

## Frequently Asked Questions about Increase in Employer Contribution To Local Governmental Employees' Retirement System (LGERS) Effective February 2011

The Retirement Systems Division of the Department of State Treasurer receives numerous questions about the increase in the employer contribution rate for the Local Governmental Employees' Retirement System (LGERS). We have tried to capture most of the answers to those questions in this document.

### **1. What is the Local Governmental Employees' Retirement System (LGERS)?**

This system provides retirement benefits to employees and retirees of local governments (e.g., counties, cities, and towns) in North Carolina that have elected to participate in the system. Almost all local governments have elected to participate. As of 12/31/2009, there were a total of 123,398 active employees, 46,557 benefit recipients and 888 local governments in the system.

### **2. What body sets the employer contribution rate for the LGERS system?**

The Board of Trustees sets the employer contribution rate equal to the Annual Required Contribution (ARC), as developed by the system actuary (Buck Consultants). An actuary is a credentialed professional with expertise in probability and finance. N.C. Statutes require the use of an actuary to calculate the contribution. The Board approved the increase in question at its January 28, 2011 meeting.

### **3. Does the rate increase still need to be approved by the General Assembly?**

No. General Statute 128-28(a) charges the Board of Trustees with "responsibility for the proper operation of the Retirement System" and 128-30(h) authorizes the Board to "make such changes in the accounting methods and procedures of the System from time to time as, in its opinion, are in the interest of sound and proper administration of the System."

### **4. When was the last increase?**

The last increase in the base contribution rate was effective July 1, 2010 when the base rate increased to 6.35% of pay from 4.80% of pay. Prior to July 1, 2010, the last increase in the base employer contribution rate was effective July 1, 1983. There were annual increases in the years leading up to 1983.

**5. How much is the increase?**

The employer contribution is increasing from a base rate of 6.35% of pay to 6.88% of pay, i.e. by .53% of pay. The dollar amount of the increase will differ depending on the payroll of the local government.

**6. When is the new rate effective?**

July 1, 2011

**7. What is the new rate that employers pay for law enforcement officers?**

The rate for law enforcement officers is increasing from 6.82% of pay to 7.35% of pay, i.e. by the same .53% of pay. The law enforcement rates are sometimes expressed differently. The following table shows the full reconciliation:

	Before 7/1/2011	After 7/1/2011
Law-enforcement rate in valuation	6.82%	7.35%
Death benefit contribution (required)	0.14%	0.14%
Offset for court costs	<u>-0.55%</u>	<u>-0.45%</u>
Net law-enforcement contribution	6.41%	7.04%

**8. Our rate was not 6.35% before. What will our new rate be?**

Some local governments contribute a higher amount because they have elected death benefit coverage for non-law enforcement, they are still paying off an initial liability created when they joined the system, or they participate in the State Health Plan. The death benefit, accrued liability contributions, and State Health Plan contributions are not affected by the same factors that increased the base contribution rate. However, they may change for other reasons, for example a change in the average age of the local government’s employees or reaching the end of the liability amortization period. You should receive a rate letter soon with your exact rate (see next question).

**9. When will the employer rate letters be sent?**

The Retirement Systems Division is in the process of producing these rate letters. We hope to have them in the mail to employers by the end of March 2011.

**10. Is this the last increase?**

No. Contributions are projected to increase again at July 1, 2012 and each year after that for the next four or so years. The base contribution is projected to peak at a little more than 9% of pay. These projections are based on a number of assumptions. Actual experience could deviate significantly from these assumptions, resulting in much higher or lower contributions. Projections further into the future are more subject to these deviations than one or two year projections.

**11. Is the employee contribution increasing?**

At this time, there has been no change to the 6% of pay employee contribution. This rate is specified in statute, so a change would require action by the General Assembly.

**12. If the employee contribution rate was increased, could the employer contribution be reduced?**

Yes, for every 1.00% increase in the employee contribution rate, the employer contribution rate could be reduced by approximately 0.95%.

**13. Why is the contribution increasing?**

Investment losses suffered by the fund during 2008. These losses totaled approximately \$4.9 billion.

**14. How did the fund lose \$4.9 billion?**

The economic downturn of 2008 impacted all pension funds. While recent returns have been positive, the impact of crisis will be felt for years to come. The return for the LGERS was so much better because it was conservatively invested, including a significant allocation to fixed income securities (bonds).

**15. Why do we have to repay this loss now? Can't we wait until the economy is better?**

The losses occurred during 2008. The first increase didn't occur until July 1, 2010. Even in the 2010-2011 fiscal year, the contribution increase is only \$82 million, less than 2% of the losses of \$4.9 billion. In other words, most of the losses are being deferred until future years.

The contribution is increasing so slowly because the system uses a common calculation method called asset smoothing. The asset values are smoothed over five years, so this initial contribution increase reflects only one-fifth of the 2008 losses. This is also why the contributions are projected to continue increasing for the next four years.

**16. Hasn't the stock market already recovered?**

No. One common measure, the S&P 500 Index, was at a high of 1,576 in October, 2007. It reached a low of 667 in March, 2009. It recovered from that low to reach about 1,100 in early 2010, but that is still more than 30% below the peak.

**17. If we increase the contribution, won't it be out of line with the amount paid by employers in other states and the private sector?**

No. The average employer contribution among public retirement systems that participate in Social Security (like most NC employers) was 8.7% of pay even before 2008 (Public Fund Survey, FY08). The employer contributions in our neighboring states average about 10% of pay. Many private sector employers also pay a higher percentage of pay for their employees' retirement benefits. The average large private employer paid 7.3% of pay for retirement benefits in June, 2009 (Bureau of Labor Statistics).

**18. Many taxpayers have lost their jobs and have seen their 401(k) account values shrink. Why should they pay taxes to cover these contributions?**

Several NC court cases, for example *Bailey v. State of N.C.* and *Faulkenbury v. Teachers' and State Employees' Ret. Sys.*, have determined that vested benefits cannot be reduced. Whether you agree with these rulings or not, the benefits will eventually have to be paid regardless of whether there are assets set aside. By not making the contributions, taxpayers would only be digging a deeper hole, as described in the next question and answer.

Over the 27 years since the last year's increase, taxpayers have paid hundreds of millions of dollars less into the system than employees, because the employee contribution has remained at 6% of pay while the base employer contribution has been only 4.80%. Over that same period, taxpayers have also been able to pay billions of dollars less than what the benefits would have otherwise cost thanks to investment gains.

**19. What would happen if we just waited a few more years to increase the contribution?**

Each year we wait, the increase to get back on track goes up dramatically. If we wait just 2 more years, the increase in contributions is projected to be about \$200 million. If we wait 5 years, it is projected to be more than \$350 million. Of course, if \$82 million was too large an increase to accept, \$350 million will be a lot harder, which might lead to a further delay. Eventually, the contribution increase is projected to be billions of dollars. Once the assets run out, no further delay will be possible, and either taxes will have to immediately increase or spending will have to be immediately cut to come up with those billions.

We have seen other states start down this slippery slope, perhaps believing their deviation would be temporary, and they still have not gotten back on track 5, 10, or even 20 years later. These include New Jersey, Maryland, Pennsylvania, Kentucky, and Colorado.

**20. Is the increase voluntary? What happens if a local government refuses to increase its contribution?**

The increase is not voluntary and is required by North Carolina state law. We do not know of any other situation in which a local government has refused to make its contribution, but presumably the same mechanisms used to enforce other state laws would apply in this case.

**21. Can a local government choose to leave the LGERS?**

No. There is no statutory provision for leaving the system.

**22. Will the current economic environment lead to lower pay increases, which lead to lower benefits, which reduce the need for higher contributions?**

This is a possibility. However, the calculations used to set the contribution rate project benefits for employees retiring 20 or 30 years in the future. The current economic environment is unlikely to determine pay increases that far into the future.

The Board sets assumptions for the contribution calculation based on a study of retirement rates, turnover rates, mortality rates, and salary increases, among other assumptions. This study is updated every five years and the next one would normally take effect with the 12/31/2010 calculations, which determine the 7/1/2012 contribution rate. Upon the request of several local governments, we agreed to accelerate this timing so that the new study would be effective for the 7/1/2011 contribution. The new study reflects future expectations based on the current economic environment.

**23. Whom can I contact with further questions?**

To obtain your new rate, you can contact our Employer Education and Services Unit at [EESU@nctreasurer.com](mailto:EESU@nctreasurer.com), 1-877-807-3131 Option 2, or 919-807-3131 Option 2.

To ask additional questions about why the rate is increasing, you can contact David Starling at 919-807-3042 or Diane Whaley at 919-508-5156.