GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2013

Legislative Retirement Note

BILL NUMBER: House Bill 1195 (First Edition)

SHORT TITLE: Fiscal Integrity/Pension-Spiking Prevention.

SPONSOR(S): Representatives Collins and S. Ross

FUNDS AFFECTED: State General Fund, State Highway Fund, other State employer receipts; local government funds

SYSTEM OR PROGRAM AFFECTED: Teachers' and State Employees' Retirement System (TSERS), Consolidated Judicial Retirement System (CJRS)**,** Legislative Retirement System (LRS), Local Governmental Employees' Retirement System (LGERS), Disability Income Plan (DIP), and Special Separation Allowances for Law Enforcement Officers.

BILL SUMMARY:

Section 1: Establishes a contribution-based benefit cap for TSERS and LGERS. The cap is intended to control the practice of "pension spiking", in which compensation increases significantly during or right before the four year period over which compensation is averaged for calculating the benefit. The cap is essentially the annuity equivalent of the accumulated balance of employee contributions, multiplied by a factor. The TSERS and LGERS benefits are typically at least two to three times the annuity equivalent of the employee contributions, so the factor set by the Boards of Trustees would presumably be somewhat greater than three. The Boards of Trustees are required to select a factor such that no more than 0.75% of retirement allowances are expected to be capped. The cap would not apply to members with an average final compensation less than $100,000, indexed.

For those who became members prior to 2015, the last employer would be required to pay an additional contribution equal to the lump sum equivalent of the benefit in excess of the cap. For those who become members after 2014, the employer and the member will both be given the opportunity to pay the cost of the excess benefit, or the member may choose to have the benefit reduced to the cap. The Retirement System is required to provide a regular report to employers listing those employees most likely to require an additional contribution.

Section 2: Provides a return of contributions with interest (currently 4%) for those terminating with less than five years of service under TSERS, LGERS, CJRS, and LRS. Under current statute, members who terminate voluntarily with less than five years of service receive only their contributions, without interest.

Section 3: Reverses the changes made in sections one through nine of Session Law 2011-232, which increased the service requirement for monthly benefits in TSERS, CJRS, and the Special Separation Allowance from five years to 10 years for those who became members on or after August 1, 2011. The service requirement would be reduced to five years for those members, the same as for those who became members before August 1, 2011.

EFFECTIVE DATE: Sections one and two of the bill would become effective January 1, 2015. Section three would become effective when it becomes law.

ESTIMATED IMPACT ON STATE:

Section 1: Both Buck Consultants, the actuary for the Retirement Systems, and Hartman & Associates, the actuary for the General Assembly, state that the impact of this section cannot be determined because:

- The impact will depend on the factors set by the Boards of Trustees.
- There is limited experience with provisions of this type on which to base assumptions.
- It is uncertain how employers will modify their compensation practices in response to this provision.

Section 2:

The actuaries estimate the following impacts due to the provisions of this section in FY 2014-15:

	Buck Consultants	Hartman & Associates
TSERS		
% of Pay	0.01%	0.01%
General Fund	$989,100	$989,100
Highway Fund	$32,900	$32,900
Other Funds	$367,569	$367,569
CJRS		
% of Pay	<0.01%	<0.01%
General Fund	$0	$0
LRS		
% of Pay	<0.01%	<0.01%
General Fund	$0	$0
LGERS		
% of Pay	0.01%	0.01%
Local Funds	$561,132	$561,132

These impacts are expected to grow with payroll, which is assumed to grow by 3.5% per year.

Section 3:

The actuaries estimate the following impacts due to the provisions of this section in FY 2014-15:

	Buck Consultants	Hartman & Associates
TSERS		
% of Pay	0.01%	0.01%
General Fund	$989,100	$989,100
Highway Fund	$32,900	$32,900

Other Funds	$367,569	$367,569
CJRS		
% of Pay	0.07%	<0.01%
General Fund	$49,000	$0

The cost of this provision is expected to grow faster than payroll over future years as the provision affects more new hires. Hartman & Associates projects a long-term cost after 30 years of 0.06% of pay for TSERS and 0.10% of pay for CJRS.

Buck Consultants estimates an increase in State-paid Special Separation Allowances as follows:

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022
	$0	$0	$0	$7,000	$15,000	$23,000	$35,000	$20,000	$0

ASSUMPTIONS AND METHODOLOGY:

The cost estimates of the System's Actuary are based on the employee data, actuarial assumptions and actuarial methods used to prepare the December 31, 2012 actuarial valuations. Significant membership and financial statistics, assumptions, and methods are shown in the following tables:

Membership Statistics (as of 12/31/2012 unless otherwise noted, M = millions)					
	TSERS	LGERS	CJRS	LRS	DIP
Active Members					
Count	312,512	122,270	564	169	326,594
General Fund Compensation	$9,891M		$70M	$4M	$10,773M
Valuation Compensation (Total)	$13,597M	$5,427M	$71M	$4M	$15,134M
Average Age	45	44	55	60	45
Average Service	10.5	10.3	13.2	8.0	Not avail.
Inactive Members					
Count	124,976	47,663	48	81	Not applicable
Retired Members					
Count	179,908	54,547	559	283	6,884
Annual Benefits	$3,713M	$972M	$33M	$2M	$77M
Average Age	70	68	72	76	Not avail.
New Retirees During 2013	12,400	4,400	40	37	1,096

Financial Statistics (as of 12/31/2012 unless otherwise noted, M = millions)					
	TSERS	LGERS	CJRS	LRS	DIP
Accrued Liability (AL)	$63,630M	Not meaningful	$528M	$24M	Not meaningful
Actuarial Value of Assets (AVA)	$59,912M	$20,295M	$481M	$29M	$433M
Market Value of Assets (MVA)	$57,780M	$19,723M	$466M	$28M	$446M
Unfunded Accrued Liability (AL - AVA)	$3,718M	Not meaningful	$46M	($6M)	Not meaningful
Funded Status (AVA / AL)	94%	Not meaningful	91%	123%	Not meaningful
Annual Required Contribution (ARC) for FY 2014-15 (as % of pay)	8.76%	6.94% (non-LEO)	26.55%	0.00%	0.41%
Assumed Rate of Investment Return	7.25%	7.25%	7.25%	7.25%	5.75%
Salary Increase Assumption (includes 3.50% inflation and productivity)	4.25% - 9.10%	4.25% - 8.55%	5.00% - 5.95%	7.50%	4.25% - 9.10%
Cost Method	Entry Age Normal	Frozen Entry Age	Projected Unit Credit	Projected Unit Credit	Aggregate
Amortization	12 year, closed, flat $	Not applicable	12 year, closed, flat $	8 year, open, flat $	Not applicable
Demographic assumptions based on 2005-2009 experience, RP-2000 mortality with age adjustments, and projection of future mortality improvement with scale AA					

Benefit Provisions					
	TSERS	LGERS	CJRS	LRS	DIP
Formula	1.82% x Service x 4 Year Avg Pay	1.85% x Service x 4 Year Avg Pay	3.02% to 4.02% x Service x Final Pay	4.02% x Service x Highest Pay	65% of salary for long-term
Unreduced retirement age/service	Any/30; 60/25; 65 (55 for LEO)/10 (5 if hired < Aug 2011)	Any/30; 60/25; 65 (55 for LEO)/5	50/24; 65/10 (5 if hired < Aug 2011)	65/5	Any/5 with permanent disability
Employee contribution (as % of pay)	6%	6%	6%	7%	None

No information is shown for the Special Separation Allowance because no consolidated valuation report is produced for that benefit. The benefit provisions are in G.S. 143-166.41 and 42.

Further detailed information concerning these assumptions and methods is shown in the actuary's report, which is available upon request from David Vanderweide.

SOURCES OF DATA:

Buck Consultants, “Pension Spiking Prevention Act of 2014 (House Bill 1195)”, May 29, 2014, original of which is on file in the General Assembly’s Fiscal Research Division.

Hartman & Associates, LLC, “House Bill 1195: An Act to Enact Anti-Pension-Spiking Legislation, to Allow Members of the TSERS and LGERS Who Leave Employment Within Five Years to Receive a Return of Their Contributions With Accumulated Interest, and to Return to a Five-Year Vesting Period, June 2, 2014, original of which is on file in the General Assembly’s Fiscal Research Division.

TECHNICAL CONSIDERATIONS:

FISCAL RESEARCH DIVISION: (919) 733-4910.

The above information is provided in accordance with North Carolina General Statute 120-114 and applicable rules of the North Carolina Senate and House of Representatives.

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Official Fiscal Research Division Publication

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Signed Copy Located in the NCGA Principal Clerk's Offices