North Carolina Total Retirement Plans

State Treasurer of North Carolina
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Summary of Funding/Benefits Alternatives for Recommendations and Decisions for Fiscal Year Ending in 2023

Local Governmental Employees' Retirement System (LGERS) Board of Trustees

Executive Summary

This document summarizes alternatives for the Board's funding and benefits recommendations and decisions for the fiscal year ending in 2023. Staff believes there are three substantive issues for the Board to consider:

(1) For LGERS, the Board has the authority to establish employer contribution rates, and limited authority to authorize increases to ongoing retirement benefits (COLAs) or one-time payments to retirees (supplements). A decision about COLAs and supplements, if any, is connected to the decision about the employer contribution rate for the upcoming fiscal year. The two are connected by actuarial assumptions and methods adopted by the Board, including the Employer Contribution Rate Stabilization Policy (ECRSP). One available alternative is for the Board to authorize a one-time supplement during the upcoming fiscal year, equal to 2% of each payee's annual pension. If the Board wished to use investment gains experienced during 2020 to pay for such a supplement (rather than increasing employer contribution rates), Staff would recommend a conforming amendment to the ECRSP.

(2) For the Firefighters' and Rescue Squad Workers' Pension Fund (FRWSPF), which receives direct appropriations from the State, the recent State budget law (S.L. 2021-180) already incorporates sufficient funding for the benefits that it promises, aligned with the most recent actuarial valuation report. The Board has a number of options available to it. One option, consistent with the description for LGERS above, is to recommend that the General Assembly provide a one-time supplement to retirees equal to $40 per retiree, equivalent to about 2% of the annual pension. Under the principles of the Board's State Contribution Rate Stabilization Policy (SCRSP), this would require a simultaneous recommendation for a one-time appropriation to the FRSWPF, equal to $630,000, in addition to what was enacted through S.L. 2021-180. This option would not require an increase to member contribution rates (currently $10 per month).

(3) The Board may direct Retirement Systems staff to study alternatives for addressing the projected shortfall in the Retirees' Contributory Death Benefit Plan, in time for the Board to make specific recommendations to the 2023 General Assembly.

The remainder of this memo provides details regarding each Retirement System.

LGERS

Issue. G.S. 128-30(d)(5) requires that employer contributions to LGERS in each year "shall not be less than the sum of the rate per centum known as the actuarially determined employer contribution [ADEC] rate… as adjusted under a contribution rate policy adopted by the Board of Trustees and known as the 'required employer contribution' rate." G.S. 128-30(d)(2a) requires that the ADEC rate "shall be calculated annually by the actuary using assumptions and a cost method approved by the Actuarial Standards Board of the American Academy of Actuaries and selected by the Board of Trustees."

1. ADEC Prior to Contribution Rate Policy

The most recent LGERS actuarial valuation report documents the ADEC rates for the fiscal year ending in 2023. The "ADEC Prior to Contribution Policy" is the mathematical contribution rate that would fund the system using the Board's assumptions and methods adopted on January 28, 2021, and plan population and asset information as of December 31, 2020. For employees other than law enforcement officers (non-LEOs), the "ADEC Prior to Contribution Policy" is 11.22% of pay. For law enforcement officers (LEOs), it is 13.00% of pay.

2. Adjustment for Employer Contribution Rate Stabilization Policy (ECRSP)

The Board adopted the current ECRSP on April 29, 2021. This policy serves to provide predictable incremental increases in the employer contribution rate to protect against potential adverse experience for the five fiscal years ending 2023 through 2027. **The ECRSP would result in recommended contribution rates for the fiscal year ending in 2023 equal to 12.10% of covered pay for non-LEOs and 13.10% of covered pay for LEOs.**

For non-LEOs, the rate is determined as the prior year's policy contribution (11.35%) plus 0.75%.[1] For LEOs, the rate is determined as the non-LEO rate (12.10%) plus 1.00%.[2]

The ECRSP rates in part (2) have the effect of increasing the ADEC from the rates in part (1), by a total of $55 million for the first year of the five-year ECRSP.[3]

Cost of Living Adjustment (COLA). Under G.S. 128-27(k) and (k1), the Board may authorize a COLA that is no greater than 4%, or a supplement that is no greater than 4% of the annual retirement allowance.[4] If the Board authorizes a supplement, the Board must also determine that it will not provide a COLA taking effect in the same year as the supplement.

[1] Additional adjustments would have been required if there had been any enacted change in benefits, assumptions, or methods, not yet incorporated in the policy contribution, with an effect measured by the consulting actuary. However, there have been no such changes. Another adjustment would have been required if the non-LEO rate described in part (1) above (11.22%) exceeded the policy rate of 12.10% by at least 1.00% of compensation, but it does not.

[2] Additional adjustments would have been required if there were enacted LEO-specific changes in benefits not yet incorporated in the policy contribution, with an effect measured by the consulting actuary, but there have been none.

[3] As illustrated in the footnotes to the "Summary" page of this document, the approximate dollar amounts for appropriations effective July 1, 2022, are estimated using the "Estimated State Payrolls for Retirement Appropriations Purposes for the 2021 Session of the North Carolina General Assembly," set forth in a letter from the Director of the Retirement Systems to the State Budget Director and the Director of the Fiscal Research Division of the General Assembly, dated June 21, 2021. For example, the approximate increase in ADEC ($55 million) is estimated as $1,324,820,000 (the LGERS LEO payroll from the aforementioned memo) times 0.10% (the difference between 13.10% in part 2 and 13.00% in part 1), plus $6,064,139,000 (the LGERS non-LEO payroll) times 0.88% (the difference between 12.10% in part 2 and 11.22% in part 1). Once a similar payroll letter is finalized for the 2022 Session of the General Assembly, the dollar amounts would change in accordance with the new estimated payroll amounts.

[4] The COLA or supplement must also be no greater than inflation during the calendar year. Since inflation during calendar year 2021 exceeded 4%, the relevant limit is 4%.

The cost of a COLA or supplement authorized by the Board is limited to the actuarial investment gains. Notwithstanding the amount of investment gains experienced in a year, the ECRSP provides that the employer contribution for any year through fiscal year ending in 2027 will be adjusted for the effect of any benefit change taking effect during the year. This would include the cost of COLAs or supplements.

In the latest actuarial valuation report, the Board's consulting actuary:

- Estimated that actuarial investment gains during calendar year 2020 were $487 million.
- Estimated that the cost of each 1% COLA, as a new monthly benefit for current payees, is approximately $183 million. If funded in a single year, this would equate to 2.48% of employee compensation. If funded over a 12-year period, the actuary estimated the required increase in employer contributions to be 0.31% of employee compensation. At current payroll levels, this would equate to approximately $23 million per year, for 12 years, for a total 12-year expenditure of approximately $275 million.
- Estimated that the cost of each one-time payment (supplement) equal to 1% of the payee's annual pension benefit is 0.22% of employee compensation paid for a single year. In dollar terms, this is approximately $16 million.

Under its current policy, the Board could:

A. **Implement a COLA** effective July 1, 2022. The maximum COLA eligible for Board enactment would be 2.66% (i.e., $487 million divided by $183 million). That amount of COLA would call for increasing the employer contribution rate by 0.82% of pay for 12 years under the ECRSP. At current payroll levels, this would equate to approximately $61 million per year for 12 years to be paid by local government employers, for a total 12-year expenditure of approximately $727 million.
B. **Implement a one-time supplement** to be paid during the fiscal year ending in 2023, for example, in October 2022 when a supplement is scheduled to be paid to State retirees. The maximum supplement eligible for Board enactment would be 4.00%, and a supplement at that level would call for increasing the employer contribution rate by 0.88% for a single year. In dollar terms, this is approximately $65 million.
C. **Implement no COLA or one-time supplement**.

The Board could implement either (A) or (B), but could not implement both.

The increase in employer contribution rates described for (A) or (B) is not a direct requirement of statute, but is part of the Board's ECRSP. Therefore, it is possible for the Board to adopt either (A) or (B) without the contribution rate increase provision. If the Board wishes to do so:

- Staff would recommend that the Board make a conforming amendment to the ECRSP to correspond to the action taken.
- Staff would recommend that the Board take caution in limiting benefits that are approved without a corresponding increase to the employer contribution. Unlike the State System's ECRSP, the Local System's ECRSP does not guarantee employer contributions at least equal to the actuarially determined requirements (ADECs) over its five-year term. There is always a risk that contributions will not reach ADECs, putting the plan at a long-term funding disadvantage and requiring steep increases in employer contributions at the end of the five years. This risk is closely correlated to the risk of capital market downturns beyond the Board's control. If this risk develops, it would likely be during the fourth or

fifth year of the ECRSP, the fiscal years ending 2026-2027. In view of this very significant risk to the stability of LGERS, the ECRSP is designed to ensure funding exceeding actuarially determined amounts in its early years (e.g. the $55 million planned for the fiscal year ending 2023), to build protection against this risk for the remainder of the five years. COLAs or supplements not paid for by an adjustment to employer contributions reduce the extent to which the ECRSP protects against this risk.

An alternative that has been publicly supported by the Chair has been for the Board to implement a one-time supplement equal to 2% of annual pension amounts, without an increase to employer contribution rates for the fiscal year ending in 2023. In this scenario, the value of the supplements paid to retirees would be approximately $33 million, increasing the actuarially determined contributions for the fiscal year ending 2023 by $33 million. The contributions in excess of actuarially determined amounts for the first year of the five-year ECRSP, instead of being $55 million, would be $22 million (i.e., $55 million minus $33 million). As illustrated in today's projection from the consulting actuaries, the ECRSP in the second year of its operation is currently projected to require contributions at least $150 million greater than actuarially determined amounts.

Policy Options for Consideration by the Board of Trustees.

- The Board may provide a one-time supplement equal to 2% of annual pension benefits, without adjusting the employer contribution rates. The employer contribution rates for retirement benefits for the fiscal year ending 2023 would be 12.10% for non-LEOs, and 13.10% for LEOs. This would follow the Chair's public recommendation. In this case, Staff would recommend the Board adopt a conforming amendment to its ECRSP (for example, ECRSP Draft Amendment No. 1, attached hereto). As part of this action, the Board would determine that it will not authorize a COLA taking effect in the same year.
- The Board may follow any of the options in (A) through (C) above, with or without a corresponding adjustment to the employer contribution rates. If there is not an adjustment to employer contribution rates corresponding fully with the cost of any benefits authorized, Staff would recommend that the Board amend the ECRSP to correspond to the action taken.

Firefighters' and Rescue Squad Workers' Pension Fund (FRSWPF)

Issue. The Board adopted the State Contribution Rate Stabilization Policy (SCRSP) on April 29, 2021. Under Section IV of the SCRSP, recommended State contribution for the fiscal year ending in 2023, prior to any adjustment for benefit changes, is the greater of (1) the recommended appropriation for the fiscal year ending in 2022, plus $350,000; or (2) the underlying actuarially determined contribution (ADEC) determined by the consulting actuary for the fiscal year ending in 2023. The ADEC for the fiscal year ending 2023 is the mathematical contribution amount that would fund the system using the Board's assumptions adopted on January 28, 2021, and plan population and asset information as of December 31, 2020.

Item (1) is equal to the recommended and actual appropriation for the fiscal year ending 2022 ($19,352,208) plus $350,000, or $19,702,208. Item (2), the underlying ADEC, is $13,806,519 according to the most recent FRSWPF actuarial valuation report. Therefore, the SCRSP results in a recommended State contribution of $19,702,208 for the fiscal year ending in 2023, which is the greater of item (1) or item (2). This recommendation matches the amount already appropriated for the second fiscal year of the 2021-2023 biennium by S.L. 2021-180. The SCRSP provides that this recommendation should be adjusted if there is a recommendation for a benefit increase as described below.

Benefit Increase.

Option A: It would be consistent with the SCRSP, and consistent with actions recently taken by the General Assembly and contemplated by the Boards for other Retirement Systems, for the Board to recommend that the General Assembly provide a one-time supplement payment to FRSWPF retirees. Although the SCRSP does not specifically describe one-time supplements, the Board could recommend a one-time payment supplement along with the funding principles outlined in the SCRSP for other benefit changes. For example, the Board could recommend a one-time supplement equivalent to the 2% annual pension amount that the Chair has publicly supported for LGERS retirees. A dollar amount of $40 would be approximately equal to 2% of the annual pension benefit payable to each FRSWPF retiree.

The SCRSP provides that if the Board recommends additional benefits for FRSWPF, the Board will also recommend additional funding beyond the $19,702,208 amount. The additional funding, which the SCRSP calls the Benefit Improvement Funding Requirement (BIFR), would be intended to fully fund the recommended supplement within the fiscal year ending in 2023.

The consulting actuary has determined that the BIFR for a one-time payment of $40 to each retiree would be $630,000. Therefore, the recommended contribution amount under the SCRSP to go along with a recommendation of providing a one-time supplement of $40 to each retiree during the fiscal year ending in 2023 would be $19,702,208 + $630,000 = $20,332,208.

Options B-K: Under Section V of the SCRSP, the Board could recommend that the General Assembly increase the pension amount of $170 per month by up to $9.[5] If so, the SCRSP

[5] Specifically, the SCRSP provides that the Board may recommend a benefit increase if all of four conditions are met. The first condition is that the benefit increase is not greater than the most recent June-over-June increase in the Consumer Price Index. That increase was 5.4%, which would equate to an increase in the pension from $170 to $179 (i.e., $180 would exceed this limit). The second condition is that the Board recommends an additional appropriation as outlined in these materials. The third condition is that the Board recommends an adjustment to the member contribution rate as outlined in these materials. The fourth condition is that the

provides that the Board would also recommend that the General Assembly make an additional appropriation in the upcoming fiscal year to pay for the cost of the benefit increase as follows. Further, the SCRSP provides that along with any increase in the benefit, the Board would recommend that the member contribution rate be increased from $10 to $15 per month.

Recommendation	Monthly Pension	Add'l Appropriation (FY Ending 2023)	Member Monthly Contribution Rate
B	$170 (current)	$0	$10 (no change)
C	$171	$2,917,719	$15 ($5 increase)
D	$172	$5,835,438	$15 ($5 increase)
E	$173	$8,753,157	$15 ($5 increase)
F	$174	$11,670,876	$15 ($5 increase)
G	$175	$14,588,595	$15 ($5 increase)
H	$176	$17,506,314	$15 ($5 increase)
I	$177	$20,424,033	$15 ($5 increase)
J	$178	$23,341,752	$15 ($5 increase)
K	$179	$26,259,471	$15 ($5 increase)

Policy Options for Consideration by the Board of Trustees. The Board may consider any of recommendations A through K as described above.

- Option A would be to recommend a one-time supplemental payment of $40 per retiree, would be consistent with the Chair's policy recommendation for LGERS. It would require a recommended appropriation of $20,332,208 for the fiscal year ending in 2023, which is greater than the amount already enacted in S.L. 2021-180 by $630,000. It would not require recommending an increase the member contribution rate.
- Option B is to recommend no change to benefits, appropriations, or member contributions, and would not require a vote of the Board.
- Options C through K would be to recommend an increase in the pension amount. Each of these recommendations would require a significant recommended increase in appropriations, beyond the amounts already funded in S.L. 2021-180, and would further require an increase in the member contribution rate from $10 to $15 per month.

Board consider any change that has been made to the tax on gross premiums on property insurance. This tax, as provided under G.S. 105-228.5, was amended by S.L. 2021-180, effective January 1, 2022, to clarify the definition of "gross premiums" as it pertains to surety bonds. In the judgment of Retirement Systems staff, this amendment is not material to the Board's analysis.

<u>Registers of Deeds' Supplemental Pension Fund (RODSPF)</u>

Issue. The most recent valuation report shows the recommended Actuarially Determined Employer Contribution (ADEC) for the fiscal year ending in 2023. The ADEC for FY 2023 is the mathematical contribution amount that would fund the system using the Board's assumptions adopted on January 28, 2021, and plan population and asset information as of December 31, 2020. The estimated ADEC of $0 for the fiscal year ending in 2023 is less than the 1.5 percent of monthly receipts collected pursuant to Article 1 of Chapter 161 of the N.C. General Statutes. (Statutory amounts collected were $1,085,980 in calendar year 2020 and $895,784 in calendar year 2019.) Additionally, the fund is over-funded with a funded ratio of 154.1% as of December 31, 2020.

Based on these facts, the monthly benefit amount could be increased. However, increasing the maximum monthly benefit would make it more likely that the ADEC in a future year would be greater than $0.

Policy Option for Consideration by the Board of Trustees. Recommend no change to the current benefit structure. ***Making no recommendation does not require a vote of the Board.***

Death Benefit Plans

Death Benefit Plan for Members of LGERS

Issue. The actuarial valuation of the Death Benefit Plan for members of LGERS as of December 31, 2020, shows that the plan has liabilities of $53,469,194. Against these liabilities, the plan has current assets of $96,572,606. Prospective contributions by the participating employers have a present value of $40,511,754. The present and prospective assets, which amount to $137,084,360, exceed the liabilities of $53,469,194 by $83,615,166.

Policy Option for Consideration by the Board of Trustees. Recommend no change to the current contribution rates or benefit structure. ***Making no recommendation does not require a vote of the Board.***

Retirees' Contributory Death Benefit Plan

Issue. Benefits payable under the Retirees' Contributory Death Benefit Plan are supported entirely by the contributions of the participants and the investment earnings on those contributions. The actuarial valuation as of December 31, 2020, shows that the plan has liabilities of $1,481,794,308. Against these liabilities, the plan has current assets of $296,209,705. Prospective contributions of participants eligible for benefits have a value of $1,052,703,904. The total present and prospective benefits amount to $1,348,913,609, which are less than the liabilities of $1,481,794,308 by $132,880,699. The Board's consulting actuary has advised that, based on the assumptions of the actuarial valuation, the current assets and contribution rates of the plan are not adequate with the current plan provisions and contribution rates; and that the plan provisions and/or contribution rates should be changed to reverse this projected shortfall.

The Boards faced a similar situation about six years ago, in response to which the Boards voted in April 2016 to increase the premiums for enrollees retiring March 1, 2017 or later, and to reduce the interest rate paid on returns of contributions to 1.20% per year.

Pursuant to S.L. 2020-29, no decision of either the State Board or the Local Board related to this plan can take effect unless and until the same decision has been made and voted on by the other Board.

Policy Option for Consideration by the Board of Trustees. Direct staff to engage with the Board's consulting actuary in studying a range of options to address the projected shortfall of the plan. Such options may include premium increases for retirees choosing to enroll, benefit reductions, or other administrative approaches. Direct staff to report back to the Boards on alternatives in time for the Boards to consider a specific recommendation to the 2023 General Assembly. ***Staff Recommendation.***

Summary of Alternatives
For Presentation to the 2022 General Assembly*

Retirement System	Employer Contributions	Enhance Benefits
Local Governmental Employees' Retirement System **(Actions by Board of Trustees)**	Increase employer contribution rate by 0.75% for non-LEOs and 1.00% for LEOs for a cost in the first year to employers of $58,729,243.[1] Adopt Draft Amendment No. 1 to ECRSP as presented at 1/27/2022 Board of Trustees meeting.	Provide one-time supplement in Oct. 2022 equal to 2% of annual allowance. Determine that the Board will not authorize a COLA taking effect during the fiscal year ending 2023.
Firefighters' and Rescue Squad Workers' Pension Fund	Increase appropriation for fiscal year ending 2023 by $630,000, to $20,332,208, in order to fund the supplement recommended by the Board[2]	See discussion material
Registers of Deeds' Supplemental Pension Fund[3]	No change to employer contributions	Increases have not been requested or contemplated
Death Benefit Plans[4]	No change	No change

* Assumes Board of Trustees adopts draft motions presented by Staff at January 27, 2022 meeting.

FOOTNOTES:

[1]The employer contribution rates for the fiscal year ending June 30, 2022, are 11.35% for employees other than Law Enforcement Officers (non-LEOs) and 12.10% for Law Enforcement Officers (LEOs). For the fiscal year ending June 30, 2023, the Board's Employer Contribution Rate Stabilization Policy calls for contribution rates of 12.10% for non-LEOs and 13.10% for LEOs. The total estimated payroll for the 2021 Session of the General Assembly was $7,388,959,000, which includes $6,064,139,000 for non-LEOs and $1,324,820,000 for LEOs.

[2]The total appropriated employer contribution for fiscal year ending June 30, 2022 is $19,352,208. For the fiscal year ending June 30, 2023, the Board's State Contribution Rate Stabilization Policy calls for a contribution at least equal to $19,702,208, which is the amount enacted in S.L. 2021-180. If the recommended supplement ($40 per retiree) is paid to Firefighters' and Rescue Squad Workers' Pension Fund retirees, the additional contribution necessary to fund the cost of the supplement in a single year is $630,000.

[3]The total actuarially determined employer contribution for fiscal year ending 2021 is $0 after taking into account the fund assets in excess of the actuarial accrued liability. Contributions to the fund are set by statute.

[4]The Board has requested a study of alternatives for addressing the projected shortfall in the Retirees' Contributory Death Benefit Plan, as documented by the consulting actuary.

(DRAFT)

Amendment No. 1 to Employer Contribution Rate Stabilization Policy (ECRSP) for the Local Governmental Employees' Retirement System (LGERS)

Whereas the Board of Trustees of LGERS (Board) adopted the ECRSP on April 29, 2021; and

Whereas, in the time since the adoption of the ECRSP, Session Law 2021-178 created G.S. 128-27(k1), authorizing the Board in certain circumstances to provide for LGERS retirees to receive one-time payments or "supplements"; and

Whereas the Board wishes to authorize a supplement for monthly LGERS benefit recipients without unduly increasing contributions required from local government employers, and while maintaining the ECRSP's effect of protecting LGERS from the risk of capital market underperformance;

Effective January 27, 2022, Section IV, Part (A), item (3) of the ECRSP is amended to read as follows:

IV. Determining the Policy Contribution (Non-LEO)…

(A) Rate for Fiscal Years 2023-2024 Prior to Discretionary Adjustment…

(3): An adjustment (increase or decrease) for the effect of any enacted benefit change taking effect before or during the fiscal year that was not incorporated in the Policy Contribution (Non-LEO) for the previous fiscal year, equal to the Actuarial Measurement of the effect of the enacted benefit change on the Underlying ADEC for the fiscal year. Notwithstanding this provision, in the case of a one-time supplement authorized by the Board under G.S. 128-27(k1) for the fiscal year ending in 2023 in the amont of 2% of each payee's annual pension, the adjustment under this item (3) will be zero.

<u>Draft Motions to Approve Chair's Recommendations for LGERS; to Recommend a One-Time Supplement for FRSWPF Consistent with Recommendation for LGERS; and to Direct a Study of the Contributory Death Benefit Plan</u>

(1) "Move to provide a one-time supplement from LGERS equal to 2% of annual retirement allowances in October 2022 to payees as of September 2022; determine that the Board will not authorize a COLA taking effect during the fiscal year ending 2023; and adopt the draft of Amendment No. 1 to the ECRSP as presented by Staff."

(2) "Move to recommend that the General Assembly provide a one-time supplement from FRSWPF equal to $40 per retiree in October 2022 and an additional State appropriation of $630,000 to pay for this supplement in one year."

(3) "Move to direct Staff to engage with the consulting actuary to study alternatives for addressing the projected shortfall in the Retirees' Contributory Death Benefit Plan, as documented by the consulting actuary."