

How do Teachers' and State Employees' Retirement System (TSERS) contributions work?

Based on North Carolina General Statute 135-8(b)(1), employee contributions are set at six percent of compensation every year. The rate has been the same since 1975. These contributions are made through automatic payroll deductions.

Employer contributions from the State are composed of two pieces. The first is called the Normal Contribution and is equal to the cost of new benefits earned during the year. In the most recent year, the Normal Contribution was 6.26% of compensation. The second piece is called the Accrued Liability Contribution. This contribution is the extra amount needed to get back to a 100% funded status over the next nine years. When the system is overfunded, this amount is negative. Essentially, the State is "spending" down the surplus to get back to a funded status of 100%. During FY 2009, the Accrued Liability Contribution was -2.90% of compensation, making the total employer contribution $6.26\% - 2.90\% = 3.36\%$.

Why have employer contributions to TSERS been so low? In particular, why have employers contributed less than employees in recent years?

The employer contribution has been below the employee contribution since July 1, 2000 because the funded status of the system has been over 100%. As noted above, when the system is over 100% funded, the Accrued Liability contribution becomes negative to gradually bring the system back to being 100% funded. These contribution rates have been calculated by the actuary in accordance with government accounting standards and the State has contributed the full amount calculated by the actuary, not less.

There is no requirement that the State contribute at least the same amount as employees. However, over the last 30 years, the average State contribution has been 6.8% of compensation, a little higher than the average employee contribution of 6.0%. Keep in mind that if the State did adopt a goal of contributing the same amount as employees on average, it would have to contribute less than employees in some years, knowing that the contribution will be higher in other years when the plan is underfunded. In a sense, the lower contributions in some years are the State's reward for taking the risk of higher contributions when the plan becomes underfunded due to low investment returns or significant benefit enhancements.

How do Local Governmental Employees' Retirement System (LGERS) contributions work?

Based on North Carolina General Statute 128-30(b)(1), employee contributions are set at six percent of compensation every year. The rate has been the same since 1976. These contributions are made through automatic payroll deductions.

The LGERS employer contributions are paid by each county, city, town, or other local governmental unit that participates in the system. The calculation of those contributions

is somewhat different than the TSERS calculation. The basic employer contribution has been fixed since 1983 at 4.8% of compensation. Some local governments pay more because they have elected to offer a death benefit. The rate for law enforcement officers can be slightly different. Also, some local governments joined the system in the last 24 years and are still paying off the cost of the benefits initially granted at the time they joined. This combination of factors can push an individual government's rates as high as 43% of compensation, although most are less than 10%.

The employer contribution has been kept constant mostly in order to reduce volatility in local budgeting. This has advantages and disadvantages for both members of the system and for employers. When investment returns are good, members receive more cost-of-living adjustments and other enhancements, rather than giving employers a break by reducing contributions. Conversely, when investment returns are bad, members receive fewer enhancements than could be provided if the employer contribution was allowed to increase.

Keep in mind that some local governments also make employer contributions to the NC 401(k) or similar plans. The combined employer contributions to both LGERS and these other plans could easily exceed 6% of compensation.

Why are the employer contributions projected to increase so much now?

The employer contribution rate for both systems is expected to increase dramatically over the next 5 or so years. The TSERS rate is projected to increase to 6.63% of compensation at July 1, 2010 and may go over 16% several years later. The LGERS base rate is projected to increase to 5.79% of compensation at July 1, 2010 and reach almost 11% within 5 years after that.

These projected increases are entirely due to bad investment returns in 2008, which was a very unusual year. The S&P 500 stock index returned -37% for the year, the worst performance since 1931 (10 years before the TSERS and LGERS systems were formed). The return for TSERS and LGERS was -20%, far better than the S&P 500 index, but also much worse than the expected return of +7.25%. The total reduction in assets measured in dollars came to roughly \$17 billion. Unless the stock market quickly returns to its previous levels, that \$17 billion will have to be recovered through higher contributions.

The State has been contributing about \$0.5 billion to the TSERS each year and local governments have been contributing about \$0.25 billion to LGERS. To pay off \$17 billion, the state and local governments will need to dramatically increase their contributions, just as an individual would need to pay a lot more than \$750 per year to pay off a \$17,000 loan.

These contributions will represent a noticeable portion of the state and local budgets. For reference, the General Fund budget for FY09-10 is set at roughly \$19 billion.