Testimony in Opposition to House Bill No. 1040

Scott Miller, Executive Director

NORTH DAKOTA
PUBLIC EMPLOYEES
RETIREMENT SYSTEM

$4.5 Billion More Expensive

- This is the present value of how much MORE expensive over the next 22 years it will be to close the Defined Benefit plan and have all new employees go into the new Defined Contribution plan, than it is to maintain the current DB plan
- Unfortunately, you cannot require future Legislatures to maintain adequate funding

Contributions to the DB Plan and DC Plan			
	Present Value of Total Employer Contributions for 2023 to 2045[1]	Difference from Baseline	Difference from Baseline - ADEC Funding
Baseline	$1,628,872,628		
Baseline - ADEC Funding	$2,451,546,855	$822,674,227	
Bill 280 - 6.50% Investment Return	$3,237,625,450	$1,608,752,821	$ 786,078,595
Bill 280 - 5.50% Investment Return	$4,494,009,269	$2,865,136,641	$ 2,042,462,414
Bill 280 - 4.50% Investment Return	$6,165,090,492	$4,536,217,864	$ 3,713,543,637

Milliman Analysis

- Milliman, the Retirement Committee's actuarial expert, did not analyze this bill
- However, they did provide an analysis of the total projected employer contributions over a 20-year period for a somewhat-similar scenario, with these differences:
  1. $50 million/biennium infusion instead of $70 million
  2. No $250 million infusion
  3. Employer contribution of 6% to the DC plan, instead of 8.26%
  4. 5.5% investment return assumption/discount rate
- Over the 20-year period analyzed by Milliman, the GRS projection, using a 5.5% discount rate, is within 2.5% of the Milliman projection when accounting for the differences in plans

Milliman Analysis

Same scenarios with 5.50% interest rate	Scenario 12
Funded Ratio	
2021	70%
2031	75%
2041	101%
2051	108%
Unfunded Accrued Liability ($ millions)	
2021	1,425
2031	2,094
2041	(121)
2051	(820)
DB + DC Employer Contributions ($ millions)	
FYE 2024	330
Cumulative 2023-2032	3,324
Cumulative 2023-2042	7,720
Cumulative 2023-2052	9,534

This $7.720 billion estimate from Milliman is within 2.5% of GRS's estimate for the same timeframe when accounting for the differences in scenarios

$470 Million Increase

- The total of additional State and Political Subdivision contributions for the 2023-25 biennium, including the $250 million from the general fund and $70 million from the Legacy Earnings fund
- Next biennium the additional contributions will be $670 million
- State Employer contribution goes up an additional 39.9%, to 48.16% of compensation
- Agencies with federally-funded positions will need to find alternate funding sources

	2023-2025 Biennium	2025 - 2027 Biennium
State Agencies (39.9% increase)	$ 146,937,828	$ 587,751,310
Counties (1% increase)	969,058	3,876,232
Cities (1% increase)	631,368	2,525,474
School Districts (1% increase)	1,304,516	5,218,065
Other Political Subs (1% increase)	249,375	997,500
Lump Sum Deposits	320,000,000	70,000,000
Total	$ 470,092,145	$ 670,368,581

Traditional defined contribution plans - disadvantages

- Inefficient use of taxpayer money

- Milliman, the Retirement Committee's own actuarial expert, called Defined Contribution plans an "inefficient use of taxpayer money"
  - Milliman Presentation to Retirement Committee, slide 22 (April 11, 2022).
- Why is it "inefficient"?

- Inefficient use of taxpayer money: need almost twice as much $$s to fund same level of benefits as a DB plan* Still a Better Bang for the Buck: An Update on the Economic Efficiencies of Defined Benefit Pensions, National Institute on Retirement Security, December 2014

- Said another way, you can only get half the benefit in a DC plan for the same cost

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
- Employees would receive about twice the retirement benefit in a DB plan for the same cost as a DC plan

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

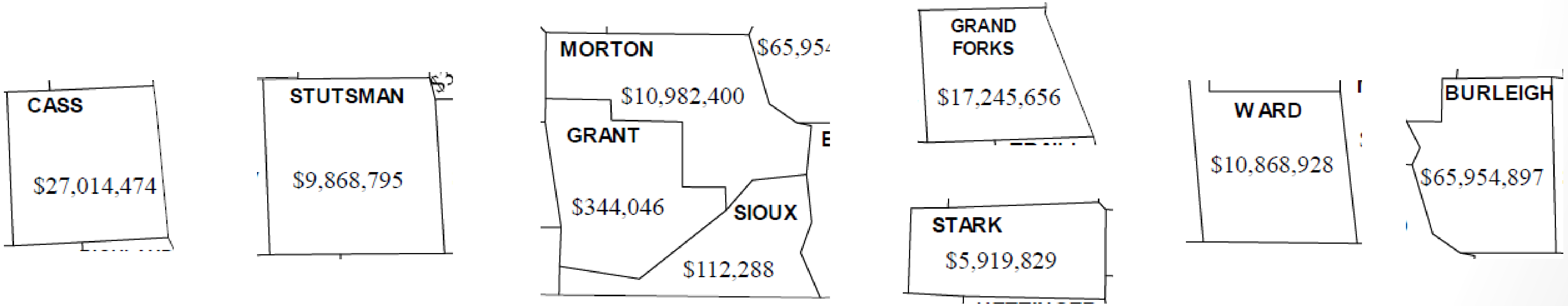
- The average benefit in the DB plan under the Main 2020 Plan versus the average projected benefit under the new DC plan
  - Using average retiree numbers from 2021 valuation (21 years of service, final average salary of $40,000), a 1.75% multiplier, and a DC plan return of 6% compounded annually
  - 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

$200 Million

- NDPERS currently pays out over $200 million in benefits to DB retirees in the State of North Dakota. Every year.
- Total retirement payments to all beneficiaries are over $236 million per year.
- Total employer contributions last year were just under $97 million. Clearly, the return on those contributions is massive.

$100 Million

- Future annual benefits will be cut in half as a result of moving to a DC plan; a DC plan can only provide about half the benefit of a DB plan for the same cost, which will affect all the North Dakota communities you represent
- Similar reduction in economic benefit for your communities



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
- Only 2.36% of 20-somethings 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 came back to the DB plan when given the opportunity to do so
- Those members agreed to pay an extra 2% of employee compensation to come back to the DB plan

15.26% vs. 9.26%

- 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, only 43% of employees elect to contribute more than the minimum
- Notably, 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).

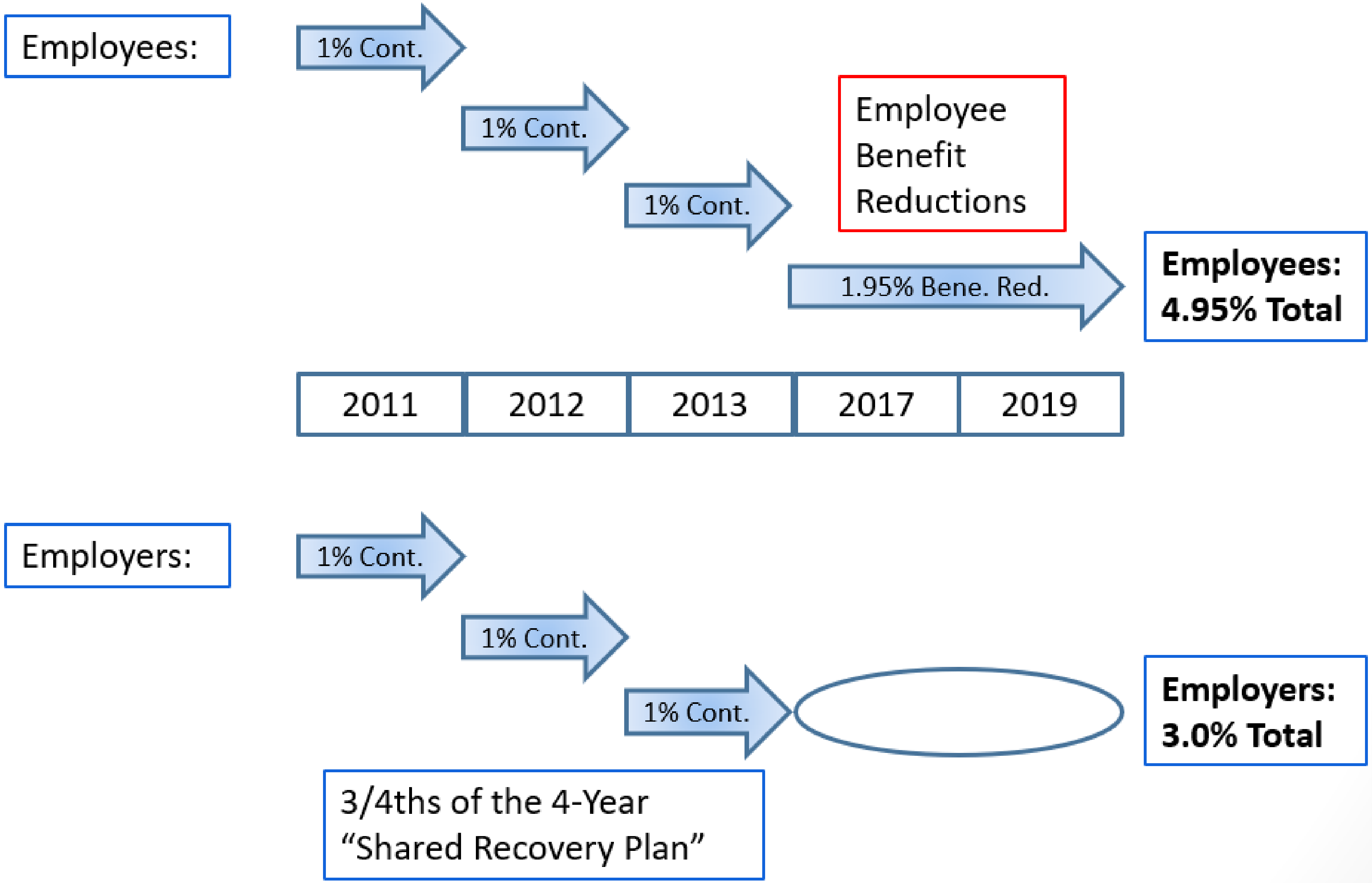
Employees must stay at least 2 years to vest

- The vesting schedule for <u>employer</u> 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 <u>employee</u> contributions

Annuity Default?

- “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 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

Employees Did Their Part



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
- Oklahoma – closed the DB plan in 2018 and created a new DC plan somewhat similar to this bill, and has already had 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"

Conclusion:
An Inefficient Decision

- $4.5 billion more expensive over the next 20 years
  - Future Legislatures cannot be required to adequately fund this decision
- 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
- Retirement adequacy under the new DC plan is questionable, especially for public safety employees
- The new DC plan may 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
- The economic benefit to our communities could be halved, if not worse
- Recruitment and retention may become major issues for the state and political subs

Questions?

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