



RETIREMENT SYSTEMS DIVISION

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Decisions on Local Governmental Employees' Retirement System (LGERS)

Issue. The LGERS Board of Trustees (the Board) adopted the *Employer Contribution Rate Stabilization Policy (ECRSP)* on January 21, 2016. The ECRSP was intended to provide predictable incremental increases in the employer contribution rate to protect against potential adverse experience. The ECRSP as adopted on January 21, 2016, would result in recommended contribution rates for the fiscal year ending in 2020 equal to 8.00 percent of covered pay for employees other than law enforcement officers (non-LEOs) and 8.75 percent of covered pay for law enforcement officers (LEOs).

Under the ECRSP as adopted January 21, 2016, the contributions for non-LEOs were set at 7.25 percent of covered pay for the fiscal year ending in 2017 and were scheduled to increase each year by 0.25 percent of covered pay, with additional adjustments, if applicable:

1. If the underlying Actuarially Determined Employer Contribution (ADEC) for non-LEOs for a given fiscal year is 50 percent greater than the scheduled employer contribution rate, then the scheduled employer contribution rate for that fiscal year and later fiscal years would increase by 0.50 percent of pay.
2. If the underlying ADEC for non-LEOs for a given fiscal year is 50 percent less than the scheduled employer contribution rate, then the scheduled employer contribution rate for that fiscal year and later fiscal years would decrease by 0.50 percent of pay.
3. Contribution rates for LEOs are 0.75 percent of pay greater than rates for non-LEOs.
4. If the General Assembly grants any additional cost-of-living allowance (COLA) beyond the COLA amount approved by the Board, increases the benefit multiplier for active employees, or changes the benefit structure in a way that results in a cost to LGERS, the schedule of contributions for the current and future fiscal years will be increased to recover the resulting cost.
5. The cost of any allowable COLA granted by the Board under the authority allowed by statute will not impact the scheduled contribution rates.

The most recent LGERS actuarial valuation report documents the ADEC rates for the fiscal year ending in 2020. The ADEC for the fiscal year ending in 2020 is the mathematical baseline contribution rate that would fund the system using the Board's assumptions and methods adopted in January 2016, as further adjusted for the change to the assumed rate of return adopted in April 2018, including direct rate smoothing of that change. It uses plan population and asset information as of December 31, 2017. The ADEC rates are as follows:

- For non-LEOs, the ADEC rate is 8.56 percent of pay, which is greater than the scheduled contribution rate of 8.00 percent under the ECRSP.
- For LEOs, the ADEC rate is 10.22 percent of pay, which is greater than the scheduled contribution rate of 8.75 percent under the ECRSP.

Since the ADEC rate for non-LEOs is within 50 percent of the rates otherwise set by the ECRSP, there is no automatic adjustment to the ECRSP under items (1) or (2) as previously described.

Projections presented by the Board's consulting actuary show that, while contributions under the ECRSP have exceeded the ADEC overall during the first three years of the ECRSP, they are projected to fall substantially short of ADEC rates in the remaining three years of the ECRSP (July 1, 2019 through June 30, 2022). The Board may amend the ECRSP if it chooses.

Cost of Living Adjustment (COLA). Based on the actuarial losses recognized in this December 31, 2017, valuation, no Cost-of-Living Adjustment (COLA) that would be effective July 1, 2019, may be granted by the Board under G.S. § 128-27(k). Further, based on the methods and assumptions of the projections provided to the Board in October 2018, Cavanaugh Macdonald Consulting LLC has estimated that a potential COLA effective July 1, 2020, may be granted by the Board following the December 31, 2018, valuation as follows:

1. If calendar year 2018 market value returns exceed 7.8 percent (or about \$1.9 billion for LGERS), the plan is estimated to have an actuarial investment gain (rather than a loss) and a COLA could be considered; and
2. If calendar year 2018 market value returns exceed 10.9 percent (or about \$2.7 billion for LGERS), the plan is estimated to have an actuarial investment gain (rather than a loss) and such gain may be enough to provide a one percent recurring COLA.

These estimates assume no other offsetting losses in the December 31, 2018, valuation.

Policy Options for Consideration by the Board of Trustees. The following policy options are available to the Board:

- **Option 1.** Set the employer contribution rates for the fiscal year ending in 2020 in accordance with the ECRSP as adopted on January 21, 2016. Increase the employer contribution rate from 7.75 percent to 8.00 percent for non-LEOs, and from 8.50 percent to 8.75 percent for LEOs. The increase in cost to employers, from the fiscal year ending in 2019 to the fiscal year ending in 2020, would be \$15.9 million.¹
- **Option 2.** Amend the ECRSP to provide for additional funding. The "LGERS ECRSP Alternatives" presentation made by staff as part of this Board meeting contains certain potential alternatives. The Red Option in that presentation would result in an increase in cost to employers of \$76.4 million from the fiscal year ending in 2019 to the fiscal year ending in 2020. The Blue Option would result in an increase in cost to employers of \$15.9 million from the fiscal year ending in 2019 to the fiscal year ending in 2020. **Staff Recommendation.**

¹ As illustrated in the footnotes to the "Summary" page of this document, the approximate dollar amounts for appropriations effective July 1, 2019, are estimated using the "Estimated State Payrolls for Retirement Appropriations Purposes for the 2018 Session of the North Carolina General Assembly," set forth in a letter from the Executive Director of the Retirement Systems to the State Budget Director and the Director of the Fiscal Research Division of the General Assembly, dated April 17, 2018. For example, the approximate increase in cost under Option 1 (\$15.9 million) is estimated as \$6,366,026,000 (the LGERS payroll from the aforementioned memo) times 0.25 percent (since both the non-LEO and LEO contribution rates would increase by 0.25 percent of pay from FY 2019 to FY 2020 under Option 1). Once a similar payroll letter is finalized for the 2019 Session of the General Assembly, the dollar amounts would change in accordance with the new estimated payroll amounts.

Decisions on the Firefighters' and Rescue Squad Workers' Pension Fund (FRSWPF)

Issue. The Board adopted the State Contribution Rate Stabilization Policy (SCRSP) on January 26, 2017. Under the SCRSP, recommended state contributions are the greater of (1) the prior year's appropriation plus \$350,000 and (2) the actuarially determined contribution.

For the fiscal year ending in 2020, item (1) is equal to the appropriation for the fiscal year ending in 2019 (\$18,302,208) plus \$350,000, or \$18,652,208.

For the fiscal year ending in 2020, item (2), the ADEC amount, is \$14,323,684 according to the most recent FRSWPF actuarial valuation report. The ADEC for FY 2020 is the mathematical baseline contribution amount that would fund the system using the Board's assumptions adopted on January 21, 2016 (and April 26, 2018 with respect to the rate-of-return assumption including direct rate smoothing of that change). It uses plan population and asset information as of December 31, 2017.

Therefore, the SCRSP results in a recommended state contribution of \$18,652,208 for the fiscal year ending in 2020, which is the greater of item (1) or item (2).

Benefit Increase. Under the SCRSP, a benefit increase may be considered when FRSWPF has undistributed investment gains, meaning that FRSWPF's deferred gains exceed its deferred losses. According to the consulting actuary's valuation report as of December 31, 2017:

- Undistributed investment gains at December 31, 2017, were approximately \$5.95 million.
- If the General Assembly appropriates the funding indicated by the SCRSP for the fiscal year ending in 2020, then the state contribution for the fiscal year would exceed the actuarially determined amounts by approximately \$3.2 million². This contribution would fully fund the actuarial accrued liability of approximately \$2.8 million associated with a \$1 increase in the monthly benefit (from \$170 to \$171 per month).
- An increase of \$1 would increase the monthly benefit by 0.6 percent, which is less than the Consumer Price Index increase that the actuary estimated as 2.1 percent.

Consideration of a benefit increase should also take into account the following factors:

- Although FRSWPF had undistributed investment gains as of December 31, 2017, the Retirement Systems' in-house actuary estimates that FRSWPF will have net deferred losses (rather than gains) of \$15 million to \$25 million as of December 31, 2018.
- Under the SCRSP, a benefit increase would require an increase in the member contribution rate to achieve a balance of cost sharing closer to 50/50 between members and the state. Members currently contribute \$10 per month over the course of 20 years (a total of \$2,400). As documented in the consulting actuary's valuation report, a benefit increase would require that the member contribution be increased to \$15 per month.

Policy Options for Consideration by the Board of Trustees. The following policy options are available to the Board. Staff is making no recommendation between the two options.

² For this purpose, contributions are compared to an actuarially determined contribution amount that fully reflects the Board's assumed rate of return of 7 percent per year, rather than employing the "direct rate smoothing" that is used in the minimum funding calculations.

- **Option 1.** Recommend an increase in the state contribution to \$18,652,208 for the fiscal year ending in 2020, pursuant to the SCRSP. Recommend that the monthly benefit be increased from \$170 to \$171, and the monthly member contribution rate be increased from \$10 to \$15.
- **Option 2.** Recommend an increase in the state contribution to \$18,652,208 for the fiscal year ending in 2020, pursuant to the SCRSP. Recommend that the benefit and contribution rates be unchanged, in light of the likely deferred asset losses as of December 31, 2018.

Decisions on Registers of Deeds' Supplemental Pension Fund

Issue. The most recent valuation report shows the recommended Actuarially Determined Employer Contribution (ADEC) for the fiscal year ending in 2020. The ADEC for FY 2020 is the mathematical baseline contribution amount that would fund the system using the Board's assumptions adopted on January 21, 2016. It uses plan population and asset information as of December 31, 2017.

The estimated ADEC of \$0 for the fiscal year ending in 2020 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 \$844,228 in calendar year 2017 and \$853,599 in calendar year 2016.) Additionally, the fund is over-funded with a funded ratio of 160.2 percent based on the assumptions adopted by the Board in April 2016 and incorporated into the most recent actuarial valuation.

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.***

Decisions on the 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, 2017, shows that the plan has liabilities of \$58,843,388. Against these liabilities, the plan has current assets of \$83,717,208. Prospective contributions by the participating employers have a present value of \$40,967,648. The present and prospective assets, which amount to \$124,684,856, exceed the liabilities of \$58,843,388 by \$65,841,468.

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, 2017, shows that the plan has liabilities of \$1,223,715,925. Against these liabilities, the plan has current assets of \$251,994,986. Prospective contributions of participants eligible for benefits have a value of \$945,074,704. The total present and prospective benefits amount to \$1,197,069,690, which are less than the liabilities by \$26,646,235. 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. Further consideration could be given based on the results of future actuarial valuations and experience studies.

Policy Option for Consideration by the Board of Trustees. Recommend no change to the current premiums, interest rate on return of contributions or benefit structure. ***Making no recommendation does not require a vote of the Board.***

**Summary of Alternatives
For Presentation to the 2019 General Assembly**

Retirement System	Employer Contributions	Enhance Benefits
Local Governmental Employees' Retirement System	Increase employer contribution rate by 1.20 percent for both law enforcement officers and all other members for a cost in the first year to employers of \$76,392,312 ¹	No undistributed gain available for benefit enhancements
Firefighters' and Rescue Squad Workers' Pension Fund	Increase employer contribution ² by \$350,000 ³	See discussion material
Registers of Deeds' Supplemental Pension Fund ⁴	No change to employer contributions	Increases have not been requested or contemplated
Death Benefit Plans	No change	No change

FOOTNOTES:

¹Based on "Red Option" presented to Board of Trustees January 31, 2019. The current employer contribution rates are 7.75 percent for employees other than Law Enforcement Officers (non-LEOs) and 8.50 percent for Law Enforcement Officers (LEOs). The total estimated payroll for the 2018 Session of the General Assembly was \$6,366,026,000, which includes \$5,220,311,000 for non-LEOs and \$1,145,715,000 for LEOs.

²The total appropriated employer contribution for fiscal year ending June 30, 2018, is \$18,302,208.

³Under the State Contribution Rate Stabilization Policy, the contribution increases by \$350,000 instead of decreasing by \$3,978,524.

⁴The total actuarially determined employer contribution for fiscal year ending 2019 is \$0 after taking into account the fund assets in excess of the actuarial accrued liability. Contributions to the fund are set by statute.

**Proposed Motion Language
Corresponding to LGERS ECRSP Alternatives**

LGERS – “Red Option”:

Move to amend the ECRSP adopted on January 21, 2016, so that the employer contribution rate for employees other than Law Enforcement Officers will be set at 8.95 percent of pay for fiscal year ending 2020, 10.15 percent of pay for fiscal year ending 2021, and 11.35 percent of pay for fiscal year ending 2022. Employer contributions for Law Enforcement Officers will remain 0.75 percent of pay greater than for non-law enforcement. Provisions of the ECRSP related to funding of COLAs, and adjustments to the contribution rates when ADECs vary significantly from scheduled rates, are not affected by this amendment.

LGERS – “Blue Option”:

Move to amend the ECRSP adopted on January 21, 2016, so that the employer contribution rate for employees other than Law Enforcement Officers will be set at 10.25 percent of pay for fiscal year ending 2021, and 12.50 percent of pay for fiscal year ending 2022. Employer contributions for Law Enforcement Officers will remain 0.75 percent of pay greater than for non-law enforcement. Provisions of the ECRSP related to funding of COLAs, and adjustments to the contribution rates when ADECs vary significantly from scheduled rates, are not affected by this amendment.

FRSWPF – Funding Recommendation (Does Not Include Any Motion Related to Benefit or Contribution Changes):

Move to recommend that the legislature increase the appropriation to \$18,652,208.