver on its promises to members and retirees.



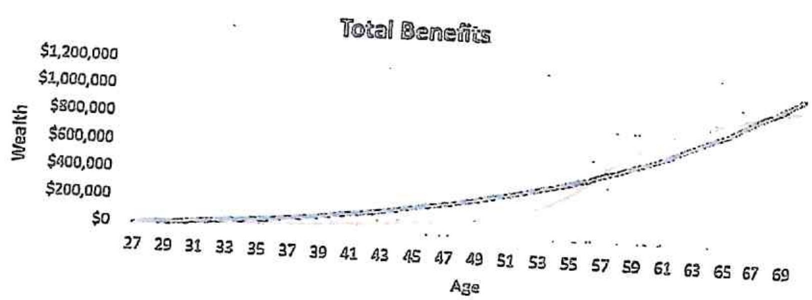


	Baseline	HB 1040
Total Employer Contribution	$2 Billion	$4.1 Billion
Ending Unfunded Liability	$2.8 Billion	-$275 Million
Total Long-term Cost	$4.9 Billion	$3.9 Billion

Saves Money for North Dakota Taxpayers

- By making a commitment to paying off NDPERS debt and preventing future debt, the state can expect to save over $1 billion in NDPERS costs over the next 20 years.

Improves Benefits For Most NDPERS Employees



*Reflects a 27-year-old new hire earning the average NDPERS entry age salary of $38,703 and participating in the full DC match..

- According to Pension Integrity Project analysis, for an average entrant into NDPERS, the proposed defined contribution plan's benefits would be more generous than the current NDPERS defined benefit plan's benefits.

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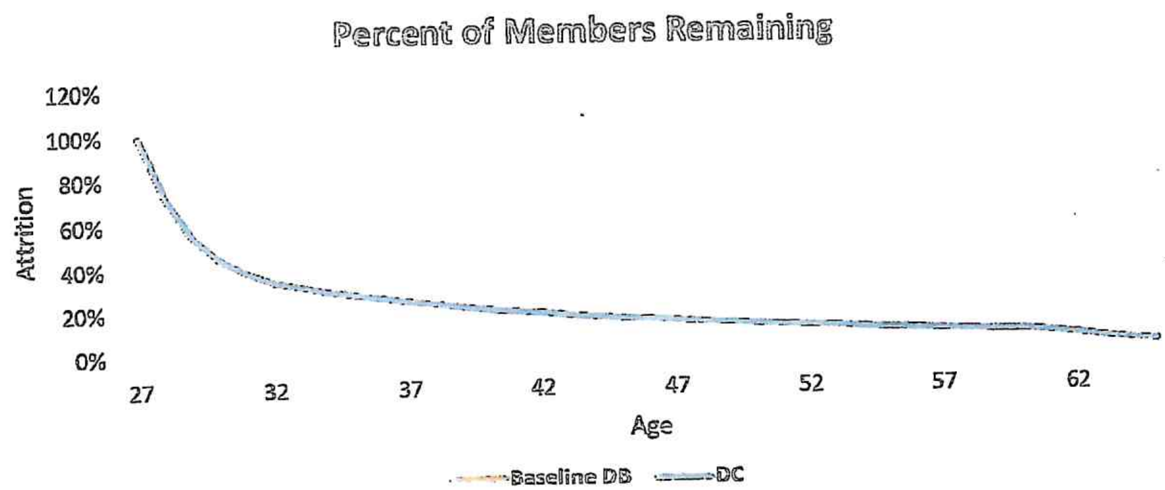
Better Retirement Security for 85% of New NDPERS Members

- NDPERS has one of the highest turnover rates of any defined benefit plan in the country.
- Approximately 50% of all new hires leave NDPERS service before they reach the plan's vesting period of three years.
- This means that half of all members leave their jobs 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.
- The defined contribution retirement plan established in HB 1040 would ensure that all North Dakota employees are on the right path to having healthy retirement savings, not just the few workers who stay for 30+ years.



Why Not Maintain the Status Quo?

- ***Workers have already spoken!*** *86 out of 100 state employees hired today will leave their public employers before earning an unreduced NDPERS pension.*
- *The benefit offered to future state employees in House Bill 1040 would provide benefit portability with a guaranteed employer contribution and match, improving North Dakota's public sector retirement benefits and making them just as—or more—attractive than most private sector retirement offerings.*

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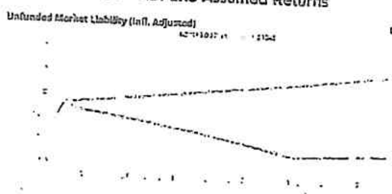
HB 1040 - NDPERS Reform

Today, NDPERS is estimated to be $1.9 billion underfunded, adding an additional $400 million since last session alone.

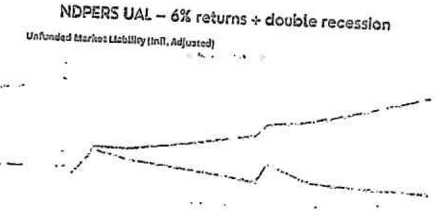
According to a recent report from the National Conference on Public Employee Retirement Systems (NCPERS), an organization that represents and advocates for defined benefit public pension plans, **North Dakota is one of just five states that has an unsustainable public pension debt trajectory.**

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 without HB1040.

NDPERS Debt– NDPERS Assumed Returns



NDPERS UAL – 6% returns + double recession



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 existing debt in the next 20 years.**

Cost of Keeping NDPERS DB vs HB 1040

If NDPERS investment return assumptions are met, HB 1040 would save **North Dakota $2.2 billion dollars** over the next 30 years compared to the current NDPERS DB.

Scenario	Total ER Cont.	Ending UAL	All-in Cost
NDPERS DB	$3.4 billion	$3.5 billion	$6.9 billion
HB 1040	$4.7 billion	$-0.1 billion	$4.7 billion

If NDPERS investment return assumptions are NOT met, HB 1040 would save **North Dakota $2.7 billion dollars** over the next 30 years compared to the current NDPERS DB.

Scenario	Total ER Cont.	Ending UAL	All-in Cost
NDPERS DB	$3.4 billion	$7 billion	$10.4 billion
HB 1040	$7.2 billion	$0.5 billion	$7.7 billion

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 pay for both benefits and debt servicing costs.

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 HB 1040, beginning with $240 million in year one and another $70 million per biennium until the plan reaches 90% funded.

HB 1040 - NDPERS Benefit

HB 1040 closes the current structurally underfunded defined benefit plan to all future new hires and instead offers them an upgraded version of the state's existing defined contribution retirement plan.

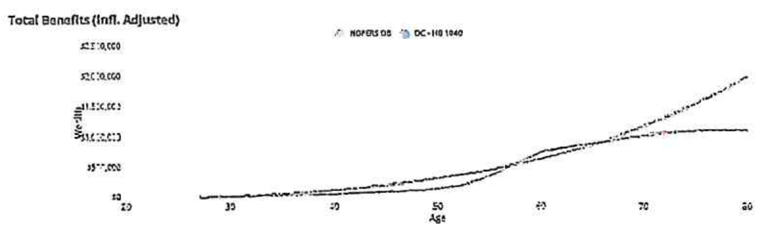
The cost of the current defined benefit is saddled by years of stifled contributions and a high interest rate (historically around 8%) on the pension system's accruing debt.

HB 1040 would ensure **zero accruals of new unfunded liabilities** related to future hires.

The level of benefits offered in the **NDPERS DB is the worst in the country.** This is due to the extremely low multiplier of 1.75% that the NDPERS pension uses for calculating benefits.

HB 1040 Offers a Better Benefit

The proposed defined contribution plan's benefits would be **more generous and advantageous to most public workers, in contrast to the pension benefit which is optimal for only a small number of workers who stay for 30 years.**

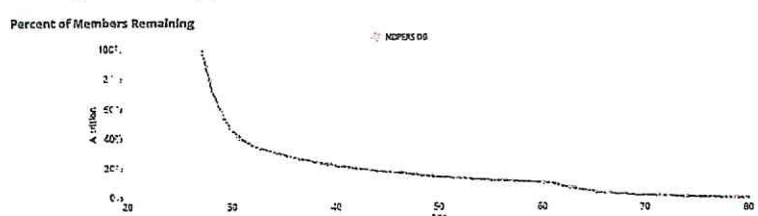


NDPERS Turnover

NDPERS currently has one of the highest turnover rates in the country. 55% of new employees leave before they reach three years of service.

Only 9% of new NDPERS hires make it to 30 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, forfeiting all employer contributions made and are ineligible for any pension benefit from NDPERS.



The current DB pension is not retaining public employees.

Pointing to "recruitment and retention" as a reason to keep the current DB plan is mistaken.

HB 1040 - Myths

Myth 1: Closing the NDPERS DB requires de-risking the investment portfolio.

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— this is a scare tactic to put a large fiscal note on the bill.

The interim retirement committee was advised by their consulting actuary, Milliman, that they were unaware of any **other reform in the past 20-30 years where an immediate de-risking** of a DB plan's assets took place when swapping to a defined contribution plan.

Myth 2: HB 1040 affects public safety employees, higher education employees, judges, and teachers

This plan only affects employees in the MAIN pers system. None of these employee groups are affected. They will still be enrolled in the current NDPERS DB.

Myth 3: HB 1040 will cost an additional $7.5 billion dollars

The cost figures of HB 1040 being propagated by opponents are dishonest. The only costs of HB 1040 come from catching up on what the state owes current and former employees for their pensions, it has nothing to do with new hires or a swap in plan design.

Public pension plans are not Social Security, they are pre-funded benefits. It's dishonest to say that new members are needed to fund previously accrued liabilities.

Any claims about cash flow issues stemming from a plan design swap are disingenuous. **NDPERS will have more money coming in over the next 23 years than at any point in the plan's history.**

If there were cash flow concerns, they are there already, as the NDPERS DB is projected to fall into insolvency in the near future. **Having MORE money coming into the plan doesn't create cash flow issues, it does the opposite.**

Oklahoma swapped their public employees to a DC plan in the early 2010s, with a similar unfunded liability figure to NDPERS, and has already fully funded their DB plan.

North Dakota Public Employees Retirement System (NDPERS)

Correcting the Record: Debunking HB1040 Opposition

Several special interest groups continue to mislead North Dakota legislators about HB1040. Below is the Pension Integrity Project's deconstruction of their latest attack.

House Bill 1040
Total Cash Outlays Over 20 Years
To Close Defined Benefit Plan

	4.5% Investment Return	5.5% Investment Return	6.5% Investment Return
General Fund Transfer	250,000,000	250,000,000	250,000,000
Legacy Fund Earnings	630,000,000	560,000,000	560,000,000
Increased ADEC	3,721,609,761	2,369,730,955	1,959,375,016
ADEC based on DC payroll	945,665,405	443,430,755	96,367,515
Total Cash Outlays	5,548,174,166	3,623,161,710	2,865,742,531
Approximate ADEC Funding Splits			
General Fund	2,749,720,000	1,672,180,137	1,078,307,646
Special Funds	1,564,400,000	990,315,299	761,905,678
Federal Funds	334,000,000	364,367,715	235,125,008
	4,663,120,000	3,026,863,151	2,075,338,332

Notes:

1. The above cash outlays are from the original HB 1040 GRS actuarial analysis. HB 1040 as amended pushes payment of ADEC out one year and the cost of that is about $45 million higher than the cash outlays shown above.

False?

2. The Reason Foundation is not an actuary and does not have North Dakota's data.

Reason Foundation's analysis is based on NDPERS' publicly available data and within 1% of NDPERS/GRS' modeling.

3. TIAA is not an actuary and does not have North Dakota's data.

4. Milliman IS an actuary but was not requested to perform an actuarial analysis on HB 1040 or the amended bill

Milliman provided an analysis on a reform scenario almost identical to HB1040 during the 2022 interim and can be found HERE.

5. GRS is licensed actuary on contract with the State of North Dakota to perform actuarial analyses and performed the actuarial analysis for the original HB 1040 and HB 1040 as amended.

6. GRS's actuarial analysis 2/1/2023 - *"The above discussion suggests that if the plan is closed, (1) it may not be possible to develop a portfolio that earns 6.5% return throughout the life of the plan, and (2) at some point, the asset allocation will be changed and lower returns should be expected. We have included alternate lower investment assumptions of 5.5% and 4.5% in our analysis. There is no way to quantitatively determine the actual closure cost of a defined benefit plan. In reality, the asset allocation would most likely be changed gradually over time and costs will be different than shown for a number of reasons. For example, if we assume an investment return rate of 6.5% for 10 years, 5.5% for the next 10 years, 4.5% for the next 10 years and 3.5% thereafter, the liabilities would be equivalent to assuming an investment return rate of 4.4% for the entire period."*

WHAT!?

Prepared by Pam Sharp
Coalition for Retirement Stability

NDPERS ignored most of this analysis when setting rates at their January Board Meeting. Rather than phasing in the lowering of the discount rate, the Board simply chose to adopt the "entire period" rate. No other pension reform has required "de-risking" in the aftermath of a pension design swap. During a July 21, 2022 hearing, Milliman stated directly that "De-risking is not something that you see in the immediate aftermath of moving employees to a DC plan."

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FALSE!
This is a financial scare tactic, and no state has ever done this. The costs come from paying down ALREADY existing unfunded liabilities. NDPERS cash flow will increase while ADEC payments are being made. Any de-risking conversation because of "cash flow" doesn't need to happen for at least 23 years, if at all.

The argument of having to sell assets due to cash flow needs is patently false. NDPERS will have more dollars coming in over the next 23 years than at any point in the plan's history.

80% funded is not fully funded. The American Academy of Actuaries has even spoken out against the "80% funded" myth.

OPPOSITION TO HOUSE BILLS 1039 AND 1040

Coalition for Retirement Stability

House Bills 1039 and 1040 Close the Defined Benefit Plan and Requires All New Employees to Enroll in a Defined Contribution Plan

HOW MUCH DOES IT COST?

The table below compares the cost of closing the Defined Benefit Plan over 20 years to providing Actuarial Determined Employer Contribution (ADEC) funding to the Defined Benefit Plan over the same time period.

For Comparison Only

But Why!?

	Total cash outlays over 20 years to close ND Defined Benefit Plan Assumes [illegible] Investment Return Due to Sold Assets	Total cash outlays over 20 years with ADEC funding, Defined Benefit Plan funded over 80% after 20 years Assumes 6.5% Investment Return
General Fund Transfer	$250 Million	$0
Legacy Fund Earnings Transfers	$630 Million	$0
ADEC for Defined Benefit Plan	$3.721 Billion: General Fund: $1.974B, Special Funds $1.414B, Federal Funds $333M	$725 Million: General Fund: $362M, Special Funds, $261M, Federal Funds: $102M
ADEC Allocation Based on Defined Contribution State Payroll	$946 Million	$0
	Additional State Cost to Close Defined Benefit Plan: $5.547 Billion	Additional State Cost to fund Defined Benefit Plan with ADEC: $725 Million Increased Employer Contributions for Political Subdivisions Amounts to $795M

HB 1040 ensures the citizens of North Dakota will soon reap the benefits of no longer having their tax dollars go towards paying down expensive unfunded liabilities.

Really, Nothing?

USE OF LEGACY FUND EARNINGS IS WRONG

Using funds from the Legacy Fund Earnings to close out North Dakota's Defined Benefit Plan is wrong.

Appropriating $630 million from the Legacy Fund earnings to close the defined benefit plan provides absolutely nothing for the citizens of North Dakota

The current pension ALREADY doesn't keep employees. 55% of employees leave before vesting. This makes NDPERS one of the highest turnover plans in the entire country.

False!

BAD FOR RECRUITMENT AND RETENTION

- State employees are paid less than the private sector is paid. The Defined Benefit Plan helps make up for the lesser salary. Closing the Defined Benefit Plan takes away that benefit.
- Only 2.87% of new employees elected to join the Defined Contribution Plan when it was made available to them from 2013 to 2017
- Just 3.95% of State employee survey respondents preferred a Defined Contribution Plan over a Defined Benefit Plan in the HRMS Survey of Current Employees.
- Current Defined Contribution Plan has mandatory contribution rate of 15.26% (7% employee + 8.26% employer). New Defined Contribution Plan has a mandatory contribution rate of 9.26% (4% employee + 5.26% employer). Employees may elect to contribute 3% more and State would match

<u>3 Things to Keep in Mind!</u>

1. The DC plan proposed in HB1040 is more generous than the current NDPERS DB plan.
2. Defaults matter. If the DC was the default, most employees would have been in the DC plan.
3. If provided with benefit accrual charts, most employees would choose the better DC benefit under HB1040.

HB 1040 doesn't require a single dollar from employees who choose not to contribute more towards their plan. If they choose to contribute towards their retirement in the future, the state will match up to 3%.

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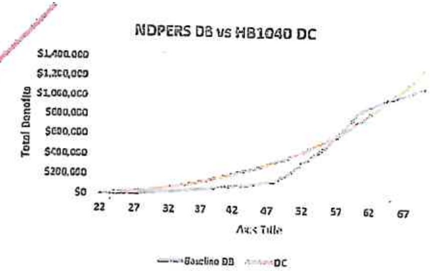
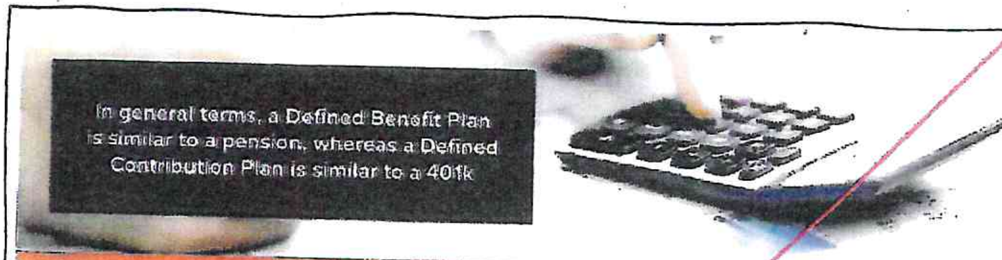
False!



The DC plan offered under HB 1040 is more generous for more employees.



The proposed Defined Contribution Plan generates about half of the retirement income of the current Defined Benefit Plan.

Defined Benefit Plan with 1.75% multiplier vs Defined Contribution Plan with 6% return

EXAMPLE:

An employee with 21 years of service, final average salary of $40,000.

Defined Benefit Plan		Defined Contribution Plan
1.75% Multiplier	←  →	6% Return
Generates $14,700 Annually in Retirement		Generates $7,640 Annually in Retirement
		(Assuming Individual Takes Out 4% Per Year)

NDPERS has seen a downward trend in its funding since 2000. Investment returns are part of the reason. Poor funding methods are another reason.

NO DISABILITY PLAN

The Defined Contribution Plan does not provide an option for long-term disability, while the Defined Benefit Plan includes long-term disability. This is particularly bad for public safety personnel

HOW DID WE GET HERE?

The 2008 financial crisis caused the fund's assets to drop by over 20% and subsequent legislative assemblies have not funded the complete recovery plan to get the fund back on track.

This can be said about any public program. The costs of this bill do not come from swapping plan designs. They come from properly funding the existing DB liabilities. The rising debt in NDPERS is already binding future legislatures to increasingly larger payments if changes aren't made.

NO LEGISLATURE CAN BIND A FUTURE LEGISLATURE

This bill assumes future legislatures will appropriate very large sums of money over 20 years, but cannot require them to do so.

WHAT HAPPENS IF FUTURE LEGISLATORS DO NOT APPROPRIATE ALL THE FUNDING?

The fund will continue to pay retirement benefits until the fund is spent down to zero, when no more retirement benefits will be able to be paid, even though the state is obligated to pay those retirement benefits.

DB benefits are constitutionally protected from impairment. They will be paid by the state, no matter what. If the fund runs out of money, the state will be funding benefits on a pay-as-you-go basis, similar to Social Security. Costs will go up 50% above what they are now. This will happen sometime in the future if changes aren't made.

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Reason Foundation is a national 501(c)(3) public policy research and education organization with expertise across a range of policy areas, including public sector pensions, transportation, infrastructure, education, and criminal justice. For more information about the Pension Integrity Project at Reason Foundation, visit reason.org.

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Opponents of HB 1040 are bringing up a few examples of states that have adopted DC plans which are reportedly "moving back" to a DB plan, citing challenges with recruiting and retention. A closer examination of each of these examples rebuts the assertion that the states are seriously considering a move back to a DB-style retirement plan. Some of the examples gained moderate levels of support last year (backed by pressure from unions), but all fell short once policymakers started to ask questions about the actual long-term risks and costs of reopening their pension plans. Looking back, there is just one example where a state switched to a DC plan and later went back to a DB plan, that being West Virginia in 2005. Details on all three of these examples are given below:

West Virginia

- West Virginia closed their DB plan in 1991 in favor of a new DC plan, only to reopen their DB plan in 2005. The original reasoning for closing the DB plan was due to funding issues, which were never addressed despite the closure of the DB. West Virginia's DC strategy didn't work for the following reasons:
  - The funding problems that spurred the switch away from a DB plan were never addressed. A decade later, the state still had significant funding problems with the legacy plan, which brought many to the incorrect conclusion that the DC reform didn't work.
  - The DC plan was poorly structured with contributions that didn't adequately save enough for retirement.
- HB 1040 explicitly avoids the mistakes that West Virginia made.
  - The reform addresses the funding problems with ADEC contributions, which will ensure that the legacy DB plan will actually see significant improvement in its funding.
  - The DC plan is structured to adhere to best practices in retirement savings. Unlike West Virginia's attempt, the contributions going into this DC plan are adequate.
- 2022 legislation in West Virginia (HB 2800) was a proposal to let those who elected to be in the remaining optional DC plan to switch their choice to the existing DB plan. Considering this legislation never made it out of committee, this is a poor argument for a state moving from DC to DB.

Oklahoma

- Oklahoma closed its non-teacher pension plan to new members in 2014 after major funding challenges. Due to this and their focus to pay down the legacy debt accrued by the DB plan, the state has gone from 66% funded to 100% funded in 2021.
- A freshman Republican ran a bill last year (HB 2486) to reopen the DB plan. The motivation behind this effort was clearly to please the unions in his district. The Speaker let the vote happen before much scrutiny was applied. The bill did not have any support in the Senate and failed to move.

Pension Integrity Project at Reason Foundation

Modeling Methodology & Approach to Analysis of Public Retirement

The Pension Integrity Project (PIP) at Reason Foundation provides technical assistance to government policymakers to assess the solvency of public employee retirement systems and analyze the potential impacts of potential reforms. This assistance is grounded in years of experience developing effective, bipartisan policy solutions that address the complex needs of government employers, employees, retirees, and taxpayers. PIP's work demystifies complicated retirement policies with advanced actuarial modeling, built by a team of experts and backed by industry-leading actuarial consultants.

To advise on the immediate and long-term effects of policy decisions, PIP uses custom-built actuarial and employee benefit models that are tailored to reflect each unique retirement system. While PIP does not have access to individual participant-level data—accounting of the behavior of each individual participating member—given its proprietary nature, *that level of data is not necessary to develop highly accurate models* that allow for forecasting the factors most relevant to policymaking: general projections of liabilities, assets, and employer/employee contributions.

Highly accurate actuarial models require only the assumptions used by the pension system, which are publicly available and reported in the annual actuarial valuation and other common reports. PIP uses the system's current assumptions to develop advanced and dynamic actuarial modeling to provide valuable context on the near and long-term fiscal and financial impacts of various policy options.

PIP's team of experts frequently carries out checks and calibrations—holding findings up to official actuarial reporting—to ensure the accuracy of the models used. PIP also subjects forecasts and outputs to rigorous review by policy experts and licensed consulting actuaries.

Reason Foundation experts are particularly proficient at delivering intricate and plan-specific analyses in a way that is easy to understand and applicable to policymakers. PIP even develops interactive tools that put the wide possibilities of modeling directly in the hands of policymakers.

The Pension Integrity Project develops several different types of modeling to address the various policies that affect the overall success of a public retirement plan:

- Funding models project the liabilities of a plan as well as the short and long-term costs associated with policies.
- Employee benefit models calculate the utility of a retirement plan over time, illustrating how well a plan delivers on benefits offered to public workers at different ages and years of service.
- Return probability analyses evaluate the likeliness of specific plans achieving different market results.

Reason's actuarial modeling and analysis have contributed valuable, decision-relevant information to the policymaking process in several states that have successfully implemented bipartisan pension, including Texas, Michigan, Arizona, Colorado, New Mexico, and Florida.

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