North Carolina Retirement Systems

MEMORANDUM

TO: Teachers' and State Employees' Retirement System (TSERS) Board of Trustees (Board)

FROM: Patrick Kinlaw, Director of Policy, Planning, and Compliance

DATE: January 30, 2025

RE: Summary of Information Regarding Investment Returns and Benefit Improvement Decisions for TSERS as of January 2025

I. Key Statutory Provisions and Board Policy Provisions

a. G.S. 135-5(o) provides that TSERS retirees and beneficiaries "shall be entitled to" inflation-based (limited to 4%) adjustments to retirement allowances "provided that any such increase in allowances shall become effective only if the additional liabilities on account of such increase do not require an increase in the total employer rate of contributions."

b. G.S. 135-5(o) further provides that TSERS retirees and beneficiaries "may receive cost-of-living increases in retirement allowances if active members of the system receive across-the-board cost-of-living salary increases. Such increases in post-retirement allowances shall be comparable to cost-of-living salary increases for active members in light of the differences between the statutory payroll deductions for State retirement contributions, Social Security taxes, State income withholding taxes, and federal income withholding taxes required of each group. The increases for retired members shall include the cost-of-living increases provided in this section [i.e., in I.a. above]. The cost-of-living increases allowed retired and active members of the system shall be comparable when each group receives an increase that has the same relative impact upon the net disposable income of each group."

c. Under the Board's Employer Contribution Rate Stabilization Policy (ECRSP), the Board should recommend a contribution rate for FY ending 2026 at least equal to the recommended contribution rate for FY ending 2025 plus 0.35% of compensation. For this purpose, the recommendation for FY ending 2025 "should be adjusted for the effect of any benefit change enacted by the General Assembly, taking effect during [FY ending 2026], including COLA supplements, that was not incorporated in the Board's recommendation for [FY ending 2025]."

II. Statements by Consulting Actuary (Gallagher) in Most Recent Actuarial Valuation Report

a. "The December 31, 2023, valuation indicates an actuarial investment loss was incurred during 2023, and there are no investment gains available to support a recommendation of either of the following by the TSERS Board of Trustees: [1] a cost-of-living adjustment (COLA) that would take effect on July 1, 2025; or [2] a one-time supplement to participants in receipt of benefits, payable July 1, 2025." (p. 13)

b. "Based on the methods and assumptions used for the projections discussed later in the presentation, the standard conditions for the Board to consider proposing a potential COLA effective July 1, 2026, following the December 31, 2024, valuation would include the following minimal levels of investment return on market values of assets during 2024. Note, however, the ECRSP would require an increase in the employer contribution rate to cover the cost of a COLA. If calendar year 2024 market value returns exceed 16.07% (or about $13.3 billion for TSERS), [TSERS] is estimated to have an actuarial investment gain (rather than a loss) for 2024 and a COLA effective July 1, 2026 could be considered." (p. 14)

c. "Gallagher cannot provide legal advice. Neither this slide, nor any other slide, should be interpreted as legal advice as to the Board's ability to provide a COLA to retirees or recommend a COLA to the legislature." (p. 13)

III. Preliminary Calendar Year 2024 Investment Returns

a. In January 2025, staff of the Department of State Treasurer's Investment Management Division (IMD) informed RSD that the preliminary calendar year 2024 rate of investment return for the North Carolina Retirement Systems was +7.4%. This estimate is subject to change.

IV. Staff Observations

a. Based on p. 13 of the consulting actuary's most recent valuation report, there were no actuarial investment gains as of December 31, 2023 available to support a benefit improvement during FY ending 2026.

b. Based on p. 14 of the consulting actuary's most recent valuation report, the preliminary investment return of +7.4% during calendar year 2024 is less than the rate of +16.07% that would have been necessary to establish an actuarial investment gain to support a potential benefit improvement during FY ending 2027.

c. Benefit promises must be funded either by future contributions (and investment returns thereon), or by past contributions (and investment returns thereon), or some combination. An unfunded actuarial accrued liability (UAAL) means that the past contributions and investment returns thereon have not been fully sufficient to support already-promised benefits.

V. Additional Resources

a. TSERS actuarial valuation report published October 2024, describing the funded status of TSERS as of December 2023, relative to benefits already promised.
    i. UAAL as of 12/31/2023: $11.2 billion (p. 8)
    ii. Actuarial Value of Assets as of 12/31/2023: $88.6 billion (p. 47)
    iii. Actuarial Accrued Liability as of 12/31/2022: $99.8 billion (p. 47)
    iv. Additional cost of 1% permanent increase in retirement allowances: $571.1 million, or an increase of 0.40% in the employer contribution rate for a 12-year period (p. 13)
    v. Additional cost of one-time 1% supplemental payment: $57.7 million, or an increase of 0.30% in the employer contribution rate for a single year (p. 13)

b. TSERS funding projections from Gallagher in these meeting materials, taking into account only benefits already promised. See agenda item titled "Actuarially Determined Employer Contribution (ADEC) Projections for State System."
   i. Preliminary Estimated UAAL as of 12/31/2024: $11.1 billion (p. 8)
   ii. Projected Employer Contribution Toward Retirement in FY ending 2026: 17.14% of compensation (p. 3); equates to $2.2 billion General Fund, $3.4 billion all funding sources; does not include member contributions (6% of compensation) or contributions toward retiree medical, death, or disability
   iii. Projected Employer Contribution Toward Retirement in FY ending 2027: 17.49% of compensation (p. 3); equates to $2.2 billion General Fund, $3.4 billion all funding sources; does not include member contributions (6% of compensation) or contributions toward retiree medical, death, or disability

c. Recommendation alternatives from RSD staff in these meeting materials. See agenda item titled "Presentations on the 2025 Alternatives for the General Assembly" under "State System."

d. Consumer Price Index history through June 2024 from the U.S. Bureau of Labor Statistics.

e. Board of Trustees website with past meeting materials, including minutes describing quarterly updates on Investment Advisory Committee (IAC) meetings.

f. IAC website with meeting materials, including link to archived years' materials, containing quarterly reports on investment performance and other information about investment policies and recommendations.

g. Investment performance and fee reports published by IMD; some reports are quarterly and some annual.