Testimony before the North Dakota House Government and Veteran Affairs Committee
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Chairman Kasper, and members of the Committee, thank you for taking the time today to discuss the issue of pension reform. The Heartland Institute, founded in 1984, is an independent, national organization whose mission is to discover, develop, and promote free-market solutions to social and economic problems. Heartland is headquartered in Illinois and focuses on providing national, state, and local elected officials with reliable and timely research and analyses on important policy issues. Heartland would like to submit the following testimony.

The Public Employees Retirement System (PERS) Plan has seen a growing unfunded liability since 2003. In 2012, the PERS Plan had a funded ratio of 64.7 percent and an unfunded liability of $862 million. Based on the 2018 actuarial report for the PERS Plan, the funded ratio was 71.6 percent, which seems like an improvement, but the unfunded liability in dollar terms was just under $1.1 Billion.

The taxpayers, who are ultimately responsible for paying the PERS Plan obligations, are less concerned with the funded ratio percentage than they are with the $1.1 billion (and growing) unfunded liability.

In 2012, the legislature increased the combined employer/employee contribution rate by 2 percent. An additional 2 percent increase was made in 2013 and another 2 percent increase in 2014. Even with these increases in Plan contributions the unfunded liability has grown by over 27 percent since 2012.

Currently the statutory contribution rates for the PERS Plan are 7.12 percent for the employer and 7 percent for the employee for a total of 14.12 percent of each employee’s compensation. It should be added that the state pays 4 percent of the employee share.

How does a defined benefit retirement plan work?

Defined Benefit (DB) plans are complicated. The retirement benefit due to a retiree is determined by formula based, in part, on the employee’s average compensation in the years prior to retirement. A new employee, age 25, may not retire for forty years and estimating that employee’s retirement benefit over a 20 year or so retirement in difficult at best.

DB plans utilize actuaries to estimate the plan’s ultimate liability to the participating employees and the plan contributions required to meet those future obligations.
Actuaries also estimate the plan investment returns and for the PERS Plan the annual assumed rate of return on Plan investments is 7.75 percent. Actual investment returns above that assumed rate increase the Plan’s Funded Ratio and returns below that assumed rate of return decrease the Plan’s Funder Ratio.

There are also many misconceptions about DB plans. With the current (June 30, 2018) unfunded liability of nearly $1.1 billion, many assume that if it were possible to inject $1.1 billion into the Plan that the problem would be solved. But, sadly, that is not the case. It is important to understand that the $1.1 billion figure is the present value of the future calculated Plan liability. That $1.1 billion added to the Plan would need to increase by 7.75 percent a year, every year, for the actuarial period to cover the Plan liability.

It is also important to understand that each DB plan has a “Normal Rate” of contribution. Actuaries will tell you that the Normal Rate of Contribution is the percent of each employee’s compensation that (invested at 7.75 percent/year) will be sufficient to fully pay that employee’s retirement benefit through retirement. For the PERs Plan, the normal rate of contribution is about 11 percent. So, by definition according to the actuaries, any plan contribution over the normal rate is only done to reduce the plan’s unfunded liability.

The current combined employer/employee contribution is 14.12 percent, which is 3 percent higher than the normal rate. For 2018, this additional 3 percent contribution amounted to $31 million based on 2018 covered compensation. Yet, the unfunded liability increased from the 2017 level.

The recommendation from the actuaries is to increase the combined employer/employee contribution to at least 16.69 percent, but their analysis shows that the contribution rate will need to be increased to over 18 percent to begin reducing the unfunded liability. And that is assuming an investment rate of return of 7.75 percent a year, every year.

So, what to do?

A large, one-time, deposit into the PERS Plan is like putting all your chips on red. A bad year or two in the stock market and the impact of any large deposit on the unfunded liability will be minimal.

The projected Plan liabilities will be paid out to retirees over generations. Adding funding on an annual basis is the more prudent approach. But, to truly address the issues posed by the PERS Plan, fundamental reform is required.

The experience with the PERS Plan over the past 15 years shows a pattern that cannot be ignored. The state continues to make promises to its employees that the state cannot pay. The taxpayer, who is ultimately responsible to make good on these promises, deserves consideration.

Thank you for your time.

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