RETIREMENT COMMITTEE

The Retirement Committee was tasked with developing a plan for new hires under the Public Employees Retirement System (PERS) main system to participate in the defined contribution (DC) plan and to close the defined benefit (DB) plan to new entries effective January 1, 2024, pursuant to House Bill No. 1209 (2021). The committee, upon approval of the Chairman of the Legislative Management, had the authority to use the services of a third-party contractor to assist in the study.

Additionally, the committee received authorization from the Legislative Management to develop a plan for new hires under the PERS main system to participate in a DC, cash benefit, or hybrid plan and to close the DB plan to hires effective on a date certain.

Committee members were Representatives Mike Lefor (Chairman), Rick Becker, Joshua A. Boschee, Jason Dockter, Scott Louser, Austen Schauer, Vicky Steiner, and Greg Stemen and Senators Howard C. Anderson, Jr., Karen K. Krebsbach, Doug Larsen, Tim Mathern, Kristin Roers, and Shawn Vedaa.

BACKGROUND

Original Main System Defined Contribution Plan

Senate Bill No. 154 (1965), created a PERS DC plan, effective July 1, 1966, Senate Bill No. 2068 (1977) converted the main system DC plan to a DB plan.

Main System Defined Benefit Plan

Contribution Rates

The PERS main system DB plan is funded from employer contributions, employee contributions, and investment earnings. Contributions are calculated based on a percentage of gross pay. From 1977 through 1989, the employer contribution was 5.12 percent of state employee salaries and the employee contribution was 4 percent. In lieu of state employee salary increases in 1983 and 1984, the state began to pay the 4 percent employee contribution. In 1989, the employer contribution was reduced by 1 percent and reallocated for a retiree health benefit credit. In January 2012, January 2013, and January 2014, the employer and employee contributions each increased by 1 percent annually. Senate Bill No. 2046 (2019) reallocated the 1.14 percent employer contribution for the retiree health insurance credit to the main system DB plan for employees hired after December 31, 2019. The following reflects the history of employer and employee contribution rates for the main system DB plan:

1989 Through December 31, 2011		Effective January 1, 2012		Effective January 1, 2013		Effective January 1, 2014	
Employer	Employee	Employer	Employee	Employer	Employee	Employer	Employee
4.12%	4.00%[1]	5.12%	5.00%[1]	6.12%	6.00%[1]	7.12%[2]	7.00%[1]

[1]The state pays 4 percent of the employee share of retirement contributions.

[2]Senate Bill No. 2046 (2019) reallocated the 1.14 percent employer contribution for the retiree health insurance credit to the main system DB plan for employees hired after December 31, 2019, resulting in a total employer contribution rate of 8.26 percent for employees hired after December 31, 2019.

Membership

The following is a summary of membership of the PERS main system DB plan as of January 1 of each year:

Calendar Year	Active State Members	Active Political Subdivisions Members	Retirees and Beneficiaries	Deferred Members	Total
2013	10,014	10,264	7,214	7,634	35,126
2014	10,437	11,511	7,907	8,304	38,159
2015	10,536	12,097	8,628	9,503	40,764
2016	10,783	12,750	9,291	10,733	43,557
2017	10,605	12,965	9,790	11,654	45,014
2018	10,237	13,119	10,957	12,186	46,499
2019	10,073	13,343	11,759	13,267	48,442
2020	9,998	13,693	12,117	14,000	49,808
2021	10,553	15,101	13,259	13,887	52,800
2022	10,361	15,253	14,000	15,020	54,634

Assets, Liabilities, and Funded Ratio

The actuarial funded ratio is the percentage of the retirement fund's actuarial value of assets to its actuarial accrued liabilities. The actuarial value of assets is determined by spreading market appreciation or depreciation over 5 years. This procedure results in recognition of all changes in market value over 5 years. The following schedule shows the actuarial assets and liabilities of the main system DB plan since 2000.

Fiscal Year	Actuarial Value of Assets	Actuarial Value of Liabilities	Actuarial Surplus or (Unfunded Liability)	Actuarial Funded Ratio	Assumed Rate of Return	Actuarial Rate of Return[1]	Rate of Return Variance[2]
2000	$1,009,744,796	$879,189,877	$130,554,919	114.8%	8.00%	13.71%	5.71%
2001	$1,096,115,648	$993,851,809	$102,263,839	110.3%	8.00%	9.36%	1.36%
2002	$1,129,697,099	$1,087,003,336	$42,693,763	103.9%	8.00%	3.91%	(4.09%)
2003	$1,145,284,302	$1,170,477,887	($25,193,585)	97.8%	8.00%	2.18%	(5.82%)
2004	$1,172,258,036	$1,250,849,240	($78,591,204)	93.7%	8.00%	3.16%	(4.84%)
2005	$1,210,287,848	$1,333,491,341	($123,203,493)	90.8%	8.00%	4.36%	(3.64%)
2006	$1,286,478,642	$1,450,113,412	($163,634,770)	88.7%	8.00%	7.79%	(0.21%)
2007	$1,470,367,098	$1,575,666,628	($105,299,530)	93.3%	8.00%	15.84%	7.84%
2008	$1,571,159,912	$1,700,171,588	($129,011,676)	92.4%	8.00%	8.51%	0.51%
2009	$1,577,552,012	$1,861,032,305	($283,480,293)	84.8%	8.00%	1.72%	(6.28%)
2010	$1,576,794,397	$2,156,560,553	($579,766,156)	73.1%	8.00%	1.48%	(6.52%)
2011	$1,603,718,656	$2,284,199,019	($680,480,363)	70.2%	8.00%	3.31%	(4.69%)
2012	$1,579,933,179	$2,442,299,210	($862,366,031)	64.7%	8.00%	(0.15%)	(8.15%)
2013	$1,632,915,720	$2,650,525,018	($1,017,609,298)	61.6%	8.00%	3.93%	(4.07%)
2014	$1,837,902,845	$2,866,511,290	($1,028,608,445)	64.1%	8.00%	12.20%	4.20%
2015	$2,027,476,214	$2,976,071,808	($948,595,594)	68.1%	8.00%	10.01%	2.01%
2016	$2,180,748,616	$3,299,381,100	($1,118,632,484)	66.1%	8.00%	6.59%	(1.41%)
2017	$2,529,631,008	$3,618,083,973	($1,088,452,965)	69.9%	8.00%	8.98%	0.98%
2018	$2,752,053,305	$3,841,701,179	($1,089,647,874)	71.6%	7.75%	9.22%	1.47%
2019	$2,949,967,049	$4,136,252,987	($1,186,285,938)	71.3%	7.50%	8.64%	1.14%
2020	$3,112,920,033	$4,557,679,020	($1,444,758,987)	68.3%	7.00%	7.26%	0.26%
2021	$3,369,943,759	$4,795,054,158	($1,425,110,399)	70.3%	7.00%	10.38%	3.38%
2022	$3,553,539,588	$5,304,187,804	($1,750,648,216)	67.0%	6.50%	7.43%	0.93%

[1]The average actuarial rate of return during fiscal years 2000 through 2022 was 6.95 percent.

[2]The average actuarial rate of return during fiscal years 2000 through 2022 was 0.87 percent below the average assumed rate of return.

PUBLIC EMPLOYEES RETIREMENT SYSTEM

The committee received testimony from PERS regarding the estimated unfunded liability of the main system DB plan, issues related to the impact of closing the DB plan, and the possible effects of separating political subdivisions from state employees. Testimony indicated the main system DB plan is not expected to reach 100 percent funded status with the current statutory contribution rates and projected investment returns. Retirement funding received by PERS from state agencies is derived from the general fund (48 percent) and federal and state special funds (52 percent).

The 2013 Legislative Assembly expanded eligibility for the DC plan to include all new employees for a limited time. Approximately 3 percent of new employees chose to participate in the DC plan rather than the DB plan. The 2015 Legislative Assembly provided DC plan members the option to transfer to the DB plan. Approximately 75 percent of DC plan members transferred to the DB retirement plan. There are approximately 100 employees participating in the DC plan.

Testimony provided by PERS indicated closing the main system DB plan to new hires may have a negative effect on employee recruitment and retention for state agencies and political subdivisions and the plan's investment portfolio assumed risk rate would be gradually reduced, resulting in an increase in the plan's unfunded liability. The unfunded liability could increase to approximately $3.1 billion, which may affect state and political subdivision bond ratings. Additional funding is needed to replace the reduction of employer and employee contributions. Additional funding can be obtained by increasing statutory contribution rates or providing for transfers from other funds to the PERS fund. Providing benefit payments to retiring members will be necessary for approximately 80 years.

Testimony provided by PERS indicated it is not possible to separate the main system DB plan between the state's responsibility and political subdivisions' responsibility.

ACTUARIAL REPORTS

The committee received testimony from Gabriel, Roeder, Smith & Company Holdings, Inc. regarding the unfunded liability of the DB plan. Testimony indicated the main system DB plan unfunded liability as of July 1, 2021, was $1.43 billion and the total actuarial rate of the main system was 19.5 percent. The unfunded liability as of July 1, 2022, was $1.75 billion and the total actuarial contribution rate of the main system was 21.7 percent.

The main system DB plan was 70.3 percent funded on July 1, 2021, and 67 percent funded on July 1, 2022. The July 1, 2022, actuarial valuation of the main system DB plan indicated the plan is estimated to be less than 50 percent funded by 2062.

The committee was informed PERS adopted the actuary recommendation to decrease the main system DB plan investment return assumption from 7 percent to 6.5 percent effective July 2022.

REQUEST FOR PROPOSAL AND CONSULTANT SELECTION

The committee received approval from the Chairman of the Legislative Management to issue a request for proposal to contract with an actuary to assist the committee with its study of developing a plan to close the PERS main system DB plan for state and political subdivision employees and transition new hires to a DC plan. The committee considered the importance of specifying the scope of the consultant's work and the possible impact decreasing retirement benefits might have on employee attraction and retention.

The committee contracted with Milliman, Inc. to provide actuarial estimates and consultation regarding options for a DC plan and potential alternatives to a DC plan. The contract provided actuary and analysis services may not exceed $90,000 and consultative services may not exceed $40,000. The final billing for services provided by Milliman, Inc. was not available at the time of this report but the estimated total for actuary and analysis services is $90,000 and the estimated total for consultive services is less than $40,000.

MILLIMAN, INC.

The committee received testimony from Milliman, Inc. addressing advantages and disadvantages of DB and other plans, financing models to explore asset derisking, biennial funding, bonding, the effect of increasing employer and employee contribution rates, and the long-range financial impact of changing the retirement program for future hires.

Milliman, Inc.'s approach to the study included replicating the July 1, 2021, PERS valuation results, building interactive financial projection and retirement income models, evaluating current benefits, studying administrative and transition issues of switching from a DB plan to a DC plan, and researching alternative plan options. Milliman, Inc. surveyed committee members and interested organizations regarding the prioritization of potential retirement plan elements, including portability, contribution levels, recruitment and retention goals, ability for retirement benefits to provide lifetime income, inflation protection, efficient use of taxpayer funds, and eliminating the possibility of retirement benefit reductions.

The committee was informed alternative plans to a DB plan include a DC, cash balance, DB and DC hybrid, or variable plan. The Public Employees Retirement System offers employees the option of electing a 401(a) DC plan. Other popular DC plans include 401(k) and 457(b) plans. Milliman, Inc. reviewed a retirement alternative of state and political subdivisions participating in a DB and DC hybrid plan.

Milliman, Inc. provided alternative financial models for the PERS main system plan. Milliman, Inc. reviewed 14 DB, DC, and actuarially determined employer contribution (ADEC) plan scenarios. The scenarios include assumptions of investment returns of either 6.5 or 5.5 percent and the effect on the funded ratio of the PERS main system plan if $0, $50 million, or $150 million was transferred to the PERS main system fund during the 2023-25 biennium and future bienniums. The scenarios assumed a 20-year amortization period and that a portion of contributions be redirected ("spillover") to the closed DB plan. Changing the main system plan to require new employees to enter a DC plan that includes 6 percent employee contributions and actuarially determined contributions from employers would result in the plan being 98 to 103 percent funded by 2041 and 105 to 110 percent funded by 2051, depending on investment returns.

The following is a summary of the Milliman, Inc. main system retirement plan scenarios:

Scenario	Description	Ongoing Biennial Transfers (Millions)	2023-25 Biennium Transfers (Millions)	Estimated Cumulative Employer Contributions (Billions)		Estimated Surplus (Unfunded Liability) (Billions)		Estimated Funded Ratio	
				2041	2051	2041	2051	2041	2051
Assumed Rate of Return: 6.5%									
1	Current DB plan	$50	$0	$3.21	$5.78	($3.92)	($5.39)	65%	66%
2	DC plan for new hires and 6 percent employer contributions	$50	$0	$2.95	$5.06	($4.76)	($8.29)	49%	15%
3	Scenario 2 with 1% additional employer and employee contributions	$50	$0	$3.15	$5.32	($4.00)	($6.66)	57%	31%
4	Scenario 3 with an additional $100 million transfer	$50	$100	$3.25	$5.42	($3.70)	($6.10)	60%	37%
5	Scenario 2 but includes ADEC	$50	$0	$5.91	$7.57	$0.23	$0.27	102%	110%
6	Scenario 5 with an additional $100 million transfer	$50	$100	$5.83	$7.48	$0.94	$0.96	103%	110%
7	Scenario 5 with no transfers	$0	$0	$5.84	$7.63	($0.14)	$0.51	98%	105%
Assumed Rate of Return: 5.5%									
8	Same as scenario 1	$50	$0	$3.21	$5.78	($6.87)	($11.05)	45%	38%
9	Same as scenario 2	$50	$0	$2.95	$5.06	($7.16)	($11.94)	31%	(13%)
10	Same as scenario 3	$50	$0	$3.15	$5.32	($6.48)	($10.60)	38%	0%
11	Same as scenario 4	$50	$100	$3.25	$5.42	($6.22)	($10.16)	40%	4%
12	Same as scenario 5	$50	$0	$7.72	$9.53	$0.12	$0.82	101%	108%
13	Same as scenario 6	$50	$100	$7.66	$9.45	$0.15	$0.82	101%	108%
14	Same as scenario 7	$0	$0	$7.57	$9.58	($0.24)	$0.47	98%	104%

INTERESTED ORGANIZATIONS

TIAA

The committee received testimony from TIAA regarding best practices for DC plans, including a review of fixed and variable annuities and retirement benefit scenarios under a DC plan. Testimony indicated TIAA has provided retirement and consulting services for the North Dakota University System for 58 years. TIAA noted best practices for DC plans include allowing all employees access to the plan, providing automatic enrollment, setting a target savings rate of between 12 and 15 percent, providing a low-cost custom default investment option that includes a guaranteed lifetime income, offering an investment menu of 15 to 20 low-cost funds and annuities, and maintaining flexibility to adjust plan goals based on outcomes, member behavior, and needs. Inclusion of an annuity in the qualified default investment alternative of a retirement plan does not conflict with federal guidelines.

Reason Foundation

The committee received testimony from the Reason Foundation regarding alternative financial models and plan options for the PERS main system plan. Testimony indicated the average long-term portfolio returns on the main system DB plan assets have not matched long-term investment return assumptions. The Public Employees Retirement System historically has assumed an investment rate of return of 8 percent and has lowered the assumed rate to 6.5 percent. However, national data suggests assuming investment returns of 6 percent may be optimistic. Best practices for DC plans include total contributions of 10 to 15 percent of pretax earnings, encouraging the use of target date funds, and expanding lifetime income options to improve retirement security. Use of an ADEC model is necessary for the main system plan to reach 100 percent funded status and will save the state and political subdivisions billions of dollars in long-term costs. Plans suggested as alternatives to the current DB plan included, a reduced risk DB and DC hybrid plan that would stabilize market volatility for the DB plan and provide predictable benefits for DC members; a cash balance plan, which is designed to guarantee asset growth while providing a steady accrual rate to offer members portability and provide retirement security; and a plan requiring new hires to participate in a DC plan with 6 percent employer contributions and 7 percent employee contributions, providing a one-time transfer of $100 million into the PERS fund for the main system DB plan, and using an ADEC model with a closed 20-year amortization period.

North Dakota Association of Counties

The committee received testimony from the North Dakota Association of Counties regarding issues related to closing the PERS main system DB plan to new hires and the impact of separating the political subdivision employees from state employees. Testimony indicated 51 of 53 counties participate in a PERS retirement plan and the counties view the DB plan as a valuable workforce retention tool for participating political subdivisions. The committee was informed active political subdivision employee membership exceeds active state employee membership, resulting in local government agencies contributing more to the DB plan than state government agencies. The North Dakota Association of Counties did not take a position on the work of the committee or bill drafts recommended by the committee.

North Dakota League of Cities

The committee received testimony from the North Dakota League of Cities regarding issues related to closing the PERS main system DB plan to new hires and the impact of separating the political subdivision employees from state employees. Testimony indicated cities expressed concerns regarding recruitment and retention of employees if political subdivisions move from a DB plan to a DC plan and if the DB plan is separated between political subdivisions and the state.

North Dakota United

The committee received testimony from North Dakota United regarding the committee's studies. Testimony indicated North Dakota United considers the DB plan an irreplaceable resource to recruit and retain highly talented employees. North Dakota United does not support efforts to close the main system DB plan and require new state employees and political subdivision employees to participate in a DC plan.

Retirement and Investment Office

The committee received testimony from the Retirement and Investment Office regarding the status of investments of the PERS fund and effects on the Teachers' Fund for Retirement (TFFR) if the main system DB plan is closed. Testimony indicated the TFFR Board will discuss policy components of the committee's work in November 2022 in preparation for the 2023 legislative session.

Office of Management and Budget

The committee received testimony from the Office of Management and Budget Human Resource Management Services Division regarding the committee's study and the state of the workforce, including recent employee recruitment and retention trends, state employee age demographics, turnover rates by age, and turnover costs. Testimony indicated from January 2020 to January 2022, more than 600,000 workers across the country left government agencies. By 2025, Millennials and younger generations will account for approximately 75 percent of the workforce and it is estimated these workers will have held 10 to 14 jobs by age 38. After the COVID-19 pandemic, employee job location preference shifted from on-site work locations (9 percent) to remote work environments (32 percent) or a combination of on-site and remote options (59 percent). As compared to private industry, the state is not consistently attracting workers younger than 30. Twenty-five percent of state employees, excluding higher education employees, will be eligible for retirement within 5 years. Excluding higher education employees, the state has experienced employee turnover rates of 10 to 14 percent each year since 2012. The employee turnover rate in 2021 was 14 percent, derived primarily from turnover in employees aged 30 and younger. The estimated turnover cost of employees leaving state government in 2021 ranged from $29.7 million to $118.9 million.

National Conference of State Legislatures

The committee received testimony from the National Conference of State Legislatures regarding alternatives to traditional DB plans. Testimony indicated during 2021 legislative sessions, 41 states considered pension-related legislation. As of August 2021, 11 states have replaced traditional DB plans with alternative plans and of the states with DB plans, 7 states were at least 90 percent funded while 9 states were less than 60 percent funded.

RETIREMENT PLANS OF OTHER STATES

Alaska

The committee received testimony from the Alaska Division of Retirement and Benefits regarding the Alaska experience of transitioning from a DB plan to a DC plan. Testimony indicated legislation enacted in 2005 resulted in a transition to a DC plan in 2006. Corrective legislation was needed in 2007 and 2009 due to the short transition period. Testimony included a discussion of the current rate of unfunded liability of the Alaska plans and how the state implemented a cash infusion transfer in 2015.

Oklahoma

The committee received testimony from the Oklahoma Public Employees Retirement System regarding the Oklahoma experience of transitioning from a DB plan to a DC plan. Testimony indicated after the 2008 and 2009 financial crisis, the Oklahoma DB plan was 66 percent funded. The state undertook multiple pension reform efforts from 2010 to 2015 to address the underfunded plan, resulting in increasing the minimum member retirement age, increasing vesting requirements, eliminating rounding of employee service time, expanding the final average salary calculation from 3 to 5 years, and eliminating cost-of-living adjustments unless the adjustments were funded by the legislature. These adjustments resulted in the funded ratio of the DB plan increasing to 80 percent funded status. The current system requires Oklahoma state employees hired after October 31, 2015, to participate in the state's DC plan. The plan provides for a minimum employee contribution of 4.5 percent with an employer match of 6 percent and an option for the employee to contribute 7 percent or more with an employer match of 7 percent. The DC plan consists of 401(a) and 457(b) plans.

Kansas

The committee received testimony from a representative of the Kansas House of Representatives regarding the Kansas experience of transitioning from a DB plan to a cash balance plan. Testimony indicated in 2010, the Kansas DB plan was the second-lowest funded retirement plan in the country. Kansas formed a pension reform commission in 2011 to develop a plan to reduce the unfunded liability of the plan, minimize employer costs, reduce risk for employees, and maximize benefits for employees. The commission recommended a transition to a DB and DC hybrid plan in 2012.

COMMITTEE CONSIDERATIONS AND RECOMMENDATIONS

Considerations

The committee considered two revisions to a bill draft to close the PERS main system DB plan and expand the DC plan as of January 1, 2024, and two revisions to a bill draft to close the PERS main system DB plan and expand the DC plan as of January 1, 2025.

The bill draft revisions included consideration of whether to have the optional 3 percent DC employee contribution and matching employer contribution addressed as part of the DC plan or as part of the 457 deferred compensation plan, whether to codify mandatory PERS annuity provider selection requirements or whether to provide codified guidance to PERS, whether the bill drafts adequately address treatment of new hires who have prior TFFR service, whether the bill drafts adequately address how higher education's retirement plan works alongside the PERS DC plan, and whether the qualified default investment alternative should be required to include an annuity component.

The committee's final revisions to the bill drafts included clarifying the new hire use of the 457 deferred compensation plan for any optional employee contribution and employer matching contribution is not a limitation on contribution amounts, other than the federal cap, providing the $250 million appropriation to PERS is not limited to offsetting the state's share of the PERS unfunded liability of the retirement plan, and providing the qualified default investment alternative must include an annuity component.

Discussion

Discussion between the committee and PERS regarding the bill drafts indicated the committee preferred the effective date January 1, 2025, due to PERS administrative requirements, including time needed to adopt administrative rules, the hiring of four additional employees to close the DB plan and implement DC plan changes, and to contract for the annuity provider of the DC plan.

The Public Employees Retirement System indicated the estimated cost of hiring four additional employees and other transitional costs to implement requirements of bill drafts effective January 1, 2025, is approximately $836,000. An actuarial analysis is needed to determine the total cost of the bill drafts. Upon completion of the committee's study charge, the Employee Benefits Programs Committee will determine whether to take jurisdiction over the recommended bill drafts and have actuarial analyses conducted pursuant to Section 54-35-02.4.

The committee was informed that based on the 2022 actuarial valuation, the total combined ADEC rate of the state and political subdivisions which exceeds current statutory contribution rates is approximately 13.7 percent and could be as much as a 15 percent increase. During the 2021 legislative session, a 1 percent increase in the state's employer contribution rate was estimated to cost approximately $9.4 million for 18 months of the 2021-23 biennium.

Recommendations

The committee recommends a bill draft [23.0280.03000] to close the main system DB plan to new hires beginning January 1, 2025, provide a one-time transfer of $250 million from the general fund to the PERS fund to reduce the unfunded liability of the main system DB plan, create a DC plan with 4 percent employee and 4.12 percent employer contribution rates, optional additional 3 percent employee and 3 percent employer matching contributions provided through the PERS 457 deferred compensation plan; and require employer contribution rates for the DB plan to be based on ADEC rates, of which the state would be responsible for the state and political subdivision employer shares.

The committee recommends a bill draft [23.0196.05000] to close the main system DB plan to new hires beginning January 1, 2024, provide a one-time transfer of $250 million from the general fund to the PERS fund to reduce the unfunded liability of the main system DB plan, create a DC plan with 4 percent employee and 4.12 percent employer contribution rates, optional additional 3 percent employee and 3 percent employer matching contributions provided through the PERS 457 deferred compensation plan; and require employer contribution rates for the DB plan to be based on ADEC rates, of which the state would be responsible for the state and political subdivision employer shares.