TESTIMONY OF

SPARB COLLINS ON

HOUSE BILL 1228

Madame Chair, members of the committee, my name is Sparb Collins. I am the Executive Director of the North Dakota Public Employees Retirement System or PERS. Our agency is responsible for administering about 10 different retirement plans for the state and participating political subdivisions. The bill before you today affects two of those plans. These plans are the PERS Main system which is a Hybrid or modified defined benefit plan and our defined contribution plan. I appear before you today on behalf of the PERS Board and in a neutral position on the bill. However, the Board did want me to share with you:

1. Background information on our defined contribution plan,
2. The effect of this bill on the Main Plan, and
3. Benefit observations/implications that we shared with the interim committee.

<u>Background information on our defined contribution plan</u>

In 1999 the legislature passed HB 1257 which allowed nonclassifed state employees the opportunity to elect to withdraw from the PERS Main plan and move to a defined contribution plan. PERS set up this plan which included establishing the plan document, preparing informational material for the members, counseling them on the existing plan and the new plan, determining the investment options and monitoring those options and selecting a vendor. After preparing a bid, soliciting responses and evaluating those responses PERS selected Fidelity.

In our administration of the plan, we utilize a bundled provider/vendor approach. That is our vendor/provider not only provides recordkeeping but also the investment options. I have attached for your information the list of funds offered to the members of the plan. Each quarter the PERS investment committee meets with Fidelity to review the funds and if adjustments in the line up of funds need to be made due to performance issues, style creep or other reasons we will drop a the fund in question and add a new one. Our plan also has an investment window. That is, member can, after signing the appropriate papers, add about 300 additional funds for their consideration.

The present DC plan is an option available to nonclassifed employees. The following is information on the number offered the plan and those selecting the plan:

Year	Contacts	Transfers
2001	98	20
2002	48	6
2003	48	6
2004	46	4
2005	61	5
2006	100	12
2007*		
2008	82	6
2009	50	6

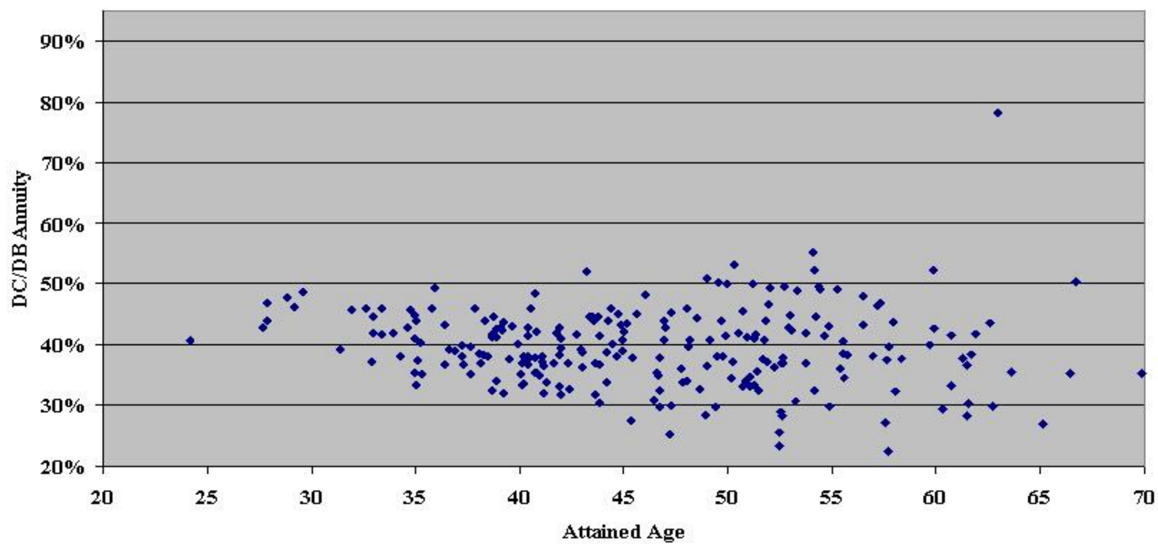
2008 figure includes both 2007 and 2008 eligibles.

When the plan was first offered about 38% of the member elected to participate. This last year about 10% selected the plan.

Contributions to the DC plan are the same as the Main Plan. Presently 8.12% of salary is contributed to the plan.

This DC plan just like the Main plan has been hit hard by the recent downturn in the financial markets. This last interim the Board had a study done projecting what benefit these members may get at retirement and benchmarked that to members of the Main Plan. For this plan we asked the actuary to project for participants in the DC plan what their benefit would be utilizing their existing fund balance and the assumptions used in the Main plan and compare that to what they would have received from the Main Plan. The following table is that information:

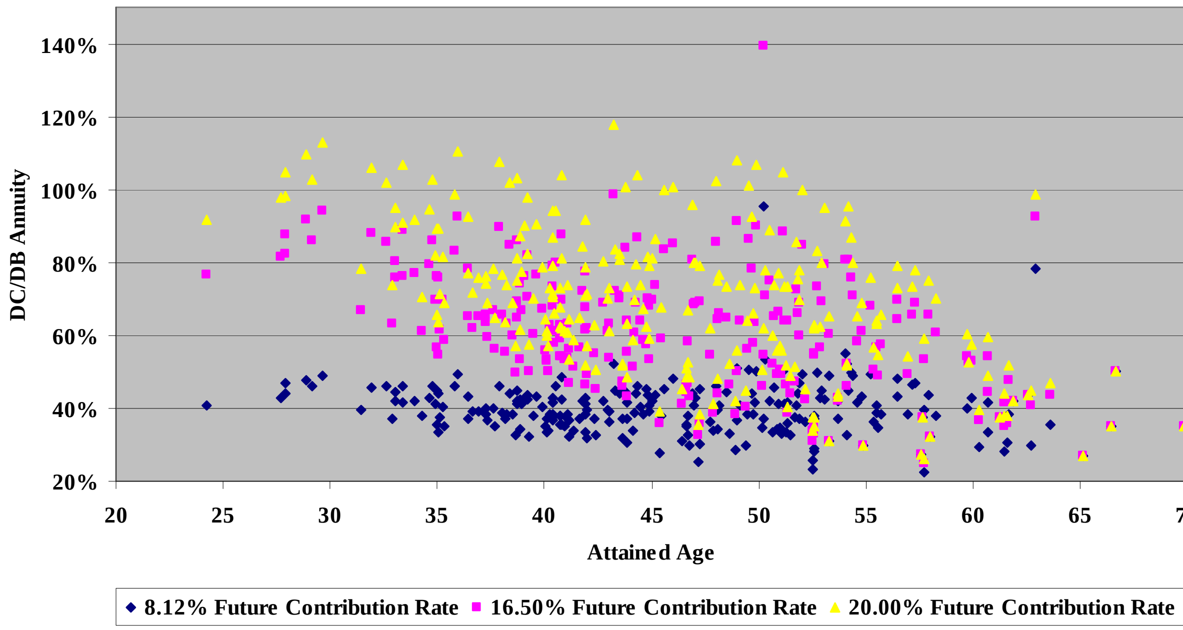
Exhibit III
Ratio of Projected DC Account (Converted to an Annuity) to DB Benefit
by Attained Age as of July 1, 2010
With 8.12% Future Contribution Rate



As the above table shows, these individuals will be getting less than half what they would have received. This shows the challenge facing them and the effect the downturn in the markets have had on them. Our DC plan has a challenge that is as dramatic as our hybrid plan or defined benefit plan.

We also had our actuary run a table assuming contributions would increase to 16.5% or 20%. The table shows the results:

Exhibit IV
Ratio of Projected DC Account (Converted to an Annuity) to DB Benefit
by Attained Age as of July 1, 2010



We see the increase in contributions does help them. As a result we proposed in SB 2108 an increase in contributions for our defined contribution plan members to the same level as that proposed for the main plan which would be to 16.12%. Both plans have a significant challenge if they are to provide the necessary retirement benefits. This increase was included in the executive budget.

If the increase in SB 2108 is approved for the PERS DC plan and if both PERS and TFFR are to be defined contributions, they will have approximately the same level of contributions or benefit as they do today (both have a multiplier of 2 in the present plan). If this increase is not provided, the benefit differential would be dramatic between the two systems since benefits in a DC plan are based upon contributions and earnings.

<u>The effect of the bill on the Main Plan</u>

If HB 1228 passes, it would also have an affect on the Main PERS Plan. During the interim, the Legislative Employee Benefits Committee studied the bill and as part of that study the actuary did an analysis of the bill. Our actuary is the Segal Company and along with me today is the actuary who did the study, Mr. Brad Ramirez who is available to answer your questions. Segal determined that the required actuary rate if this bill would pass for the Main system should be a total of 23.91%. As mentioned earlier in my testimony, our total rate today is 8.12%. However, the effect of this bill is not the difference between 23.91% and 8.12% because part of that increase includes the cost of getting the main plan back to 100% funded status and addressing the funding issue mentioned above for the existing DC plan. SB 2108 sets forth a strategy to get the retirement plans back on a path to recovery as a result of the recent downturn in the financial markets. A separate actuarial study was done and after consideration by many parties. That proposal (in SB 2108) requests contributions to increase to 16.12%. Consequently, the cost of this bill would be the amount required in addition to the 16.12% and that is 7.79% (23.91%-16.12).

	Total Rate	Rate Change
HB 1228[2]	23.91	7.79%
SB 2108[1]	16.12	8%
Present Rate	8.12	

1. Is the rate increase in SB 2108 to get the main plan back to 100% funded status
2. Is the additional cost of having new members go to the DC plan instead of staying in the DB plan

Why the increase? It is not that it will cost more to pay off the unfunded liability. The affect is that there will be less members to pay it off. In fact, the following table from our actuary shows how this will work for the next several years:

Plan year beginning	Total Payroll	Active Count in Main Plan
07/01/2011	$460,954,194	10,610
07/01/2012	446,907,274	9,684
07/01/2013	433,864,385	8,900
07/01/2014	421,129,833	8,206
07/01/2015	408,507,025	7,576
07/01/2016	395,054,545	7,002

You can see from the above that by 07/01/2016 the main plan will have approximately 3,000 less members. These individuals will all be in the defined contribution plan if HB 2128 is passed. The total covered payroll decreases due to the smaller number of members. Since contributions are a percent of covered payroll, the total contributions to the main plan will decrease as well. Since the size of the unfunded liability does not diminish by an equal amount, then we need a higher contribution to raise the same amount of money to pay it off due to the smaller membership.

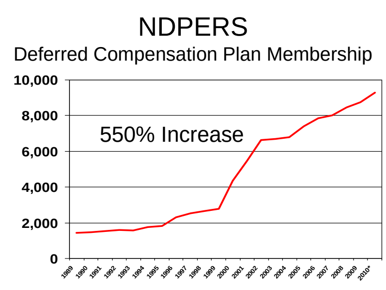
An analogy would be a family of 2 brothers and 2 sisters that decide to buy a second home together. Let's say the cost is around $240,000. They get a variable rate loan at 4.5% for 30 years. Their payment would be about $1,200 per month or about $300 each ($1,200/4). Our unfunded liability in the main plan is like the mortgage that needs to be paid off. Now assume after a couple of years that one of the brothers decides he is going to buy a second home of his own since prices have come down so much. He leaves the arrangement. However, the cost of the mortgage for the remaining 3 does not change due to his departure; however, the number of individuals paying on it does. With the one brothers departure there is 3 people left to pay it. So their monthly payment increases from $300 to $400 ($1,200/3). In concept this is what is happening here to the Main retirement plan. Members who were counted on to help pay this cost out into the future are not going to be in the plan. The result is an increase in cost to the remaining members. If everyone stayed, the cost would not need to increase.

The fiscal note shows the cost of the change. The fiscal note only shows projected expenditures that will be incurred if the HB 1228 is passed not including the transfer provision for existing members. However, you will note there is no appropriation to pay this projected additional cost. Consequently, I have attached to my testimony an amendment to the bill to increase the contributions for those remaining effective July 1, 2011 and an appropriation to each state agency to pay the additional cost. As mentioned in the fiscal note, "If contributions are not increased and funds are not appropriated to pay the additional contribution for the remaining members and the actuarial assumptions are met, this cost will continue to accrue and roll over into future bienniums for payment".

Benefit observations/implications that we shared with the interim committee

The following are some observations and implications that were shared with the Legislative Employee Benefits Committee when this change is viewed from a total benefits perspective. Please note these are not a direct affect of HB 1228 but only considerations that could arise in the future

Benefit	Description	Considerations	Cost Estimate[3]
Survivor Benefit	The DB plan provides for survivor benefits. Four options are provided including a lifetime benefit of 50% of the accrued benefit payable to the spouse for the remainder of their life. The DC spouse benefit is the account balance. Consequently the DC plan does not provide as sound of a benefit for spouses for employees without a significant account balance. For many employers that is offset since they provide their employees employer paid life insurance that will help the spouse. In North Dakota we provide $1,300 in coverage but since the DB plan had a sound spouse benefit this was not as critical	An alternative to providing survivor benefits in the retirement plan could be to expand the employer provided life insurance coverage from the existing $1,300 to a higher amount such as $50,000.	$3.5 Million[1]
Disability	The PERS DB plan has a disability retirement benefit of 25% of final average salary. The DC plan's only benefit is that account balance which for many members unless	An alternative to providing this in the DB plan would be to add an employer paid disability insurance as a benefit for state employees to offset the reduction in the disability retirement benefit	$1.6 Million[1]

Benefit	Description	Considerations	Cost Estimate[3]
	they are older with many years of service would not be adequate. Some employers have employer paid disability that insures against this contingency		
Investor Education	In a DC plan the individual member is responsible for setting up their investment plan. In the DB plan that responsibility is with the PERS Board and the SIB. In the DC plan the member's ability to retire and the type of retirement they can afford is directly related to how effective they are in establishing and maintaining their investment strategy in an age appropriate manner.	To provide DC member the resources to manage their investments consideration could be given to allowing each members up to 4 hours per year of employer work time to meet with their investment advisor, participate in investment education meetings and view on line education video's	$1.9 Million[2] (this is a soft dollar cost)
Savings Incentive	The PERS plan added the PEP program to its plan design in the late 90's. This provision enhances the portability of the plan and also provides an incentive for members to engage in supplemental retirement savings in the deferred comp program by matching their contribution in the DB plan with increased vesting in the employer contribution. This program has been very successful and since its initiation supplemental retirement savings has increased. The proposed DC plan does not have a	Since the DC plan does not have a similar incentive an alternative would be to provide a direct match to employees participating in supplemental retirement savings  	$37 Million[1]

Benefit	Description	Considerations	Cost Estimate[3]
	similar incentive.		
Retiree Increases	The state's present process for providing retiree increases is by Ad Hoc adjustments. That is if the fund can support an increase it is considered by the Legislature and Governor and if passed will then take effect. Given the retirement plan's existing funded status it is unlikely that it will be able to support any increases for many years. However, if new employees are moved to a DC Plan it will insure that the fund will likely never to able to give a retiree increase due to the continued decline in covered payroll.	If the DC plan is passed a new method for considering and funding retiree increases may need to be considered. One option would be set up a separate funding mechanism. An example would be to put a 1% contribution of all covered payroll into the plan for such increases (this would need a study to determine what would be appropriate)	$9.3 Million
Administration and plan design	1. The PERS Business system will need to be modified to provide for the different eligibility procedures 2. The implementation may be a challenge 3. Not clear what should happen to a member of the DB plan who returns to service as a new employee after the DC bill would be implemented	1. Update the business system code 2. Later date is helpful but we have already modified our RFP that is now in the marketplace 3. Have a returning member stay in the Hybrid Plan to maintain continuity of retirement plan	1. We will draw on contingen cy for these costs ($20 to $40,000) 2. No Cost 3. Minimal cost

Assumptions: 10,800 PERS State FTE & $926,151,000 biennium payroll

1. Assumes the benefit is provided to all PERS employees at the same time, except for the life insurance which assumes all state employees including Higher Education. If only applied to DC plan members it would start lower and then grow as more members joined the plan.
2. Would be the full cost at full implementation. That is when all employees are in the DC system.
3. All cost estimates are very preliminary and are only provided to give a very general estimate. Full cost is shown so it can be factored down based upon estimated participation.

My comments on this bill do not include the transfer provision since it is my understanding that it may be removed. If this provision remained, we would have additional comments and the cost would be different. That provision was not considered during the interim and therefore no cost study has been done on these implications. Madame Chair, members of the committee, this concludes my testimony.