GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2017

Legislative Retirement Note

BILL NUMBER: Senate Bill 467 (First Edition)

SHORT TITLE: North Carolina Retirement Reform.

SPONSOR(S): Senators Wells, Rabon, and Rabin

FUNDS AFFECTED: State General Fund, State Highway Fund, other State employer receipts; local government funds

SYSTEM OR PROGRAM AFFECTED: Teachers' and State Employees' Retirement System (TSERS), Consolidated Judicial Retirement System (CJRS)**,** Legislative Retirement System (LRS), Local Governmental Employees' Retirement System (LGERS), Disability Income Plan (DIP), Death Benefit Plans, Optional Retirement Program (ORP), Supplemental Retirement Income Plan (NC 401(k)), and the Public Employee Deferred Compensation Plan (NC 457).

BILL SUMMARY: Senate Bill 467 (First Edition) closes TSERS, CJRS, LRS, and LGERS to new hires and enrolls new hires in the NC 401(k) and/or NC 457 with automatic features designed to prepare for and facilitate their retirement. The bill also expresses the intent to increase employer contributions to TSERS by $100 million in FY 2017-18 and $200 million in FY 2018-19 and eliminates retiree medical benefits for new hires. The effect of each subsection is as follows:

<u>Section 1(a)</u>: Adds automatic features to the NC 401(k) and/or NC 457 for future hires including: auto-enrollment, auto-resetting of contributions to a level projected to provide adequate retirement income, target-date default investment including an inflation-indexed bond option to help guide employees to annuitization, and auto-commencement of distributions in the amount of potential annuity payments.

<u>Section 1(b)</u>: Expresses intent to set the initial State match in the NC 401(k) and/or NC 457 at 100% of the first 6% of compensation contributed by new hires and to continue unfunded liability contributions to the existing retirement systems based on the compensation of new hires.

<u>Section 1(c)</u>: Creates a benefit similar to the existing Transfer Benefit option that would allow new hires to transfer 401(k) and/or 457 funds to a new retirement system to generate lifetime inflation-indexed benefits. The Department of State Treasurer would administer this new system and would be required to minimize risk by closely matching investments to projected payments.

<u>Section 1(d)</u>: Makes conforming changes to NC 401(k) statutes to allow new hires to participate and requires five years of service before new hires are vested in the employer contributions to the NC 401(k).

Section 2(a): Closes membership in TSERS on July 1, 2018. Existing members would stay in the System, but no new members could join.

Section 2(b): Closes membership in LGERS on July 1, 2018.

Section 2(c): Makes conforming change for TSERS.

Section 2(d): Makes conforming change for LGERS.

Section 2(e): Closes employer participation in LGERS to new local governments on July 1, 2018, with notice of desire to join required by January 1, 2018. Existing participating governments would continue to participate, but no new local governments could join.

Section 2(f): Closes membership in CJRS on July 1, 2018.

Section 2(g): Closes membership in LRS on July 1, 2018.

Section 2(h): Closes membership in the UNC ORP to new SHRA (Subject to the Human Resources Act) employees on July 1, 2018. New EHRA (Exempt from the Human Resources Act) employees will join, but will no longer have a choice between ORP and TSERS.

Section 2(i): Closes membership in the Community College ORP on July 1, 2018.

Section 2(j): Provides for a window in which existing members of TSERS, CJRS, LGERS, and LRS can elect to cease participation in the existing systems, join the plans for new hires, and transfer their employee contributions to the new plan.

Section 2(k): Requires the Department of State Treasurer to produce a report on policy options with respect to local government employees who do not participate in Social Security. These employees are mostly police and firefighters at certain municipalities.

Section 3: States intent to appropriate $100 million in FY 2017-18 and $200 million in FY 2018-19 to more quickly repay unfunded liability in TSERS.

Section 4(a): Continues participation in DIP for new State government hires on or after July 1, 2018.

Section 4(b): Continues participation in the Death Benefit Plan for new State government hires on or after July 1, 2018.

Section 4(c): Continues participation in the Death Benefit Plan for certain new local government hires on or after July 1, 2018.

Section 5(a): Modifies the definition of Retired Employee in statutes governing the State Health Plan to require contributory retirement service earned prior to July 1, 2018.

Section 5(b): Ties eligibility for retiree coverage in the State Health Plan to those meeting the new definition of Retired Employee.

EFFECTIVE DATE: July 1, 2018

ESTIMATED IMPACT ON STATE:

Conduent, the actuary for the Retirement Systems, estimates that the actuarially determined employer contribution (ADEC) rate would increase as follows due to closing TSERS, CJRS, LRS, and LGERS to new hires:

System/Group	Increase in ADEC
TSERS	2.40% of pay
LGERS – General and Fire	2.73%
LGERS – Law Enforcement	1.89%
CJRS	1.54%
LRS	6.29%

These increases assume that the Board of Trustees would adopt changes to the funding calculations, specifically changing from the entry age normal cost method to the aggregate cost method and resetting the actuarial (smoothed) value of assets to the market value. The change to the aggregate cost method is recommended for closed systems by the Government Finance Officers Association in a set of best practices titled "Core Elements of a Funding Policy" adopted by its Executive Board in September 2016. The aggregate cost method by itself results in contribution rates that are roughly the same or lower than those under the entry age normal method. Thus, the increases above are largely caused by resetting the actuarial value of assets. Note that the additional funding described in Section 3 would cover some or all (depending on the year) of the increased ADEC.

Hartman & Associates, the actuary for the General Assembly, notes the following impacts:

- The ultimate employer contribution rate for new hires may be between 5% and 6% of pay, which is higher than the 4.31% of pay normal cost of TSERS. This would increase expected employer costs, assuming a 7.25% investment return, but decrease variability in those costs.
- The changes will not affect the current unfunded accrued liability in TSERS, CJRS, LRS, and LGERS and the additional appropriations in Section 3 would amortize the unfunded liability faster than under current funding policy.
- The Retirement Income System in Section 1(c) is expected to be cost neutral, but would be exposed to any longevity risk and reinvestment risk for unmatched cash flow.
- The changes to retiree medical eligibility in Section 5 would not alter the current liabilities for those benefits, but would eliminate the 8.35% of pay normal cost for new hires.
- The financial impact will occur gradually over the next 30 years as the workforce transitions to new hires.

ASSUMPTIONS AND METHODOLOGY:

The cost estimates of the System's Actuary are based on the employee data, actuarial assumptions and actuarial methods used to prepare the December 31, 2015 actuarial valuations. Significant membership and financial statistics, assumptions, and methods are shown in the following tables:

Membership Statistics (as of 12/31/2015 unless otherwise noted, M = millions)				
	TSERS	LGERS	CJRS	LRS
Active Members				
Count	305,291	124,974	561	170
General Fund Compensation	$10,185M		$70M	$4M
Valuation Compensation (Total)	$13,897M	$5,869M	$70M	$4M
Average Age	45	44	55	59
Average Service	10.7	10.2	12.9	6.2
Inactive Members				
Count	143,214	59,289	45	90
Retired Members				
Count	201,522	63,110	647	300
Annual Benefits	$4,202M	$1,182M	$40M	$2M
Average Age	71	68	72	77
New Retirees During 2016	11,100	4,100	20	2

Financial Statistics (as of 12/31/2015 unless otherwise noted, M = millions)				
	TSERS	LGERS	CJRS	LRS
Accrued Liability (AL)	$71,522M	$24,360M	$616M	$29M
Actuarial Value of Assets (AVA)	$66,169M	$23,649M	$550M	$28M
Market Value of Assets (MVA)	$62,669M	$22,404M	$521M	$27M
Unfunded Accrued Liability (AL - AVA)	$5,353M	$711M	$66M	$0M
Funded Status (AVA / AL)	93%	97%	89%	99%
Required Employer Contribution for FY 2017-18 (as % of pay)	10.33%	7.50% (non-LEO)	30.23%	18.27%
Salary Increase Assumption (includes 3.50% inflation and productivity)	3.50% - 8.10%	3.50% - 7.75%	3.50% - 5.50%	5.50%
Assumed Rate of Investment Return: 7.25%				
Cost Method: Entry Age Normal				
Amortization: 12 year, closed, flat dollar				
Demographic assumptions based on 2010-2014 experience, RP-2014 mortality, and projection of future mortality improvement with scale MP-2015				

Benefit Provisions				
	TSERS	LGERS	CJRS	LRS
Formula	1.82% x Service x 4 Year Avg Pay	1.85% x Service x 4 Year Avg Pay	3.02% to 4.02% x Service x Final Pay	4.02% x Service x Highest Pay
Unreduced retirement age/service	Any/30; 60/25; 65 (55 for LEO)/5	Any/30; 60/25; 65 (55 for LEO)/5	50/24; 65/5	65/5
Employee contribution (as % of pay)	6%	6%	6%	7%

Further detailed information concerning these assumptions and methods is shown in the actuary's report, which is available upon request from David Vanderweide.

SOURCES OF DATA:

Buck Consultants, “North Carolina Retirement Reform – Senate Bill 467”, May 2, 2017, original of which is on file in the General Assembly’s Fiscal Research Division.

Hartman & Associates, LLC, “Senate Bill 467: An Act to Reform the North Carolina Retirement System”, April 20, 2017, original of which is on file in the General Assembly’s Fiscal Research Division.

TECHNICAL CONSIDERATIONS:

FISCAL RESEARCH DIVISION: (919) 733-4910.

The above information is provided in accordance with North Carolina General Statute 120-114 and applicable rules of the North Carolina Senate and House of Representatives.

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