

COMMENTS ON PROPOSED 20 N.C. ADMIN. CODE 02B.0405

From the Johnston County Board of Education

The Johnston County Board of Education submits these comments on the proposed rule, 20 N.C. Administrative Code 02B.0405, of the Board of Trustees of the Teachers' and State Employees' Retirement System. The rule would establish a cap factor of 4.5 for implementation of the contribution-based benefit cap codified in General Statutes § 135-5(a3).

Unfortunately, it is clear that the Board of Trustees has undertaken this rulemaking reluctantly and only in response to the litigation brought by the Johnston, Wilkes, Cabarrus and Union county boards of education. Consequently, the proposed rule does no more than ratify the cap factor the board adopted previously in violation of the Administrative Procedure Act ("APA"). The materials provided by the board in support of the proposed rule demonstrate that it has failed once again to undertake the independent assessment of the cap factor which is its obligation under the APA.

Overview

Reflecting the pro forma nature of the Board of Trustees' rulemaking process, the board offers no explanation for why it has chosen a particular cap factor within the wide range allowed to it under the pension cap statute. Without such an explanation, the board's choice appears to be arbitrary. There are a number of criteria

the board should consider, but has not, in setting the cap factor so as to meet the purposes of the statute.

Additionally, the board has failed to follow the requirements of the APA to determine the effect of the proposed rule on employers who will be assessed “additional contributions” as a result of the rule. And the board has ignored the statutory requirement that it consider and propose alternative rules when the economic impact will exceed one million dollars in a 12-month period.

The absence of an explanation as to the board’s choice

The enabling statute authorizes the Board of Trustees to adopt a cap factor anywhere within a wide range, from a cap factor that affects virtually none of the state’s retirees to a factor that affects .75 percent of all retirements in a year. As illustrated by projections by Buck Consultants reproduced on page 17 of the fiscal impact analysis, a cap factor set toward one end of the acceptable range under the statute, say 4.2, would affect three times as many employers, 66, as a factor set near the other end, say 4.9, which would affect only 21 employers. The statute, though, offers no guidance to the trustees as to where to set the cap factor within that range. Nor do the materials accompanying the proposed rule offer a rationale for setting the cap factor at one point in the range rather than another.

One explanation of the board’s reasoning in choosing the 4.5 cap factor is distressingly inappropriate. Page 18 of the fiscal impact analysis states that the board’s selection of a lower cap factor would result in more employers being affected

and having to pay more to the retirement system. It then goes on to say that the result of affecting more employers would be the “increased likelihood of generating political opposition to the policy” In short, the board states explicitly that a principal consideration in setting the cap factor at 4.5 rather than at a different number is to avoid affecting so many employers as to stir up opposition to the pension cap law.

It is not the Board of Trustees’ responsibility to craft the cap factor to protect the pension cap law from political opposition. Inclusion of that consideration demonstrates the board’s lack of an appropriate, articulable basis for choosing one cap factor over another. The board is obligated to determine and express the basis on which it chooses to exercise the wide range of discretion granted to it by the General Assembly. It has not done so.

Criteria that should be considered

There are any number of goals the trustees might have in setting the cap factor. They might wish to come as close as possible to affecting a full .75 percent of retirements, and thereby maximize cost-shifting from T&SERS to employers. Alternatively, at the other end of the spectrum the trustees might wish to minimize the impact on those employers who set their employees’ compensation well before a pension cap was contemplated and had no opportunity to avoid the cap. The board, though, offers no explanation for its choice.

Because the board asserts that the principal purpose of the pension cap law is to advance equity among participants in the retirement system, matters of equity

should be taken into account in setting the cap factor. The most significant equity issue is pension spiking. Yet, even though the pension cap law is labeled and promoted as a solution to the practice of pension spiking, there is nothing to suggest that the application of the cap factor is affected by whether the employer has actually engaged in pension spiking. As the trustees acknowledge, circumstances other than pension spiking may trigger the application of the pension cap. Early retirement is perhaps the most significant of those factors (see page 18 of the fiscal impact analysis). Still, the trustees have given no consideration to whether the “inequities” to be addressed by the pension cap law arise from actual pension spiking or some other more benign cause.

Likewise, the board says that the law is intended to discourage employers from overcompensating some employees and putting too great a burden on the retirement system, yet there is nothing to suggest that the application of the cap factor is affected by when the employer set the compensation which triggers the pension cap — whether the compensation was set well before the pension cap was enacted or was decided in the face of the new law. Nor is there any consideration of whether the employee has been compensated in line with the employee’s peers and with the usual range for the market, or actually is being given special consideration.

The board says, too, that it wishes to affect employers’ decisions so as to reduce the burden on the retirement system, yet there is nothing to suggest that the application of the cap factor is affected by whether the cap comes into play not because

of action by the employer but rather because the employee makes an entirely independent decision to retire early.

These are all important considerations the Board of Trustee should take into account in determining the amounts employers will be required to pay in the implementation of the pension cap. None is addressed in the rulemaking.

Disparity in treatment of employers in identical situations

As a matter of equity, the treatment of employers in T&SERS and employers in the Local Government Employees' Retirement System ("LGERS") should be the same. Yet the cap factor proposed by the Board of Trustees for T&SERS is different than the factor proposed by LGERS trustees. As a result one T&SERS or LGERS employer might be subject to the pension cap and the other not, one employer might be required to pay an additional contribution and the other not, even though the years of service and average final compensation for a T&SERS retiree are exactly the same as a LGERS retiree.

Effect on employers

The materials provided by the Board of Trustees show no consideration of the effect of the proposed cap factor on T&SERS employers. The choice of one factor or another can mean a difference of hundreds of thousands of dollars for the employer, and can have a substantial impact on the employer's operations. Applying the invalid cap factor adopted unlawfully by the Board of Trustees, the Johnston County Board

of Education was assessed over \$435,000 in 2016 for the early retirement of its superintendent. A school board has no taxing authority, it is entirely dependent on state appropriations and county supplemental funding, meaning it cannot make up a loss of \$435,000 without substantial disruption such as cutting positions or eliminating educational programs. The Board of Trustees' materials, however, show no acknowledgement of this effect of the cap factor.

Data from the Retirement Systems Division shows the significance of this omission by the board. Its list of pension cap invoices as of January 10, 2018, includes nearly 100 T&SERS employers. The amounts of the additional contributions charged to those employers varies widely, but over 30 exceed \$100,000. Despite this significant burden on employers, the fiscal analysis accompanying the proposed rule makes no effort to assess the burdens those sums place on employers. There is no attempt to gauge how the losses will affect the operations of those employers.

Failure to comply with APA provisions on substantial economic impact

General Statutes § 150B-19.1(f) requires the Board of Trustees to consider at least two alternatives to the proposed rule if the rule will have a substantial economic impact. General Statutes § 150B-21.4(b1) defines a substantial economic impact as “an aggregate financial impact on all persons affected of at least one million dollars (\$1,000,000) in a 12-month period.” Although the cap clearly has a substantial economic impact — as explicitly acknowledged on the first page of the fiscal impact analysis — the board has failed to consider any alternative.

The Retirement Systems Division's own list of assessments to T&SERS employers for retirements in calendar year 2015 under the pension cap law identifies 16 employers assessed a total of nearly \$1.5 million. For subsequent years, after the lowering of the cap factor, the numbers are higher. For 2017 over 40 T&SERS employers were affected, being assessed more than \$3.6 million in additional contributions. The January 10, 2018, list identifies 30 T&SERS employers who have been assessed over \$100,000 each. Of those 30 employers, six were assessed more than \$200,000; three more than \$300,000; three more than \$400,000; and one more than \$500,000.

Despite this obvious substantial economic impact, and in violation of the statute, the Board of Trustees has failed to consider any alternative to its proposed rule or to explain why it will not choose that alternative.

Conclusion

The Board of Trustees again has failed to comply with the rulemaking procedures of the APA and needs to reconsider its proposed cap factor. The board acts arbitrarily in failing to articulate any basis for setting the factor at a particular point within the wide range allowed to it under the statute. In doing so, the board ignores the equities that it promotes as the purpose of the pension cap law, making no distinction between employers who have engaged in intentional pension spiking and those who have not; between employers who set compensation well before the enactment of the pension cap and those who did so with knowledge of the cap;

between employers who compensated the retiree within a normal range expected for the position and those who clearly overpaid; between employers in T&SERS and those in LGERS; and between employers who brought the pension cap on themselves and those affected by independent decisions of retirees over which they had no control.

As proposed, the cap factor is a blunt instrument that fails to properly implement the pension cap law as anticipated by the General Assembly. The Board of Trustees needs to start over and develop a cap factor that is true to the purposes of the law.

RESPECTFULLY SUBMITTED, this 5th day of March 2018.

JOHNSTON COUNTY BOARD OF EDUCATION

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