North Carolina Total Retirement Plans

State Treasurer of North Carolina
Dale R. Folwell, CPA

**MINUTES**

**BOARD OF TRUSTEES**

**OF THE LOCAL GOVERNMENTAL EMPLOYEES' RETIREMENT SYSTEM**

The regular quarterly meeting of the Board of Trustees was called to order at 9:30 a.m., January 25, 2018, 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 reviewed recent press releases with the Board and introduced Patrick Kinlaw, the Retirement System's Director of Policy, Planning and Compliance. The Chair indicated there would be a public comment period for organizations and individuals to address the Board later in the agenda.

**Members Present**

The board members present were: Treasurer Dale R. Folwell, Lentz Brewer, Brenda Howerton (by telephone), Aaron Meredith, Greg Patterson, Sally Sandy, Carson Smith, Mark Stohlman and Ashley Wooten.

**Members Absent**

The board members absent were: David Dear, John Aneralla, Kevin Gordon and Claire Miller (on behalf of Superintendent Mark Johnson).

**Guests Present**

The guests attending were: Joseph Newsome with the Attorney General's Office; and Michael Ribble and David Driscoll with Conduent.

**Department of State Treasurer Staff Present**

The staff members present were: Steve Toole, Thomas Causey, Joan Fontes, Jaclyn Goldsmith, Sam Hayes, Timeka Holden, Patrick Kinlaw, Fran Lawrence, Karah Manning, Mallori Morris-Bloom, Lisa Norris, 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.

**Approval of the Minutes from the October 26, 2017, Board Meeting**

It was moved by Mark Stohlman, seconded by Ashley Wooten, and carried unanimously by the Board that the minutes from the board meeting held on October 26, 2017, be approved.

**Approval of the Minutes from the December 4, 2017, Special Board Meeting**

It was moved by Sally Sandy, seconded by Mark Stohlman, and carried unanimously by the Board that the minutes from the board meeting held on December 4, 2017, be approved.

**Retirement Systems Division Operations**

The Chair recognized Thomas Causey, Deputy Director of Operations, for an update on the Division's operations department. Mr. Causey reviewed the key takeaways from the operations report, noting that turnaround times for processing remain low and the team is working on completing many year-end required activities. Mr. Causey highlighted that retirement processing went from a 32-day processing period to a nine-day processing period over the last year. Mr. Causey also reported that the division is reviewing the disability programs and processes to ensure those members who are disabled receive timely service and the benefits promised to them.

The Chair recognized Deputy Director of Member Services, Vicki Roberts, for a presentation on the metrics for member services. Ms. Roberts reported on member correspondence metrics, noting that while volume was up 15 percent, staff processed the correspondence 64 percent faster than last year. Ms. Roberts highlighted a 28 percent increase in member counseling sessions compared to the previous year. Next, Ms. Roberts reported on call center metrics. She noted that the team is meeting their objectives by answering 87.5 percent of calls over the past year in less than a minute. Executive Director Steve Toole complimented the work of the call center staff and leadership for responding to members' needs so efficiently and effectively.

The Chair recognized the Director of Policy, Planning and Compliance, Patrick Kinlaw. Mr. Kinlaw reported on the Contribution-Based Benefit Cap (CBBC) Liabilities, noting the total CBBC liabilities invoiced as of January 10, 2018, were $12.5 million. Mr. Kinlaw also reported that $11.2 million in overpayments was collected over the past 13 months. Board member Michael Mebane asked what the reasons were for overpayments. Mr. Kinlaw responded that overpayments may occur for a number of reasons, including reasons related to the design of the benefit programs (such as the state's covering Social Security Disability payments while disabled members are awaiting Social Security approval), incorrect information provided by employers or members, or other administrative issues. He also reported that 3,331 retirement and disability plan members with overpayment balances were notified in December 2017 that their outstanding balance information had been provided to the NC Department of Revenue (NCDOR) for possible collection. The notification letter informed members that all or part of any NC income tax refund or lottery winnings may be withheld by NCDOR and forwarded to RSD to be applied to the overpayment balance.

**Investment Advisory Committee (IAC) Update**

The Chair recognized Greg Patterson for an update on the November 16, 2017, Investment Advisory Committee (IAC) Meeting. Mr. Patterson gave an update on the cost-efficiencies initiative, stating that cost savings have reached over $67 million annually. Mr. Patterson reported that for the one (1) year ending September 30, 2017, the portfolio return was positive

10 percent. The portfolio has exceeded its actuarial assumed rate of return of 7.2 percent over the five-year and 15-year historical periods, but it has not exceeded those returns over the three-year, 10-year or 20-year historical periods. The average return over the 20-year historical period is positive 6.5 percent. Mr. Patterson explained that the U.S. large cap equity market segment is becoming increasingly efficient and the Public Equity team views passive management as the most prudent and cost-efficient approach in this segment of the market. The Public Equity team estimated that in just a few years, the cumulative net savings generated from managing U.S. large cap passive assets internally will be about $2 million. Mr. Patterson discussed the real estate portion of the portfolio, pointing out that it is 8.5 percent of the portfolio. Mr. Patterson concluded his remarks by updating the board on the results of the CEM Investment Benchmark Study.

**Legislative Enactment Implementation Arrangement (LEIA)**

The Chair introduced Steve Toole, Executive Director of the Retirement Systems Division (RSD), to speak on the “Legislative Enactment Implementation Arrangement” (LEIA) that was enacted by Session Law 2017-129. Mr. Toole outlined that the purpose of LEIA is to provide for timely administrative implementation of legislative provisions regarding the retirement of or payment of retirement benefits to public officers or public employees. In the event the General Assembly creates or modifies any provision for the retirement of, or payment of, retirement benefits to public officers or public employees that has a cost savings as measured by actuarial note, the Boards of Trustees may direct up to one on-hundredth of a percent (0.01%) out of the required employer contribution rate to fund the LEIA.

Mr. Toole explained that two LEIA accounts were set up on October 1, 2017. One is under the management of the TSERS Board and the second under the LGERS board. The boards have full discretionary authority to interpret, construe and implement the LEIA and to adopt any rules and regulations necessary or desirable to implement the provisions of LEIA. Annually on or before August 1, DST must report to the TSERS and LGERS Boards, the Joint Legislative commission on Government Operations and the Fiscal Research Division on the amounts and sources of funds collected by year and the amounts expended, the projects for which those funds were expended and the current status of the projects. This report must be submitted on or before August 1 of each year. Each Board of Trustees must also post this report on its public website.

**Presentation on the Decennial Rules Final Report Pursuant to N.C.G.S. §150B-21.3A**

The Chair recognized Christina Strickland, General Counsel for the Retirement Systems, for a presentation on the Decennial Rules Review Final Report. Ms. Strickland stated that based upon the Board’s initial determination of rule classifications in the Decennial Rules Review Initial Report at its October 26, 2017, the Decennial Rules Review Initial Report was published in the Register and the public comment period began. The public comment period began on November 3, 2017 and concluded on January 2, 2018. Ms. Strickland informed the board members that there were no public comments received.

Ms. Strickland stated that once the final determination of the rule classifications have been approved, staff will submit the report to the Rules Review Commission (RRC). The RRC’s review of the final report on retirement rules is currently scheduled for August 2018.

Carson Smith made a motion to make the determination classifying each rule in the Decennial Rules Review Final Report pursuant to N.C.G.S. § 150B-21.3A, and authorize Department of

State Treasurer staff to take all additional necessary steps required to complete the decennial rules review process, in accordance with N.C.G.S. § 150B-21.3A. The motion was seconded by Sally Sandy and carried unanimously by the Board.

**Increase in the Amount of Reemployment Earnings before Suspension of Retirement Allowance**

Mr. Toole gave a presentation on 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 reported that the increase in the relevant measure of the Consumer Price Index (CPI) was 2.1 percent between December 2016 and December 2017.

It was moved by Sally Sandy, seconded by Mark Stohlman, and carried unanimously that the amounts which may be earned before suspension shall be increased effective January 1, 2018, equal to the increase in the CPI of 2.1 percent, as published by the United States Department of Labor, and the 50 percent of compensation amount should be increased by the same percentage increase in the CPI effective January 1, 2018. Under this motion, the 50 percent of compensation amounts would increase by 2.1 percent and the adjusted amount would increase from $32,260 to $32,940, effective January 1, 2018.

**Actuarially Determined Employer Contribution (ADEC) Projections for the Local System**

The Chair recognized Michael Ribble and David Driscoll for a presentation on the projected actuarially-determined employer contribution (ADEC) rates for the Local System.

Mr. Ribble and Mr. Driscoll presented a baseline deterministic projection that was based on the December 31, 2016, valuation results, an assumed investment return of 13.25 percent for calendar year 2017, an investment return of 7.2 percent on market value of assets for all future years, and application of the Employer Contribution Rate Stabilization Policy (ECRSP) through fiscal year 2022. The baseline projections showed an increase in the employer contribution rate until fiscal year 2022, after which time the rate is projected to decrease, eventually to 6.0 percent of covered payroll. Mr. Ribble reviewed the future funding status under this projection.

Mr. Ribble and Mr. Driscoll presented two alternative deterministic projections for the employer contribution rate and funded status. Both alternatives were based on the same assumptions as the baseline projection, except that future valuation interest rates were assumed to be 7.15 percent for the December 31, 2017, valuation with an annual decline of five basis points thereafter until reaching a rate of 6.0 percent for the December 31, 2040, and later valuations. Under the first alternative (A1), future investment returns were assumed to be equal to the discount rate from the valuation at the end of the prior year. The second alternative (A2) assumed all future investment returns were equal to 6.0 percent per year to illustrate potential adverse experience. The actuaries reviewed the employer contribution rates under these two scenarios, explaining that Alternate 2, with future investment returns equal to 6.0 percent per year, will increase the projected employer contributions due to additional unfunded accrued liability and normal cost. The actuaries then reviewed the projected funded ratios, explaining the funded ratio difference between the two alternates.

The actuaries also presented to the Boards another set of alternative deterministic projections. Both alternatives (A3 and A4) were based on the same assumptions as the baseline projection; however, they assumed that the Board elects in 2018 to use a discount rate of 7.0 percent for the December 31, 2017, valuation through December 31, 2020, valuation and continues a pattern of lowering the discount rate another 25 basis points with every experience review (every five years) until the Board reaches a discount rate of 6.0 percent in the December 31, 2036, valuation. The ADEC for each year was based on a phase-in of the newly adopted discount rate, with a phase-in period of four years for the change to the 7.0 percent discount rate, and five years of all other assumed discount rate changes. The third alternative (A3) assumed future investment returns equal to the discount rate from the valuation at the end of the prior year, and the fourth alternative (A4) assumed future investment returns equal to 6.0 percent per year to illustrate potential adverse experience. The actuaries presented a graphical representation that outlined both sets of alternate projections, showing that a lower asset return will increase projected contributions due to increased unfunded accrued liability and normal cost. Lastly, the actuaries presented that the lower asset return of 6.0 percent for all years will yield a lower projected funded ratio.

In the A3 and A4 scenarios, for GASB purposes, the discount rate would drop to the ultimate rate the board adopts (for example, the GASB discount rate would be 7.00 percent for the December 31, 2017, valuations). Similarly, the ultimate rate adopted by the Board (7.00 percent as of the December 31, 2017, valuations) would be used for plan administration and for purposes of measuring the funded status. However, the impact on employer contribution rates would be phased in over the periods described above. This is sometimes referred to as “direct-rate smoothing.”

Mr. Ribble and Mr. Driscoll noted that all of the projections were intended to illustrate the sensitivity of various outcomes to the actual or assumed investment returns and that the use of sensitivity projections should not be interpreted as an assumption recommendation.

**Presentations on the 2019 Fiscal Year Alternatives for the Local System**

Mr. Toole presented the 2019 fiscal year options for the Local Governmental Employees’ Retirement System, the Firefighters’ and Rescue Squad Workers’ Pension Fund and the Register of Deeds’ Supplemental Pension Fund.

Mr. Toole presented the fiscal policy options for the Local Governmental Employees’ Retirement System. He 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 for general employees were set at 7.25 percent of payroll for the fiscal year ending in 2017 and will increase each fiscal year by 0.25 percent of payroll. Additionally, the ADEC will be increased by an additional 0.25 percent if the ADEC rate is 50 percent greater than the scheduled employer rate for that fiscal year, and will decrease by an additional 0.25 percent if the ADEC rate is 50 percent less than the scheduled employer rate. He stated that benefit increases granted by the North Carolina General Assembly will increase employer contribution rates and as a policy for the LGERS Board, cost of any Board-adopted cost-of-living adjustment (COLA) will not increase employer contribution rates.

Mr. Toole reported that the ADEC rate based on the December 31, 2016, valuation for the Local Governmental Employees’ Retirement System is 7.40 percent for general employees (including firefighters) for fiscal year ending 2019, which is less than the recommended fiscal year ending 2019 contribution rate of 7.75 percent under the ECRSP, and is less than the fiscal year 2018 employer contribution rate of 7.50 percent for general employees. Since the ADEC rate is within 50 percent of the scheduled employer rate, an additional change to the rate for the purposes of the ECRSP is not required.

Mr. Toole reported that the ADEC rate based on the December 31, 2016, valuation for law enforcement officers is 8.99 percent, which is greater than the recommended fiscal year ending 2019 contribution rate of 8.50 percent under the ECRSP, and also is greater than the fiscal year ending 2018 employer contribution rate of 8.25 percent. Since the ADEC rate is within 50 percent of the scheduled employer rate, an additional change to the rate for the purposes of the ECRSP is not required.

Mr. Toole shared that a calendar year 2017 investment return of 19.9 percent was needed on the portfolio to offset previous investment losses that were being carried forward from previous years and produce investment gains sufficient for the Board to grant a one percent COLA for retiree benefits. The projected return of positive 13.25 percent for calendar year 2017, while strong, is not sufficient to offset the investment losses from previous years, and therefore, no COLA could be funded by actuarial gains.

Mr. Toole recommended that the Board increase the employer contribution rate for general employees (including firefighters) from 7.50 percent to 7.75 percent and increase the employer contribution rate for law enforcement officers from 8.25 percent to 8.50 percent in accordance with the ECRSP. The additional cost to employers for fiscal year ending 2019 would be $15.6 million.

Mr. Toole presented the fiscal policy options for the Firefighters' and Rescue Squad Workers' Pension Fund. He reviewed the State Contribution Rate Stabilization Policy (SCRSP) that was adopted on January 26, 2017, stating that the SCRSP stipulates that the recommended state contributions for the Fire and Rescue plan are greater of the prior year's appropriation and an additional $350,000 and greater than the actuarially determined contribution. For fiscal year ending 2019, the prior appropriation for fiscal year 2018 is $17,952,208 including the $350,000. Mr. Toole reported that the ADEC in the December 31, 2016, valuation was $14,544,083 for fiscal year ending 2019. Because of the lower rate that occurred in the valuation, the SCRSP requires a recommended state contribution of $18,302,208 for fiscal year ending 2019, meeting the conditions under the SCRSP that the recommended state contribution be greater of the prior year's appropriation of $17,952,208 plus $350,000 (or $18,302,208). Additionally, Mr. Toole reported that since the Firefighters' and Rescue Squad Workers' Pension Fund experienced an asset loss during 2016, a monthly benefit increase is not recommended under SCRSP.

Lastly, Mr. Toole presented the fiscal policy options for the Register of Deeds' Supplemental Pension Fund, stating that the estimated ADEC of $0 for fiscal year ending 2019 is less than the 1.5 percent of monthly receipts collected pursuant to Article 1 of Chapter 161 of the NC General Statutes. He reported that the fund is over-funded with a funded ratio of 154.5 percent and the monthly benefit amount could be increased. Mr. Toole noted that increasing the maximum monthly benefit from $1,500 to $1,550 for future and current members in receipt would produce an ARC above $0. The staff recommendation was that the Board of Trustees make no change to the current benefit structure.

**Court Cost Offset for Law Enforcement Officers**

Mr. Toole reported that based on a review of receipts since 2008, the court cost offset on the Local Governmental Employees' Retirement System employer contribution rate will be set at 0.14 percent of Law Enforcement Officer payroll for the fiscal year beginning July 1, 2018. The staff recommendation is that, pursuant to the ECRSP, the employer contribution rate with respect to Law Enforcement Officers for fiscal year ending 2019 will be 8.50 percent of payroll.

**Applications of Qualified Political Subdivisions of the State to Become Participating Employers with the Systems**

Mr. Toole gave a presentation on the application of qualified political subdivisions of the state to become employers in the local system. Mr. Toole reported that the town of Micro and the Valdese ABC Board submitted their application to join the Local Governmental Employees' Retirement System. Following a thorough financial review, staff recommends their entry into the system. It was moved by Ashley Wooten, seconded by Sally Sandy, and carried unanimously that the town of Micro and Valdese ABC Board be granted entry to the Local Governmental Employees' Retirement System with an effective date of April 1, 2018.

**Public Comment Period**

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

> Pam Deardorff and Lacy Presnell, on behalf of North Carolina Retired School Personnel (NCRSP), shared their support for the employer contribution rate increase to 11.98 percent. NCRSP is hopeful for opportunities in future system gains to fund COLAs for retirees.
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> Ardis Watkins, on behalf of the State Employees' Association of North Carolina, recognized the importance for lowering investment fees and asked the Board to work diligently in support of a COLA for retirees.
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> Richard Rogers, on behalf of the North Carolina Retired Governmental Employees' Association, shared his appreciation for continuing to examine the rate of return assumption, supports full funding of the employer contribution rates and reminds the Board of the importance of COLAs for retirees.
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> Rose Williams, on behalf of the North Carolina League of Municipalities, shared the League's appreciation of the Employer Contribution Rate Stabilization Policy.

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

It was moved by Carson Smith, seconded by Sally Sandy, and carried unanimously to increase the employer contribution rate for general employees (including firefighters) for the Local Governmental Employees' Retirement System to 7.75 percent of payroll and increase the employer contribution rate for law enforcement officers to 8.50 percent of payroll for fiscal year ending 2019. The increase to the employer contribution is estimated to cost employers an additional $15.6 million.

It was moved by Lentz Brewer, seconded by Ashley Wooten, and carried unanimously to recommend that the North Carolina General Assembly increase the state contribution to $18,302,208 for the Firefighters' and Rescue Squad Workers' Pension Fund. The additional appropriation needed from the General Fund would be $350,000.

There were no changes to the current benefit structure for the Register of Deeds' Supplemental Pension Fund.

**Board of Trustees Comments**

Prior to entering into Closed Session, the Chair asked the Board if there were any comments prior to adjournment of the meeting. The Board had no comments.

**Local System Adjournment**

There being no further business before the Board, Carson Smith moved to adjourn, which was seconded by Sally Sandy, and the meeting was unanimously adjourned at 12:06 p.m.

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Chair

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Secretary