

Senate Bill 2022

North Dakota Retirement and Investment Office (RIO) Testimony to the Senate Appropriations Committee David Hunter, Executive Director/CIO Fay Kopp, Deputy Executive Director/CRO

January 8, 2019

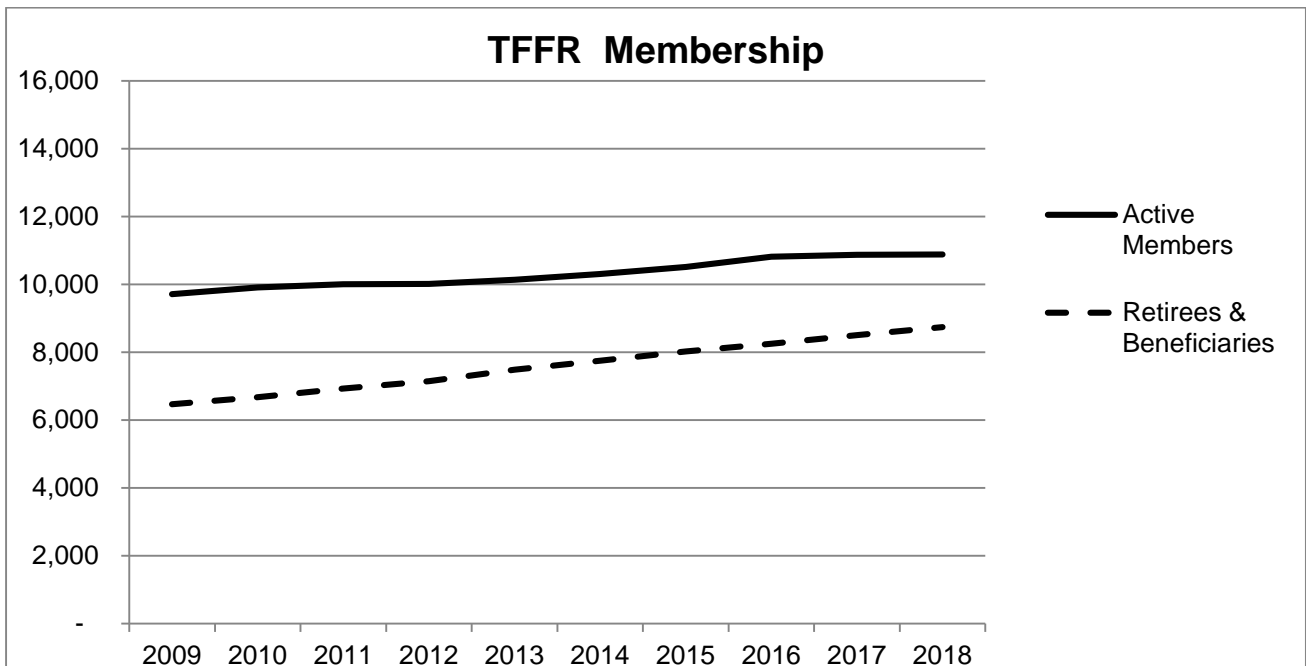
RIO Programs Overview

RIO was created by the 1989 Legislative Assembly to capture administrative and investment cost savings in the management of two important long-standing state programs – the retirement program of the Teachers' Fund for Retirement (TFFR) and the investment program of the State Investment Board (SIB). RIO is a Special Fund agency and receives no General Fund appropriation. All appropriated expenditures for the TFFR program are paid from contributions collected from members and employers and from invested assets/earnings. All appropriated expenditures for the SIB investment program are allocated directly to the client funds and paid out of their invested assets/earnings.

- **Teachers' Fund for Retirement (TFFR)**

TFFR is a qualified defined benefit public pension plan. The program is managed by a seven-member board of trustees which consists of the State Treasurer, State Superintendent, and five active and retired teachers and administrators appointed by the Governor.

The plan covers North Dakota public school teachers and administrators. Benefit funding comes from member and employer contributions and investment earnings. During the past decade, active membership has increased 12.1% from 9,700 to nearly 10,900 participants, while retirees and beneficiaries have increased 35.2% from less than 6,500 to over 8,700.



For Fiscal Year 2018 there were 214 participating TFFR employers comprised as follows:

School Districts	176
Special Ed Units	19
Vocational Centers	4
Counties	6
State Agencies/Institutions	5
Other	<u>4</u>
2017-18 Total Employers	214

The TFFR program appropriated expenses includes salaries, benefits and administrative overhead costs for the administration of the day-to-day operations of the fund and delivery of high quality services and outreach programs to members and employers. Examples of activities included in the administration of the TFFR program are detailed in the following table, based on the fiscal year ended June 30, 2018.

Activity	# of Members
Monthly collection of contributions from 214 Employers	10,881
Maintenance of Membership Records	22,218
New Retirement & Disability Claims Processed	401
Deaths Processed	226
Refunds/Rollovers Processed	228
Service Purchase Inquiries Processed	174
New Member Enrollments Processed	879
Monthly Benefit Payments Processed	8,743
Educational Outreach Programs Attended	1,047

Additional administrative activities include development of publications and educational materials for active and retired members and employers; maintenance of website, member and employer online services, and the pension administration software system that houses all TFFR member data; compliance reviews to verify accuracy of member records, contributions, and benefit payments; and staff training and education to ensure all necessary regulatory and financial reporting requirements are being met.

Benefit payments to retirees or their beneficiaries totaled \$202.4 million in fiscal year 2018. Another \$5.6 million was paid out in refunds of account values. These payments, in addition to amounts paid to actuarial, investment and other consultants, are included in a continuing appropriation under ND Century Code section 15-39.1-05.

- **State Investment Board (SIB)**

The SIB is responsible for the investment of over \$13 billion in assets for seven pension funds and 18 other non-pension funds. The following table shows the most currently available fair value of assets by fund.

	Fair Value as of 11/30/18 (unaudited)
PENSION POOL PARTICIPANTS	
Teachers' Fund for Retirement	\$2,420,114,305
Public Employees Retirement System	2,963,975,311
Bismarck City Employee Pension Fund	97,918,151
Bismarck City Police Pension Fund	39,552,163
City of Grand Forks Pension Fund	63,635,519
City of Grand Forks Park District Pension Fund	6,716,738
Subtotal Pension Pool Participants	5,591,912,187
INSURANCE POOL PARTICIPANTS	
Workforce Safety & Insurance Fund	1,883,403,124
State Fire and Tornado Fund	22,633,302
State Bonding Fund	3,419,780
Petroleum Tank Release Fund	6,186,592
Insurance Regulatory Trust Fund	1,206,840
State Risk Management Fund	4,553,198
State Risk Management Workers Comp	3,597,772
Cultural Endowment Fund	444,042
Budget Stabilization Fund	114,461,578
ND Association of Counties (NDACo) Fund	5,846,080
City of Bismarck Deferred Sick Leave	721,786
PERS Group Insurance	32,329,024
State Board of Medicine	2,247,701
City of Fargo FargoDome Permanent Fund	42,594,784
Lewis & Clark Interpretive Center Endowment	692,611
Subtotal Insurance Pool Participants	2,124,338,214
INDIVIDUAL INVESTMENT ACCOUNTS	
Legacy Fund	5,765,157,670
Retiree Health Insurance Credit Fund	124,450,806
Job Service of North Dakota Pension Fund	95,280,203
Tobacco Prevention and Control Trust Fund	48,578,910
TOTAL	\$13,749,717,990

The 11-member State Investment Board includes the Lt. Governor, State Treasurer, State Insurance Commissioner, State Land Commissioner, Workforce Safety & Insurance designee, three PERS board members, and three TFFR board members. All the funds are invested in accordance with the “Prudent Investor Rule”.

Investment guidelines and asset allocations are determined by the governing bodies of the individual funds (with assistance from consultants and/or RIO staff) and then turned over to the SIB for implementation. The SIB selects investment managers to manage different types of portfolios within each asset class with the goal of maximizing return within the clients’ acceptable risk levels. Similar client funds

are pooled together when possible to achieve efficiencies in staff monitoring and to receive lower fees from investment managers.

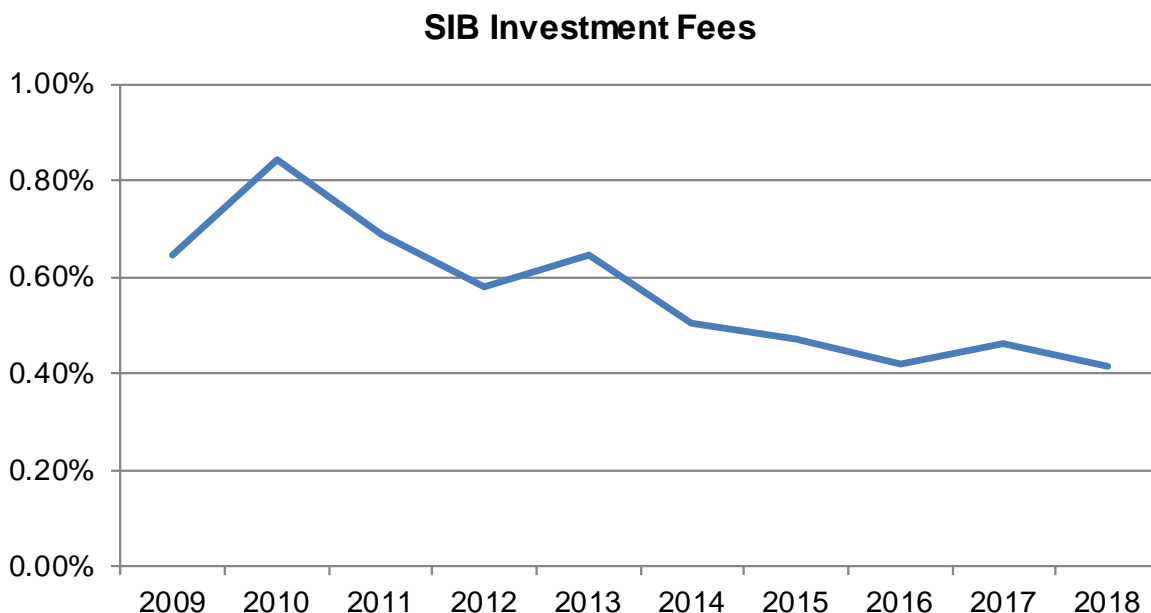
The SIB investment program appropriated expenses include salaries, benefits and administrative overhead for the management of the day-to-day operations of the program.

The staff of RIO administers the day-to-day operations of the investment program by assisting client funds with asset/liability studies; conducting investment manager searches; monitoring guidelines and asset allocations of each client fund; managing the consultant, custodian and investment manager relationships; conducting initial and continuing due diligence on the investment managers; researching new investment and risk management options; and maintaining separate monthly accounting and investment performance data for all 25 client funds. Statistics regarding the number of investment clients/managers/accounts, etc., are shown in the following table.

Client Funds	25
Asset Class Pools/Groups	34
Investment Manager Relationships	38
Investment Strategies	75
Investment Manager Accounts	113
Custodian Banks	2
Investment Consultants	3

The SIB has continuing appropriation authority under ND Century Code section 21-10-06.2 to pay for investment related costs of the program such as investment management fees, custodial fees, performance measurement fees, and fees associated with manager searches and onsite reviews of investment managers. These costs are allocated directly to the client funds affected by the expense and paid out of invested assets/earnings.

During the past 5 years, the SIB and RIO have re-intensified efforts to improve our overall return on investment management fees and expenses. As a result, SIB client investment fees have declined from 0.65% in fiscal 2013 to 0.42% in fiscal 2018. This 0.23% decrease in fees on \$10 billion in assets equates to an annual savings of approximately \$23 million. The following chart shows the downward trend in investment fees over most of the last decade.



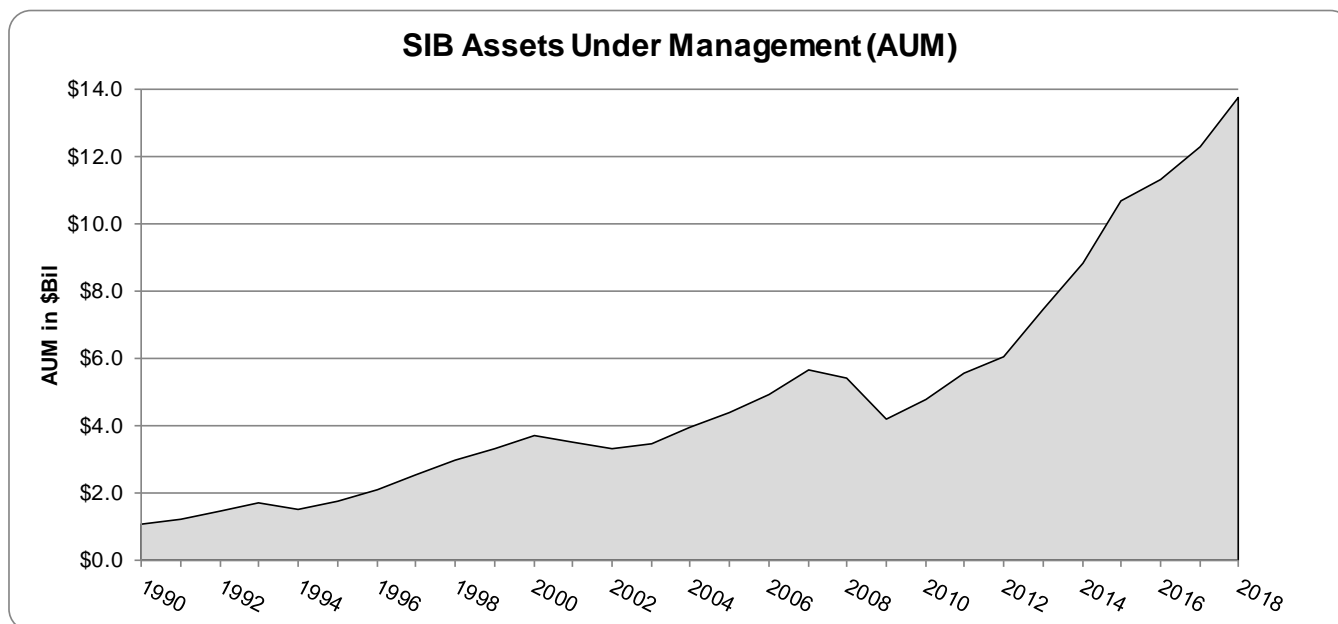
Goals for SIB Client Investment Fees and Expenses:

The SIB and RIO work to keep investment fees and expenses at or below 0.50% per year, while seeking to identify investment firms which beat their performance benchmarks by 0.50% or more (after all fees and expenses) over the long-term. If we are successful in attaining both of the above goals, our SIB clients are effectively earning a minimum 2-for-1 return on our investment fee and expense dollars. The following chart offers an example for the Legacy Fund:

	FY 2018			FY 2017		
	Average Market Value	Fees in \$	Fees in %	Average Market Value	Fees in \$	Fees in %
Investment Fees	² 5,291,348,530	15,909,882	0.30%	4,344,421,122	13,986,877	0.32%
Investment Fees & Expenses		¹ 16,635,287	0.31%		14,564,731	0.34%
Actual Performance (Net of Fees)			7.57%			12.03%
Policy Benchmark			6.51%			9.91%
			³ Outperformance 1.06%			Outperformance 2.12%

Investment fees and expenses declined to **0.31%** in fiscal 2018 from **0.34%** in fiscal 2017, while noting the use of active management paid significant returns for the Legacy Fund in Fiscal 2018 as the SIB paid ¹ \$16.6 million in fees to outperform the Policy Benchmarks by ³ 1% or \$50 million (² \$5 billion x ³ 1% = \$50 million).

SIB client investments have grown from \$6 billion in 2012 to over \$13 billion in 2018.



**RETIREMENT AND INVESTMENT OFFICE 190
2019-2021 BIENNIUM BUDGET REQUEST**

	1	2	3	4	5	6	7	8
	2017-19 Base Budget	2019-21 Base Budget Request (w/10% reduction)	Optional Adjustment #1 "Reinstate 10% Reduction"	Optional Adjustment #2 "Additional FTE"	Additional Governor's Recommendations	Total Governor's Recommendation	Optional Adjustment #3 One-time Request "Pension Admin. System Project"	Total Agency Request
Salaries & Wages	\$ 4,425,570	\$ 3,860,125	\$ 550,194	\$ 294,996	\$ 304,981	\$ 5,010,296	\$ 50,000	\$ 5,060,296
Operating Expenses	862,484	862,484	-	14,450	12,000	888,934	2,789,000	3,677,934
Contingency	52,000	82,000	-	-	-	82,000	-	82,000
Capital Assets	-	-	-	-	-	-	6,300,000	6,300,000
	<u>\$ 5,340,054</u>	<u>\$ 4,804,609</u>	<u>\$ 550,194</u>	<u>\$ 309,446</u>	<u>\$ 316,981</u>	<u>\$ 5,981,230</u>	<u>\$ 9,139,000</u>	<u>\$ 15,120,230</u>
FTE Count	19	16	3	1	-	20	-	20

10% Base Budget Reductions:

In order to meet the requirement of a 10% cut in the base budget request, RIO chose to submit the reduction to the salaries and wages line. Due to a drastic 13% reduction to the operating line for the 2017-19 biennium, it was difficult to find any additional savings in that line. In addition to that, the 10% overall reduction, if taken from the operating line, would equate to a 62% cut to the operating line. No specific positions were indicated for elimination as part of the original base budget request. Over a dozen combinations of position cuts and salary reductions were considered and most scenarios required a minimum of three positions to be eliminated to reach the 10%. Any reduction to RIO's current workforce will severely compromise the agency's ability to maintain ongoing TFFR pension administration operations and SIB investment management functions.

Optional Adjustment #1 - Reinstate 10% Base Budget Reductions:

The Governor included Optional Adjustment #1 in his recommendation.

Optional Adjustment #2 - Additional FTE for Investment Program:

This request is for an additional FTE for the SIB investment program and additional operating expenses related to that position.

As an industry best practice, RIO is currently developing a more robust investment risk management oversight and reporting function within the SIB investment program. Investment risk management is the process of identifying the level of risk that an entity wants, measuring the level of risk that an entity currently has, taking actions that bring the actual level of risk to the desired level, and monitoring the new actual level of risk so that it continues to be aligned with the desired level of risk. The process is continuous and developing an effective framework requires measuring, monitoring, and managing exposure to both economic and fundamental drivers of risk and return across asset classes to avoid over-exposures to common risk factors. Additionally, the SIB's current strategic plan includes "enhancing our internal control environment by improving the use of proven risk management solutions" noting that "a robust risk management framework serves as the foundation to support a sound internal control environment and lessen downside risk."

The SIB investment program has grown tremendously over the last six years, with client assets increasing 122% or \$7.4 billion, while staffing has remained consistent at 6.95 FTEs. Investment performance and client satisfaction have been strong, with returns in the top quartile of peer universes over the past 15 years. However, RIO recognizes that our ability to continue achieving positive results and reaching the goal of additional risk monitoring or any other enhancements to client services will be highly challenged without the additional FTE. The Governor recognized the importance of this request and has included the additional FTE in his recommendation.

Optional Adjustment #3 - TFFR Pension Administration System Project: Details regarding the methodologies used to determine the probable costs for this project are included within the testimony. This one-time project request was not included in the Governor's recommendation.

2017-19 Budget Status

As shown in Exhibit A, Column 1, the RIO 2017-19 approved budget is just over \$5.3 million. Salaries and wages for RIO's current 19 FTEs make up nearly 83% of that total. After having three vacancies early in the biennium, RIO is now fully staffed. It is anticipated that we will have approximately \$81,000 left in this line item at the end of the biennium due to those vacancies.

Operating expenses were approved at just over \$862,000 for the 2017-19 biennium. This was a 13% decrease from the previous biennium's approved operating expenses. Due to this sharp decrease, staff brainstormed ideas for cost savings across the agency. The first area that was explored was travel and professional development. Staff and board members were asked to limit their requests for out-of-state conferences and other educational opportunities to one for the biennium. Most chose to forego training in the first year of the biennium to ensure funding would be available. During this time, other longer-term cost-savings options were explored to guarantee that funds would be available for highly important education opportunities going forward.

The largest long-term cost saving idea that has been implemented relates to the printing and mailing of newsletters and other similar materials to active members of the TFFR retirement program. It was determined that TFFR employers can be utilized to assist in disseminating this information to active members through the use of emails and the RIO website. It is anticipated that RIO can save over \$20,000 per biennium due to this process change.

Staff has been very frugal, not only during this biennium but historically, when requesting the expenditure of operating funds. Because of the limitations imposed on educational opportunities as well as the savings in postage and printing, RIO expects to have a balance of approximately \$23,000 in the operating line at the end of the current biennium.

The contingency line item was also reduced in the 2017-19 biennium. The \$30,000 reduction amounted to a 37% reduction. This line item is reserved for expenses that are outside of normal operations and are difficult to plan. In the past, this line item has been used for executive search firms to assist in filling the Executive Director/CIO position. Due to the nature of these types of expenses, the costs can be high. The average expenditures from this line in the past have been in the \$75,000-\$100,000 range, therefore making the reduction to this line concerning. We have not had the need to spend anything from this line during the 2017-19 biennium-to-date.

	2017-19 Approved Appropriation	Actual Expenses through 12/31/18	Estimated Remaining Expenses	Estimated Total 2017-19 Expenses	Estimated 2017-19 Ending Appropriation Balance
Salaries & Wages	\$ 4,425,570	3,233,570	1,111,000	4,344,570	81,000
Operating Expenses	862,484	457,648	382,124	839,772	22,712
Contingency	52,000	-	-	-	52,000
	<u>\$ 5,340,054</u>	<u>3,691,218</u>	<u>1,493,124</u>	<u>5,184,342</u>	<u>155,712</u>

2019-21 Budget Request

Base Budget Request

As detailed in Exhibit A, Column 2, RIO submitted a base budget request with a 10% reduction from the 2017-19 biennium. In order to meet this requirement, RIO chose to submit the reduction to the salaries and wages line. Due to the drastic 13% reduction to the operating line for the 2017-19 biennium, it was difficult to find any additional savings in that line. In addition to that, the 10% overall reduction, if taken from the operating line, would equate to a 62% cut to the \$862,000 operating line. No specific positions were indicated for elimination as part of the original base budget request. Over a dozen combinations of position cuts and salary reductions were considered and most scenarios required a minimum of three positions to be eliminated to reach the 10%. Any reduction to RIO's current workforce will severely compromise the agency's ability to maintain ongoing TFFR pension administration operations and SIB investment management functions.

With some minor adjustments between categories within the operating line, the base budget operating line request was submitted at "hold-even". Savings identified within the postage and printing categories were deployed back into travel and professional development to ensure staff and board members are sufficiently educated on current topics in the public pension and investment communities to properly fulfill their fiduciary duties to the funds they represent.

The \$30,000 reduction in the contingency line for the 2017-19 biennium was added back in the base budget request to ensure adequate funds are available based on historical averages.

Optional adjustments included in Governor's recommendation (Exhibit A, Columns 3 & 4)

RIO included three optional adjustment packages in the original budget request, two of which were included in the Governor's recommendation.

Optional Adjustment #1 – Reinstate 10% Reduction (included in Governor's recommendation): As mentioned earlier, the 10% reduction to the base budget was submitted within the salaries and wages line. Because the salaries and wages line is over 80% of RIO's total budget, it was difficult to reach the 10% outside of that area. Many scenarios were explored in attempting to identify positions that could be eliminated but the result was that in nearly all scenarios, a minimum of three positions would need to be eliminated to meet the 10% threshold. The Governor agreed that a reduction of over 15% (3+ FTEs) of RIO's current workforce would severely compromise the agency's ability to maintain ongoing TFFR pension administration operations and SIB investment management functions and therefore included this optional adjustment in his recommendation.

Optional Adjustment #2 – Additional FTE for Investment Program (included in Governor's recommendation.): As an industry best practice, RIO is currently developing a more robust investment risk management oversight and reporting function within the SIB investment program. Investment risk management is the process of identifying the level of risk that an entity wants, measuring the level of risk that an entity currently has, taking actions that bring the actual level of risk to the desired level, and monitoring the new actual level of risk so that it continues to be aligned with the desired level of risk. The process is continuous and developing an effective framework requires measuring, monitoring, and managing exposure to both economic and fundamental drivers of risk and return across asset classes to avoid over-exposures to common risk factors.

The SIB's current strategic plan includes "enhancing our internal control environment by improving the use of proven risk management solutions" noting that "a robust risk management framework serves as the foundation to support a sound internal control environment and lessen downside risk."

Following an extensive review of leading investment risk management system vendors, RIO selected a solution in 2016 to implement a risk management system across the investment program. The state of

the art multi-asset class risk management solution combines sophisticated risk analytics and subject matter expertise to help RIO better understand and manage risk, resulting in more informed investment decisions using the system's tools for portfolio risk, stress testing and scenario analysis; asset allocation analysis; performance and attribution; and compliance and oversight.

RIO continues to work with the vendor to develop a risk dashboard for monitoring downside risk under various historical and hypothetical stress scenarios. Additionally, RIO intends to enhance its investment risk monitoring reports to include an expanded list of key risk metrics. However, current staffing within the investment program is seriously limiting the amount of time available to make these enhancements.

This request is for an additional FTE for the SIB investment program and additional operating expenses related to that position.

Significant highlights in the SIB investment program include the following; however, RIO recognizes that our ability to continue achieving these results and reaching the goal of additional risk monitoring or any other enhancements to client services will be highly challenged without the additional FTE.

- SIB client investments have increased by \$7.4 billion or 122% in the past six years while the authorized FTEs assigned to the investment program have remained steady at 6.95.
- Investment returns for the Pension Trust (including PERS and TFFR) improved from the 74th percentile for the last 10-years to the 26th percentile the last 5-years and 23rd percentile for the 3-years ended 6/30/2018.
- Legacy Fund investment earnings are nearly \$1 billion since inception including \$200 million for the 16 months ended October 31, 2018. NDCC earnings (transferable to the General Fund) were \$285 million as of October 31.
- Customer satisfaction surveys have remained strong (averaging 3.6 on a 4.0 scale)

Other Adjustments (Exhibit A, Column 5)

The Governor's recommendation also includes adjustments to RIO's base budget request in the salaries and wages line in the amount of \$304,981 which includes his recommendations for state employee salary increases as well as changes to benefit amounts for insurance and PERS retirement contributions.

Also, after the agency budget submission deadline, ITD contacted agencies regarding the state-wide implementation of Microsoft Office 365. Because we did not have any costs in our base request for Microsoft Office upgrades or replacements (we upgraded in a previous biennium), we were required to calculate the additional cost to the agency to move to Office 365. That cost was \$12,000 for the 2019-21 biennium and was included in operating expenses in the Governor's recommendation.

Optional adjustment not included in Governor's recommendation (Exhibit A, Column 7)

Optional Adjustment #3 – Pension Administration System Project (One-time Request): RIO is requesting an amendment to SB 2022 which would provide for one-time spending of up to \$9.139 million (or only as much as is necessary) of TFFR trust funds to upgrade or replace TFFR's outdated pension administration computer system.

TFFR Pension Administration Software Modernization Study

TFFR's current pension administration software (PAS) has been in operation for over 13 years. The functionality and technical architecture of this client-server technology is now at the end of its product release lifecycle and needs to be updated.

The TFFR Board and RIO staff believes it is a necessary and prudent use of TFFR funds (special fund, not general fund) to upgrade or replace the current system with a more technologically advanced, web based system which would provide significant improvements in functionality, efficiency and system security for TFFR members, employers, and staff. An updated system is needed in order for TFFR to re-engineer business processes and automate TFFR pension administration activities, reporting capabilities, electronic communications and services. The current PAS has many limitations, and without an updated PAS, TFFR will need to spend trust fund assets trying to maintain an old system, instead of investing in newer technology that includes the necessary functionality to efficiently administer the plan.

During the past year, RIO has studied the potential risks, benefits, and costs of upgrading or replacing the current PAS. We have worked with State ITD, State Procurement, PERS, and a nationwide pension software consulting firm on this study.

Risks of Current PAS:

- Functionality and technical architecture of current PAS is outdated. Continuing to utilize the current PAS does not allow RIO to take advantage of advancing technology and security improvements. Current PAS administrator interface is deployed as a client-server application which has significant limitations. For example, TFFR's current software is a 32-bit application. Most operating systems are now based on 64-bit technology platforms.
- Cost to maintain current PAS is expected to increase. While the current vendor provides limited support for the PAS product, the number of personnel familiar with the older version technical environment and TFFR customizations will diminish, resulting in a higher cost for support services as time progresses. Additionally, the older the system gets, the greater the likelihood for the system to crash and need costly fixes in order to continue operating. (See Concerns if Project is Not Approved.)
- Current Member self-service portal is very limited and provides basic "read only" functionality. It does not allow for any electronic member communication and interaction. While it can be customized to add new features (at a significant cost), the portal presentation will retain the present look and feel. The current self-service user interface uses frames technology which has limitations and is not fully ADA compliant.
- Current Employer self-service portal is also very limited and provides only basic functionality. Again, it does not allow for any electronic employer communication and interaction. Employers cannot perform any business rule validations of the member data contained in the file. RIO staff must perform the validations, evaluate any data exceptions and any action for any data corrections that are to be addressed and resubmitted by the employer, which is time consuming and inefficient.

Benefits of Updated PAS (Upgrade or Replacement):

- Most of the features needed to reinvent the way TFFR conducts its business operations are standard functions of a modern PAS.
- Updated PAS will enable TFFR to adopt best practices in self services for members and employers, achieve greater efficiencies in daily administration, and provide security improvements that are available with new technology vs old technology.
- Updated Employer self-service would allow employers to securely communicate with TFFR, and take greater ownership of their data. Employers would have the ability to securely upload contribution data, receive immediate validation results, confirm contribution remittances, and view their remittance histories and receivable accounts.

- Updated Member self-service would allow members to securely communicate with TFFR, access and update certain personal information, and run their own benefit estimates.
- Updated PAS would allow for straight-through-processing to automate enrollment, termination, retirement request processing, benefit calculations, e-communications, e-forms, and e-distribution to members and employers.
- Communications would be timelier with members and employers being able to initiate requests online and receive statements, notifications, and correspondence securely through the web portal from anywhere and at any time using a desktop computer or mobile device.
- Digital (electronic) communication is direct and secure, saves on mailing costs, and reduces reliance on paper which is a cost savings to the fund.
- An updated PAS would provide future ability to deploy the application to either a private or public cloud environment.

Additional benefits include:

- Web-based interface for administrators via commonly used and supported web browsers
- Enhanced web self-services for members, retirees, employers, and other stakeholders
- Benefit estimates and retirement modelling tools with member self-service
- Responsive web design for access with tablets and smartphones – mobile access
- Business process workflow
- Case and task management
- Email notification
- Administrator dashboards
- Employer self-service payroll contribution reporting, real-time data validation, and view access to receivable accounts
- Expanded accounting functionality to capture financial transactions, map to and export data to the general ledger system
- Integrated document imaging with bar-coding capability for process automation
- Online ad-hoc queries and reports
- Seminar scheduling
- Application management tools

Based on the anticipated benefits listed above, RIO believes there is an opportunity for post implementation efficiencies that could result in future budget reductions in the TFFR pension program. Potential budget reductions are not quantifiable at this point in the project planning. However, if TFFR is able to automate current pension administration processes with a new system and transition to secure digital communications with members and employers, at a minimum, it is expected to save printing and mailing costs and allow users to better utilize their skills and knowledge in other needed areas of retirement program administration.

In order to successfully complete the project within the anticipated project timeline (2-3 years), it will be necessary to maintain all current budget and staffing levels in order to re-engineer business processes and maintain adequate service levels during the implementation.

Cost to Upgrade or Replace Current PAS:

In order to estimate the cost to upgrade or replace the current PAS, RIO reviewed market value research conducted by a nationwide IT consulting firm specifically focused on addressing the operational and technological challenges of retirement benefits administration organizations. Two approaches were used in developing the budget estimate for this project. In these analyses, key parameters such as plan members, employers, users, and market value of assets were matched against a large database of other state and local pension systems, and averaged to those that are similar to TFFR to determine an

estimate. Additionally, RIO staff worked with state ITD in project planning and identifying other potential costs for this project.

The \$9.139 million estimated project cost includes budget estimates for:

- External vendor costs for software licensure, implementation, deployment, and post implementation maintenance and support.
- External consulting costs including procurement assistance, project management, oversight support, quality assurance, and business process improvement and reengineering.
- Internal consulting costs for ITD project management, ITD oversight, AGO legal fees, temporary salaries, and other project costs and contingencies.

It is important to note that **IF a system upgrade** by TFFR's current pension software vendor is selected, the cost could be much less than the \$9.139 million project cost estimate for a **system replacement** by a different vendor. Upgrades by a current vendor to a newer software version typically cost less, have a shorter timeline, require less staff training, and carry less risk than a complete system replacement utilizing a new vendor. (See Vendor Selection and Project Oversight.)

With over 22,200 active, inactive, and retired members, a \$9.139 million one-time cost is approximately \$411 per member, or spread over 10 years (expected software life), about \$41 per member. If the project costs less, for example \$6 million, it would be about \$270 per member, or about \$27 per member over 10 years. Based on June 30, 2018 TFFR market value of \$2.53 billion, a \$9.139 million cost is approximately 0.36% (36/100 of 1%). A \$6 million cost is about 0.24% (24/100 of 1%).

As part of our study, RIO staff also received a demo of the current web-based PERS pension administration software which utilizes a different vendor than TFFR. Through our discussions with PERS, we determined that while TFFR and PERS perform some similar pension administration functions, TFFR and PERS members are different, and most employers are different. Additionally, TFFR and PERS pension programs are administered by two separate agencies, so processes and procedures require different customizations and implementations. Even if the same vendor was utilized by both TFFR and PERS, each system requires different structures, configuration, and deployment. The RFP selection process will identify if any cost savings could be achieved by utilizing the same pension software vendor for both TFFR and PERS. Regardless, discussions with PERS regarding their pension software, implementation project, and costs have been very helpful, and we appreciate their willingness to share information.

Vendor Selection and Project Oversight

If the Legislature approves this one-time spending for the TFFR pension system upgrade or replacement project, RIO will follow all state statutes and ITD guidelines for a major IT project. RIO will work with state ITD and state Procurement in the consultant and vendor selection process. As required by state law, RIO will utilize the state's procurement process to select a consultant and a software vendor for the project to ensure a fair and competitive bidding process. RIO's current pension software vendor, and many other pension software vendors (including PERS' vendor) will be invited to submit formal proposals which will be closely scrutinized to determine the best long term solution for the best price for this important IT project. The TFFR Board must give final approval to hire both the project consultant and software vendor.

Project planning, management and oversight will be provided by state ITD. Project start up, status, and close out reports will be provided to ITD, SITAC, Legislative IT Committee, TFFR Board, and other interested stakeholders. As fiduciaries of the TFFR fund, the TFFR Board will closely monitor this project to ensure trust fund assets are being appropriately spent.

Concerns if Project Is Not Approved

If this project is not approved, RIO will need to continue operating the current PAS which utilizes outdated technology. Due to the high cost (and inability in some cases) of making technical improvements, RIO would be unable to re-engineer business processes and modernize operations, and would have to rely on an older system with less automation and less security. We would be unable to utilize secure digital communications with members and employers through online services.

Therefore, if the current PAS is not upgraded or replaced, RIO is subject to limited technical support, limited functionality, increased costs, increased security risks, and the potential for the current PAS to crash and not be fixed in a timely manner. This would cause many issues with daily pension administration functions (including monthly payroll to nearly 9,000 retired members). We have already had to make some costly fixes to the current software, and this is expected to increase as the software continues to age. We expect that RIO will incur increased costs to maintain and support the current PAS. Consequently, RIO may need to request an increase in the current IT line of RIO’s budget contained in SB 2022 if this project is not approved.

Project Summary

While a TFFR pension administration software modernization project will be costly and time consuming, we believe it is in TFFR’s best interests to make this investment now to take advantage of technology improvements and security enhancements that have been made in the years since the current software was implemented. This will allow RIO to reinvent the way it conducts business by providing significant functionality, customer service, and security improvements for over 20,000 active and retired members, 214 school districts and other participating employers, and RIO staff administering the TFFR plan.

Exhibit B (attached) provides a one-page summary of this project request. Our focus is on what is the best and most cost efficient use of TFFR trust funds. These are all special fund dollars – no general funds are being requested.

CONCLUSION – REQUEST FOR AMENDMENT

Based on the information provided within this testimony, RIO respectfully requests the following amendments to SB2022.

	2017-19 Base Level Appropriation	Adjustment to Base	Additional FTE	Additional Governor's Recommendations	One-time Request Pension Admin. System Project	Total Senate Amendment Request	Total Request from Senate
Salaries & Wages	\$ 4,425,570	(15,251)	294,996	304,981	50,000	634,726	5,060,296
Operating Expenses	862,484	-	14,450	12,000	2,789,000	2,815,450	3,677,934
Contingency	52,000	30,000	-	-	-	30,000	82,000
Capital Assets	-	-	-	-	6,300,000	6,300,000	6,300,000
	<u>\$ 5,340,054</u>	<u>14,749</u>	<u>309,446</u>	<u>316,981</u>	<u>9,139,000</u>	<u>9,780,176</u>	<u>15,120,230</u>
FTE Count	19	-	1	-	-	1	20

SB 2022 – RIO Budget

TFFR Pension Administration Software (PAS) Modernization Project Summary

Request

- Upgrade or replace TFFR pension software with web-based system
- RIO conducted study involving ITD, Procurement, PERS, and Consultant

Risks of Current PAS

- Current system is 13-years old
- Functionality and technical architecture of client-server system is outdated
- Increased costs to maintain and support
- Limited technical support
- Limited functionality of member and employer online portals – read only
- No electronic member communication and interaction
- Inability to automate manual processes and re-engineer business processes
- Inability to utilize secure digital communications w/members and employers

Benefits of PAS Upgrade or Replacement

- Web based technology is standard
- Re-engineer business processes and adopt best practices in pension administration
- Enhanced member and employer self-service and security improvements
- Straight-through-processing to automate enrollment, termination, retirement processing, calculations, communications, forms, and distribution
- Cost savings with digital communication, and reduced paper mailings
- Improved staff efficiency

Estimated Cost

- \$9.139 million (or less) one- time
- Cost could be less for system upgrade rather than system replacement by a different vendor
- Includes external vendor costs, consulting costs, project management, and ITD, legal, and other project costs and contingencies
- Special funds – no general funds

Vendor Selection and Project Oversight

- Utilize state's procurement/RFP process to select consultant and software vendor
- Follow ITD requirements in managing major IT project
- Required reports to ITD, SITAC, Leg IT Com.
- TFFR Board contract approval and project oversight to ensure TFFR trust fund assets are being appropriately spent

Summary

- Investment in updated technology will provide necessary tools to reinvent and automate TFFR retirement program operations and processes
- Updated technology will improve functionality, customer service, efficiency, and security for TFFR members, employers, and staff