Minutes

BOARD OF TRUSTEES

OF THE TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM

The regularly quarterly meeting of the Board of Trustees was called to order at 9:30 a.m., January 31, 2019, by the Chair, State Treasurer Dale R. Folwell, CPA. The meeting was held in the Dogwood Conference Room of the Longleaf Building at 3200 Atlantic Avenue, Raleigh, NC 27604. The Chair acknowledged the new members of the Board to be sworn in and thanked the other members for their service. The Chair indicated there would be a public comment period for organizations and individuals to address the Board later in the agenda.

Members Present

Treasurer Dale R. Folwell, Barbara Gibson, Dirk German, Margaret Reader, John Ebbighausen, Linda Gunter, Vernon Gammon, Jeffrey Winstead, Joshua Smith, Lentz Brewer (by phone), and Kathryn Johnson on behalf of Superintendent Mark Johnson.

Members Absent

The board members absent were: Greg Patterson and Oliver Holley.

Guests Present

Jody Newsome from the Attorney General's Office, Sarah Collins with the NC League of Municipalities, Marge Foreman with the North Carolina Association of Educators, Richard Rogers with the North Carolina Retired Governmental Employees' Association, and Johanna Reese with the North Carolina Association of County Commissioners.

Department of State Treasurer Staff Present

The staff members present were: Steve Toole, Thomas Causey, Joan Fontes, Sam Hayes, Timeka Holden, Anne Roof, Patrick Kinlaw, Fran Lawrence, Karah Manning, Vicki Roberts, David Starling, Edgar Starnes, Christina Strickland and Sam Watts.

Ethics Awareness and Identification of Conflicts or Potential Conflicts of Interest

The Chair asked, pursuant to the ethics rules, about conflicts of interest of board members. No conflicts of interest were identified by the board members. The Chair referenced the updated SEI evaluations and a new board and a new board member SEI evaluation that were completed for TSERS and LGERS members respectively for review.

Approval of the Minutes from the October 25, 2018 Board Meeting

It was moved by Vernon Gammon, seconded by Linda Gunter, and carried unanimously by the Board that the minutes from the Board meeting held on October 25, 2018, be approved.

Retirement Systems Division Operations

The Chair recognized Thomas Causey, Deputy Director of Operations, Vicki Roberts, Deputy Director of Member Services and Patrick Kinlaw, Director of Policy, Planning & Compliance for an update on the Division's administration. Mr. Causey reviewed the key takeaways from the operations report, noting that Member Services' incoming call volume and Service Level increased from prior year and Operation's turnaround times remain low. He gave a more in-depth report on the metrics for Operations, stating that retirement processing went from a 32-day processing period to a 9-day processing period over the last year. Mr. Causey also reported that the the Division is reviewing the process for disability applications.

The Chair recognized Deputy Director of Member Services, Vicki Roberts, for a presentation on the metrics for Member Services. Ms. Roberts reported on metrics on member correspondence noting volume was up 15 percent, yet staff processed the correspondence 64 percent faster than last year. Ms. Roberts gave a report on increased member attendance to 2017/2018 FY Meetings and Webinars, and the amount of walk-in office visitors vs. counseling sessions for the 2017 calendar year; noting a 28 percent increase in counseling sessions when comparing December 2016 to December 2017. Next, Ms. Roberts reported on the metrics of the Call Center. She noted that over the past year 87.5 percent of calls were answered in less than a minute, with increased call volume. Executive Director, Steve Toole complimented the work of the call center for processing members calls so efficiently.

The Chair recognized the Director of Policy, Planning and Compliance, Patrick Kinlaw. Mr. Kinlaw reported on that one of the Compliance section's responsibilities is to administer invoices when retirement benefits exceed the Contribution-Based Benefit Cap (CBBC). This results from what is commonly known as the "anti-pension spiking" law. Page 17 of the slideshow shows the cumulative invoice activity under LGERS since 2015. As you can see, since 2015, the Retirement Systems have issued 77 invoices to LGERS employers, averaging fewer than 20 per year. During that time, the Retirement Systems have invoiced over $6 million and collected about $5.6 million.

At the previous meeting of the Boards, we discussed a group of approximately 40 individuals who are receiving retirement benefits from TSERS or LGERS under "Option 4" (the Social Security leveling form of payment), whose benefit was not reduced appropriately when they turned age 62. In some instances, that reduction should have occurred many years ago. As we discussed at the October meeting, their retirement benefits were adjusted in August 2018 to be equal to the benefits that they should have been receiving all along. Meanwhile, the Retirement Systems contacted the individuals to explain why their benefit was being reduced, and further, to inform them that they had received an overpayment of benefits. The letter stated that a complete review of the issue would occur, and that they would be contacted to discuss repayment of any overpayment, but no earlier than January 2019. As of today, the review is still ongoing. Our staff is finalizing the exact amounts of the overpayments that are due, and finalizing the plans for working with the members and their representatives on repayment of the overpayment. Mr. Kinlaw also updated the Board on North Carolina's 2018 Comprehensive Annual Financial Report.

Investment Advisory Committee (IAC) Update

The Chair recognized Lentz Brewer for an update on the IAC meetings. Mr. Brewer provided an update on the Investment Performance Review of the North Carolina Retirement System pension trust funds as of Q3, 2018 and noted the volatility of the financial markets in fourth quarter of 2018. Cost-efficiencies initiative underway in the Investment Management Division are seeing great success. The year-to-date (through Q3) cost savings in the amount of $94.5MM have been realized. The goal was to accomplish $100MM over a four-year time frame. Cost-cutting measures include bringing indexed investments in-house and renegotiating contracts with existing fund managers and competitive bidding for new contracts. Mr. Brewer recognized the Investment Management Department for their efforts to rein in costs. Mr. Brewer also stated that for third quarter, we saw much better performance domestically than the system's international positions. Positive signs included unemployment rates reaching a 20-year low and consumer confidence hitting an 18-year high. Mr. Brewer shared the United States economy saw limited inflation concerns and a strong GDP growth led to solid gains within the domestic sector in the third quarter, and large caps had biggest quarter in 5 years. Each of the major indices reached all-time records. Mr. Brewer also stated that total assets under management for the Investment Management Division increased to $131 billion, up $2 billion in Q3. The N.C. Retirement Systems represent $99.5 billion of this number, up from $94.057 billion as of June 30, 2018. Mr. Brewer shared that the portfolio has beaten both benchmarks (implementation and long-term policy) in all measured periods up to 20 years. For third quarter, the pension trust funds achieved a total return of 2.1% versus an implementation benchmark of 1.9% and long term of 1.6%. Mr. Brewer also stated the 12-month rolling saw net return of 6.4% versus benchmarks of 5.1% and 4.7% respectively. The Investment Management Division continues to do a great job managing risk (83% lowest risk amongst peers) while getting consistent returns with less volatility in down markets.

Closed Session Pursuant to N.C.G.S. Sec. 143-318.11(a)(3)

The Chair asked for a motion to enter into a closed session pursuant to N.C.G.S. Sec. 143-318.11(a)(3) to consult with legal counsel regarding pending litigation involving Johnston, Wilkes, Union and Cabarrus Counties Boards of Education. It was moved by Jeffrey Winstead, seconded by John Ebbighausen, and carried unanimously by the Board to enter into closed session. The Board members and applicable staff exited the Dogwood Conference Room for the closed session.

It was moved by Vernon Gammon, seconded by Jeffrey Winstead and carried unanimously by the Board to re-open the meeting.

Presentation on "Date Set by Board of Trustees" under N.C.G.S. Sec. 128-30(g)(3) and Sec. 1358(f)(3) for Employer Contributions Satisfying Contribution-Based Benefit Cap Liabilities.

The Chair recognized Patrick Kinlaw, Director of Policy, Planning, and Compliance, for a presentation on the "Date Set by Board of Trustees" under N.C.G.S. Sec. 128-30(g)(3) and Sec. 1358(f)(3) for Employer Contributions Satisfying Contribution-Based Benefit Cap Liabilities. Mr. Kinlaw shared that staff is recommending an amendment to a policy of each Board, which will give some employers additional time to pay the contribution-based benefit cap (or CBBC) liabilities before the Retirement Systems would begin the process of intercepting their State appropriations.

Mr. Kinlaw shared that the Retirement Systems Division collects contributions from employers for various reasons, including payments to satisfy CBBC liabilities, but also other types of contributions. The Boards must set a date by which, if these contributions have not been received, the Retirement Systems will begin the process of having State appropriations to the employer intercepted in order to recover the payment. The method that the Boards have used to set this date is a policy of each Board that was adopted in October 2016. As it pertains to CBBC liabilities, the policy adopted in October 2016 is that CBBC-related contributions must be received within 12 months after the effective retirement date of the relevant plan member. Some employers have not paid certain CBBC contributions that were due before the Boards adopted administrative rules related to the "cap factor". Staff recommends that these employers be given some additional time to pay the CBBC liabilities.

For the TSERS Board, Mr. Kinlaw shared staff's recommendation of leaving the 12-month policy in place for CBBC contributions, but to extend the due date to December 1, 2019, if that is later. For the LGERS Board, the recommendation is similar, except that the due date would be extended to May 1, 2019, if that is later than the 12-month date. Neither updated Board policy would change the required payment date for contributions other than CBBC payments. Both updated Board policies would be effective today.

John Ebbighausen made a motion to approve this recommendation, which was seconded by Dirk German and carried unanimously by the Board.

Presentation on the Decennial Rules Review Readoption Date.

The Chair recognized Christina Strickland, General Counsel for the Retirement Systems Division, for a presentation on the Decennial Rules Review Readoption Date. Ms. Strickland stated that on August 16, 2018 the Rules Review Commission (RRC) approved the Decennial Rules Review report for the Teachers' and State Employees' Retirement System's (TSERS) and Local Governmental Retirement System's (LGERS) rules found in Title 20, Chapter 2 of the North Carolina Administrative Code. As required by the Administrative Procedure Act (APA), the report was then submitted to the Joint Legislative Administrative Procedure Oversite Committee, and on October 21, 2018, the report became final and effective (N.C.G.S. §150B-21.3A(c)(3)). Now that the Decennial Rules Review report is final, the next step is to establish a date by which certain rules must be re-adopted. During the decennial review process some rules were determined to be "necessary with substantive public interest." The list of TSERS and LGERS rules determined as such as attached as Appendix A. The APA requires these rules to be re-adopted by a date established by the RRC (N.C.G.S. §150B-21.3A(c)(2)(g). In establishing a re-adoption date, N.C.G.S. §150B-21.3A(d)(2) requires the RRC to consult with the agency and to "consider the agency's rule-making priorities in establishing the re-adoption date." Ms. Strickland shared that in November 2018, staff of the Department of State Treasurer consulted with RRC counsel and December 31, 2022 is proposed as the date for re-adoption. In reaching this proposed date it was noted that currently staff of the Retirement Systems Division are in the process of reviewing and revising all of the rules in Title 20, Chapter 2; including those rules requiring re-adoption. It is staff's intention to complete the full update of rules and to complete the required re-adoption of rules by December 31, 2022.

It was moved by Linda Gunter, seconded by Margaret Reader to and carried unanimously by the Board to approve the proposed re-adoption date for TSERS rules as December 31, 2022, to be presented for formal approval by the RRC.

Proposed Administrative Rules for Monthly Reports to Employers under N.C.G.S. §128-30(g)(2)b. and §135-8(f)(2)f.

The Chair recognized Christina Strickland, General Counsel for the Retirement Systems Division, and Ms. Strickland presented the Staff recommendations for the following Board actions of the TSERS Board of Trustees:

Monthly Contribution Based Benefit Cap Report to Employers

(a) The Retirement System shall provide a report each month to each employer listing the member(s), for whom the employer made a contribution to the Retirement System in the month preceding the month in which the report is issued, that are most likely to require additional employer contributions should the member(s) elect to retire within the 12 months following the month in which the report is issued.
(b) The Retirement System shall issue the report no later than the 25th day of the month following the month for which the contribution was made in Paragraph (a) above.
(c) The report shall list any active member(s) whose compensation is $95,000.00 or greater, adjusted annually from 2019 to later years based on the consumer price index, and whose estimated monthly retirement allowance exceeds the contribution-based benefit cap factor adopted under N.C.G.S. §135-5(a3), minus 0.3.
(d) Any member for whom an annual statement of benefits was not generated for the previous calendar year will not be reported as outlined in Paragraph (a) above.
Authority: N.C.G.S. §135-6(f); §135-8(f)(2)(f)

It was moved by Joshua Smith, seconded by Jeffrey Winstead and carried unanimously by the Board to adopt the proposed administrative rules for monthly reports to employers.

Contribution-Based Benefit Cap Average Final Compensation Threshold Determination.

The Chair recognized Patrick Kinlaw, Director of Policy, Planning, and Compliance, for a presentation on the Contribution-Based Benefit Cap Average Final Compensation Threshold Determination. Mr. Kinlaw shared that by statute, the contribution-based benefit cap (CBBC) can apply to retiring members only if their four-year average final compensation is greater than or equal to a certain amount, which is referred to as the "threshold" for administration purposes. If someone's average final compensation is below the threshold, the CBBC cannot apply to them. The threshold was set by law at $100,000 in 2015 and has increased each January 1 for inflation. For the first few years, the increase was based on December-to-December increases in the Consumer Price Index. For retirement dates effective in 2018, the threshold was $104,973.81.

Mr. Kinlaw shared that this year's increase, for the first time, is based on the June-to-June increase in the Consumer Price Index, as required by Session Law 2018-85. The increase in CPI from June 2017 to June 2018 was 2.9 percent. Therefore, the staff calculation is that the threshold should increase by 2.9 percent, to $108,018.05. This new threshold applies to all retirements effective in 2019.

It was moved by Jeffrey Winstead, seconded by Margaret Reader and carried unanimously by the Board to approve the recommendation.

Increase in the Amount of Reemployment Earnings Before Suspension of Retirement Allowance.

The Chair recognized Steve Toole, Executive Director of the Retirement Systems Division (RSD) to speak about the annual statutory increase in the compensation that may be earned by a re-employed beneficiary who is receiving either an early retirement benefit or a service retirement benefit, before suspension of a retirement allowance under G.S. §135-3(8)(c). Mr. Toole commented on how much retirees are allowed to earn without jeopardizing their pension. The State law says: 1) greater than fifty (50) percent of compensation twelve months prior to retirement or 2) $20,000 indexed annually for change in CPI, which would be $33,560 effective as of January 1, 2019.

It was moved by John Ebbighausen, seconded by Linda Gunter and carried unanimously that the 2019 earnable allowance is set at the greater of fifty (50) percent of reported income twelve months prior to retirement, or the rate of $33,560.00.

Teachers' and State Employees' Retirement System Actuarially Determined Employer Contribution (ADEC) Projections

The Chair recognized Larry Langer and Jonathan Craven of Cavanaugh Macdonald Consulting to provide the actuarially determined employer contribution projections. Mr. Langer and Mr. Craven shared the key takeaways from their presentation. The projections of the actuarial valuation are known as deterministic projections. Deterministic projections are based on one scenario in the future. The baseline deterministic projection is based on December 31, 2017 valuation results. The key projection assumptions include a 7.00% investment return on market value of assets, along with actuarial assumptions and methods as described in Appendix D. All future demographic experience is assumed to be exactly realized. Additionally, the contribution rate under the ECRSP is contributed until fiscal year ending 2022. There is a 0% increase in the total active member population assumed and there are no cost-of living adjustments granted, and future pay increases are based on long-term salary increase assumptions.

The ECRSP adopted by the Board of Trustees on January 21, 2016 requires that recommended contributions be 0.35% of payroll greater than the appropriated contribution during the prior year, with the following bounds: 1) contributions may not be less than the actuarially determined employer contribution (ADEC) rate and 2) contributions may not be greater than a contribution determined using the same assumptions used to calculate the ADEC but using a discount rate equal to the long-term Treasury bond yield.

In addition, Cavanaugh Macdonald Consulting provided one alternate deterministic projection. The alternate deterministic projection is based on the same assumptions as the baseline deterministic projection except that it is based on an asset return of -1.5% for calendar year 2018. The preliminary return of -1.5% for calendar year 2018 was provided by RSD Staff. It was noted that returns under this scenario were 8.5% lower than expected, as a result, the unfunded actuarial accrued liability will be higher resulting in a higher employer contribution.

Presentations on the 2019 Fiscal Year Alternatives for the General Assembly

Mr. Toole presented the 2019 fiscal year policy options and recommendations for the General Assembly for the Teachers' and State Employees' Retirement System, the Legislative Retirement System, the Disability Income Plan of North Carolina and the Budget Recommendations for National Guard.

Mr. Toole presented the fiscal policy options for the Teachers' and State Employees' Retirement System. He stated that according to the most recent actuarial valuation report, the Actuarially Determined Employer Contribution (ADEC) rate for fiscal year ending 2020 is 12.97 percent, which is greater than the currently appropriated employer contribution rate in the state budget of 12.29 percent for fiscal year ending 2020. Mr. Toole reviewed the Employer Contribution Rate Stabilization Policy (ECRSP) that was adopted by the Board of Trustees on January 21, 2016. He stated that, based on the policy, contributions will be at least 0.35 percent of payroll greater than the appropriated contribution rate from the prior fiscal year. Additionally, the contributions cannot be less than the ADEC rate (12.97 percent) and cannot be greater than a contribution rate determined using the same assumptions used to calculate the ADEC but with a discount rate equal to the long-term Treasury bond yield (approximately 68.46 percent).

Mr. Toole reported that the appropriated employer contribution rate for the fiscal year ending 2020 is 12.64 percent, which is lower than the actuarially required ADEC of 12.97 percent and not permissible. Therefore, for fiscal year 2020, staff recommended that the Board request an increase to the current appropriation to fund the employer contribution rate is 12.97 percent of payroll. This is an estimated increase to the state budget of $72.4 million.

Mr. Toole presented the fiscal policy options for the Legislative Retirement System, stating that the most recent valuation report showed that the recommended ADEC of 26.46 percent for the fiscal year ending 2020 exceeded the state budget of 22.39 percent for the fiscal year ending in 2019. Therefore, staff recommended that the Board request the legislature increase the appropriation to fund the ADEC at 26.46% of covered pay, an estimated increase from the General Fund of $147,334.

Mr. Toole presented the fiscal policy options for the Consolidated Judicial Retirement System, stating that the most recent valuation report showed that the recommended ADEC of 33.60 percent for the fiscal year ending in 2020 is less than the state budget of 33.86 percent for the fiscal year ending in 2019. Therefore, staff recommended that the Board request the legislature set an appropriation equal to at least 33.60 percent of covered pay. The appropriation from the General Fund could decrease by up to $192,514.

Mr. Toole presented the fiscal policy options for the Disability Income Plan, stating that the most recent valuation report showed that the recommended Annual Required Contribution is 0.10 percent of state payroll for the fiscal year ending 2020. Therefore, staff recommended that the Board request the North Carolina General Assembly lower the Employer Contribution Rate from 0.14 percent of payroll to 0.10 percent of payroll, an estimated reduction in the appropriation of $4.7 million.

Lastly, Mr. Toole presented the fiscal policy options for the North Carolina National Guard, stating that the most recent valuation report showed that the ADEC dollar amount of $9,031,715 for fiscal year ending in 2020 is less than the state budget of $9,071,933 for the fiscal year ending in 2019. Staff noted the relatively low funding level of the North Carolina National Guard Pension Fund and recommended an increase to the appropriation to fund the ADEC of $11,031,715. Additionally, RSD Staff proposed the development of a State Contribution Rate Stabilization Policy for the North Carolina National Guard which should include both a multi-year contribution pattern and conditions under which the Board would recommend benefit improvements.

Public Comment Period

The Chair recognized the following organizations' representatives for presentations on retirement benefit proposals for the Board to consider:

> Sarah Collins, on behalf of the North Carolina League of Municipalities, mentioned the League's members have consistently recognized the need to adequately fund the defined benefit system. The League supports an option that will spread the expected increases gradually over the next few years and prevent a sharp increase in the employer contribution in fiscal year 2023. Ms. Collins thanks the Board for its support.
>
> Marge Foreman, on behalf of the North Carolina Association of Educators (NCAE), shared a statement prepared by the NCAE President, Mark Jewell. The statement included an emphasis about how retirement is an integral part of a benefits package, and also the NCAE would like to thank the Board for their hard work.
>
> Richard Rogers, on behalf of the North Carolina Retired Government Employees' Association, discussed the decline in benefits that retirees' have seen over the last several years, specifically 12-13 percent of devaluation. Mr. Rogers questioned a plan to stabilize the contribution rate, as the Association is not aware of a plan to stabilize local and state government pensions. There was further discussion between the Chair and Mr. Rogers.
>
> Johanna Reese, on behalf of the North Carolina Association of County Commissioners, spoke about the change of the Employer Contribution Rate of Stabilization Policy. Ms. Reese also shared their concerns about long-term budget planning funding of the systems. Ms. Reese thanked the Staff for continuing strong communication efforts.

Recommendations to the North Carolina General Assembly on Actuarially Determined Employer Contribution (ADEC) Rates for Fiscal Year Ending 2019

After hearing public comments, the Board made the following fiscal recommendations to the North Carolina General Assembly:

It was moved by John Ebbighausen, seconded by Jeff Winstead and carried unanimously to recommend to the North Carolina General Assembly to increase the employer contribution rate to 12.97 percent for the Teachers' and State Employees' Retirement System. The additional appropriation needed from the General Fund would be $72.4 million.

It was moved by Joshua Smith, seconded by Dirk German, and carried unanimously to the recommend to the North Carolina General Assembly to increase the employer contribution rate to 26.46 percent for the Legislative Retirement System. The additional appropriation needed from the General Fund would be $147,334.00.

It was moved by Jeff Winstead, seconded by Linda Gunter carried unanimously to the recommend to the North Carolina General Assembly to set an appropriation equal to at least 33.60 percent for the Consolidated Judicial Retirement System. The appropriation from the General Fund could decrease by up to $192,514 based on the rate of 33.60 of pay, or the appropriation could remain the same.

It was moved by Jeff Winstead, seconded by Linda Gunter carried unanimously to the recommend to the North Carolina General Assembly to lower the employer contribution rate from 0.14 percent to 0.10 percent for the Disability Income Plan of North Carolina. This decrease creates a cost savings of $4.7 million without negatively impacting the funding of the plan.

It was moved by Treasurer Folwell, seconded by John Ebbighausen, carried unanimously to recommend to the General Assembly to decrease the employer contribution rate to 0.10 percent for the Disability Income Plan of North Carolina.

It was moved by John Ebbighausen, seconded by Vernon Gammon, carried unanimously to recommend to the General Assembly to increase the current appropriations to $11,031,715 for the North Carolina National Guard. It was also recommended that RSD Staff will develop a proposed State Contribution Rate Stabilization Policy for the North Carolina National Guard which should include both a multi-year contribution pattern and conditions under which the Board would recommend benefit improvements.

Board of Trustees Comments

The Chair asked the Board if there were any comments prior to adjournment of the meeting. The Board had no comments.

State System Adjournment

There being no further business before the Board, Vernon Gammon moved to adjourn, which was seconded by Kathryn Johnston, and the meeting was unanimously adjourned at 12:57 p.m.

____

CHAIR

SECRETARY