

Comments on Proposed 20 N.C. Admin. Code 02B.0405

Submitted by the
North Carolina Association of School Administrators
North Carolina School Superintendents Association
North Carolina Principals and Assistant Principals' Association

April 12, 2018

Organizations represented and their interests

The North Carolina Association of School Administrators (“NCASA”), North Carolina School Superintendents Association (“NCSSA”), and the North Carolina Principals and Assistant Principals’ Association (“NCPAPA”) (altogether “NCASA affiliates”) submit these comments opposing the approval of 20 N.C. Administrative Code 02B.0405 as proposed by the Board of Trustees of the Teachers’ and State Employee’s Retirement System (“TSERS”) based upon the analysis provided by the agency of the Department of State Treasurer (“agency”). This objection is based on a belief that the agency and TSERS have failed to meet the statutory requirements for rule-making, including failing to address the excessive burdens placed on leaders in the public schools and the severe economic burdens placed on their employers, the local boards of education.

Established in 1976 with the mission of ensuring student success through visionary leadership, the North Carolina Association of School Administrators (NCASA) is a non-profit serving more than 6,500 members statewide. The North Carolina School Superintendents’ Association is the professional membership organization for the state’s local superintendents that ensures that all local superintendents have a voice in state-level education policy issues affecting public schools. The North Carolina Principals and Assistant Principals’ Association (NCPAPA) represents 5,500 members and aims to promote excellence in educational leadership.

Failures to follow required rule-making procedures

These comments relate to the responsibility of TSERS to adopt rules in accordance with the Administrative Procedures Act (“APA”) regarding N. C. Gen. Stat. § 135-5:

The Board of Trustees shall adopt a contribution-based benefit cap factor recommended by the actuary, based upon actual experience, such that no more than three-quarters of one percent (0.75%) of retirement allowances are expected to be capped.

NCASA affiliates identify the following deficiencies of TSERS and the agency in meeting the requirements of the APA.

1. TSERS failed to consider the cumulative effect of its decisions regarding the formula for determining the amount owed to the retirement system, as required by G.S. 150B-19.1(a)(4).

G.S. 150B- 19.1(a)(4) An agency shall consider the cumulative effect of all rules adopted by the agency related to the specific purpose for which the rule is proposed. The agency shall not adopt a rule that is unnecessary or redundant.

While the Fiscal Impact Analysis acknowledges that “[t]he effects of even small changes to each variable in the CBBC calculation can have a dramatic and markedly variable impact” on the amount owed (agency and TSERS/LGERS Boards Fiscal Impact Analysis (“FIA”) p. 19), it did not consider the cumulative effect of the decisions it imposes in regard to the formula. Starting with an example provided by the agency, the amount owed jumps in two years from just over \$20,000 to over \$149,000 solely because of changes dictated by TSERS for the contribution based benefit cap factor and the annuity factor.

- This example was provided by the agency in 2014 to explain the formula. “Steven Spiker” has an Average Final Compensation of \$175,000, Accumulated Employee Contributions of \$213,698.27, and 30 years of service. The Annuity Factor for age 60 set by TSERS is 10.953. The Contribution Based Benefit Cap Factor set by TSERS is 4.8. Following the formula established by law, the agency calculates that Steven Spiker’s employer owes the retirement system **\$20,788.30**. (*North Carolina Retirement Systems TSERS Anti-Pension Spiking Contribution Based Benefit Cap*, North Carolina Department of State Treasurer, November 2014, Slide 16.)

- The TSERS Board then changed the contribution based benefit cap factor from 4.8 to 4.5 (the issue of the proposed rule-making). Recalculating the formula with only this change, Steven Spiker’s employer now owes **\$84,916.94**.
- Effective for retirements beginning January 1, 2017, the TSERS board adopted the recommended annuity factors as a part of its quinquennial review. (G.S.135-6(n)) For an employee retiring at age 60, the annuity factor increased from 10.953 to 11.624. The formula is recalculated with this change. Now, without any change in the actions of the employer or employee, Steven Spiker’s employer owes **\$149,030.99**.

In 2022, new annuity factors will go into effect. If members continue to live longer, this factor will again increase, likely causing substantial increases in the amount owed to the retirement system. This is not accounted for in any of the analysis provided by TSERS and the agency. Further, this is not identified at all in the cumulative impact of the rules.

The TSERS Board further notes that if it were to exercise its authority to reduce the interest rate applied to member contributions, it would “result in an increase in the incidence and cost of pension spikes.” (FIA, p. 19) And yet it fails to acknowledge this factor in considering the cumulative effect of all rules.

2. The agency fails to seek to reduce the burden and accurately quantify the costs and benefits to all parties.

G.S. 150B-19.1 (a)(2) An agency shall seek to reduce the burden upon those persons or entities who must comply with the rule.

G.S. 150B-19.1(e) Each agency shall quantify the costs and benefits to all parties of a proposed rule to the greatest extent possible. Prior to submission of a proposed rule for publication in accordance with G.S. 150B-21.2, the agency shall review the details of any fiscal note prepared in connection with the proposed rule and approve the fiscal note before submission.

TSERS has failed to fully quantify the effect of their decisions in regard to the formula. They do not discuss the burden of their changing the annuity factor and contribution-based

benefit cap in two years to cause increases such as for “Steven Spiker” from \$21K to \$149K solely on the changes that they make.

In addition, the agency makes little mention of the burdens of this rule on employees, including school administrators and superintendents. By choosing a CBBC factor that creates more liability to the employers, it has a significant impact on the careers of principals, superintendents, and other administrators in the following ways:

mobility: because the law provides that it is the last employer before retirement to assume the liability, employers do not want to hire educators who are later in their career - it also favors out of state candidates over candidates who have been educators in North Carolina for their career since the employer then has the choice whether to assume the liability for those new to the retirement system beginning in 2015;

promotions: educators can move from being principal at a small elementary school to principal at a large high school, or from associate superintendent to superintendent - this deters local boards from promoting talented employees where the new position is warranted but would be a considerable promotion;

salary raises: superintendents and other individuals with contracts may have provisions that provide for salary increases based on performance - the local board may recognize that the individual's performance merits the increase but is unwilling to provide it out of concern for spiking; and

contractual relationships: local boards now routinely ask for information regarding a candidate's contribution history to determine whether there may be a spiking issue in hiring the candidate. This interferes with the development of a contractual relationship between the candidate and the board and with the elements of the contract. Further, this could cause the board to make decisions related to age in a way that is contrary to the Age Discrimination Act or to coerce the candidate to accept liabilities for contribution gaps that are beyond his or her control.

Over time, these burdens will severely hamper careers in public education, pushing talented leaders into the private sector or to move to other states. There is virtually no analysis by TSERS of the impact on public education even though it is well understood that having strong principals and other leaders is crucial to improving educational opportunities for students. For example, a highly successful principal could be recruited specifically to help turn around a struggling school and would be paid a higher salary or merit-based bonus. This tool could be taken away from public schools because of the potential to cause liability under this formula.

The Office of State Budget and Management is statutorily required to review and certify that the agency complied with G.S. 150B-19.1(a)(2), (5), and (6) when there is a substantial economic impact. (G.S. 150B-21.4) The OSBM solely relied on the information provided by the agency and therefore was not able to provide a full review. This is reflected in OSBM's memo that does not consider any of these issues other than a cursory comment regarding the impact on the ability of the employer to attract and retain talented employees and the decrease in the pension of the employee. It also is noteworthy that the agency only identified that they received approval by a checked box on the form: no other information is routinely provided about the OSBM review and the agency did not respond to a request for a copy of the documents and correspondence with OSBM (email to Director Steve Toole, April 3, 2018). OSBM explained in response to a similar request, "[o]ur office worked with the agency to review their analysis of the rules you mentioned, but have not really generated documents of our own aside from a memo. (Email from Anca Groza Assistant State Budget Officer to Ann McColl, April 4, 2018, Attached). The memo does not address the statutory standards that must be met in the fiscal analysis or provide any conclusion of whether in fact the agency met the standards.

3. The Board fails to provide at least two alternatives to the proposed rule.

G.S. 150B-19.1(f) If the agency determines that a proposed rule will have a substantial economic impact as defined in G.S. 150B-21.4(b1), the agency shall consider at least two alternatives to the proposed rule. The alternatives may have been identified by the agency or by members of the public.

TSERS asserts that it did not have the authority to consider alternatives to what was recommended by the actuary: "it should be said that under the statute, the Boards must accept the recommendation of the actuary for a cap factor." (P.16) This interpretation shirks its

responsibilities under the APA to consider burdens and to consider at least two alternatives. This interpretation is clearly incorrect as the duties of the actuary are solely technical in nature (G.S. 135-6(l)). It is not the duty of the actuary to consider the issues required of rule-making, including considering options as required by this section, along with reducing burdens.

Rather than consider the burdens, the explanation of the selection of CBBC factor seems premised on two interests of the agency: (1) to have a high enough factor to affect member and employer behavior, (2) but not so high that it would generate political opposition to the policy. (FIA, p. 18) There is no evidence that the Board considered the issue of the burden to the employers and employees or that it considered two alternatives.

4. The Board's assessment is not based on sound, reasonably available information.

G.S. 150B-19.1(a)(5) When appropriate, rules shall be based on sound, reasonably available scientific, technical, economic, and other relevant information. Agencies shall include a reference to this information in the notice of text required by G.S. 150B-21.2(c).

There are numerous misleading statements and mischaracterizations of issues related to employer practices and the law.

The Board incorrectly states that “the cost of spiking will be paid solely by agencies that incur the additional liabilities.” (FIA, p. 8.) This is not accurate. It is the last employer who is responsible, whether or not their payments contributed to the gap. For example, if a local board unilaterally terminated a superintendent and the superintendent was willing to accept an associate superintendent position in another district at a reduced salary until eligible for full retirement, this final local board of education would incur any liability from the prior employment. This is significant in considering burdens to the employer for liability unrelated to its practices and implications for mobility: a local board may not be willing to employ someone in this type of circumstance for fear that it will be liable for the prior relationship. This error is carried over into the OSBM analysis as well: “but shifts costs for underfunded liabilities to spiking employers and employees.”

The projection of liabilities understates the liabilities that will be incurred as it does not adjust for the quinquennial annuity factor review which likely will increase the burden. (FIA,

Table 5, p. 8) This is significant in considering the unanticipated burden for local boards of education and for school administrators who join TSERS beginning in 2015.

The Board completely mischaracterizes an article it cites to support its argument that “spiking employers could reduce their costs because people often prefer lump sum payments over annuities like pension benefits.” (FIA, p. 11, citing Clark, Robert L, et al. *Defined benefit pension plan distribution decisions by public sector employees*,” Journal of Public Economics, Vol. 116, August 2014, pp 73-88,.) This study did not address this issue at all: instead, it addressed the choice made by individuals who leave employment before retirement of whether to receive a lump sum distribution or to keep funds in the retirement system to build on in the event of reemployment. This assertion of preferring lump sum payments over pension benefits certainly would not be correct in any event within the context of educators who had been building their pensions over their career and are close to retirement.

The Board fails to provide appropriate data to provide context of relative burdens. It roles up a figure of potential gaps in contributions from retirements occurring over 13 years of \$73.6 million that would be incurred by the agency over the lifetime of the retired members. It does not provide the context for this of the total resources of the retirement system. Nor does it provide a relative impact of the burden for the local board to have to immediately pay an estimated gap within its annual budget. Further, the Board does not discuss the windfall of funds it receives under this law when the school administrator chooses to return to work and thus reduces or eliminates the estimated gap in contributions; or when the school administrator dies well before the time estimated by the actuary.

Conclusion

In conclusion, the NCASA Affiliates urge the Rules Review Commission to object to this rule.

Respectfully submitted this 12th day of April, 2018

NORTH CAROLINA ASSOCIATION OF SCHOOL ADMINISTRATORS

NORTH CAROLINA SCHOOL SUPERINTENDENTS ASSOCIATION

NORTH CAROLINA PRINCIPAL AND ASSISTANT PRINCIPALS' ASSOCIATION

by

A handwritten signature in black ink, appearing to read "Ann McColl". The signature is written in a cursive style with a large initial "A" and "M".

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RE: Proposed Anti-Pension Spiking Rules, Contribution-Based Benefit Cap Factor 11/20/17

The State Treasurer (DST) is proposing rules to reduce the prevalence of pension spiking among state and local government employers. Pension spiking raises employees' pensions through large, late-career pay raises or benefit conversions. The proposed rules codify the contribution-based benefit cap factor used to identify retirements subject to the anti-pension spiking penalties of [Session Law 2014-88](#). The penalties are the difference between the lifetime retirement benefit amount and the member's contribution-based cap. The rules shift the burden of underfunded pension liabilities away from the entire pension system. School and university systems and local governments are most affected by the cap. Any taxpayer savings from the rules will be realized as costs to retirees.

Background and Purpose of Rule Change

Substantial compensation increases or large benefit conversions during a high-earning employee's average final compensation period results in higher pension costs for taxpayers. Under the current rules, any unexpected pension liabilities are funded by fees shared proportionately among all employers.

The agency has been administering S.L. 2014-88 without a rule since 2015. In 2016, four local school boards sued DST for assessing payments against them without rules. DST is initiating rulemaking now because the Superior Court found the agency's assessments to be invalid. The case is pending on appeal.

Proposed Changes

The proposed rules establish a contribution-based cap on pension benefits for state and local government employees earning \$100K or more. State and local employees must contribute 22.2% and 21.3% of their lifetime benefits, respectively. For employees hired before 2015, any liabilities over the contribution-based cap will be paid by the employer. For employees hired after that date, the employee must pay the difference or accept reduced retirement benefits. The employer *may* pay the difference.

Impact

The rule is actuarially neutral from the perspective of the pension system but shifts costs for underfunded liabilities to spiking employers and employees. Over 13 years, spiking employers are expected to pay **\$73.6M** in liability payments to the pension system as the liabilities are incurred, plus an unknown amount in alternative employee compensation that does not affect pension liabilities. All other employers will avoid **\$69.2M** in costs for these same liabilities over a longer amortization period. The net impact of this change in the distribution and timing of liability payments is neutral to taxpayers. Affected employers could face difficulties attracting and retaining top candidates.

Aside from shifting the burden between government entities, the Division expects this rule to create savings to taxpayers through avoided government pension contributions. Any net savings will be borne by affected retirees, about **0.2% of future retirees**. The rule primarily affects school system and local government employees. The magnitude of the savings depends upon two main factors:

1. The extent pension spiking is deterred and affected employees accept alternate compensation during their working years that is lower than the lifetime annuity value of the foregone retirement benefits. Neither the size of the effect of the rule on deterring pension spiking nor alternate compensation decisions are quantifiable with available data.
2. The extent employees hired in 2015 or later with pension benefits above the cap - rather than their employers - pay for their own pension benefits or accept reduced benefits. These members are eligible for retirement benefits starting in 2020. At maximum, the impact to employers and taxpayers (savings) and retirees (costs) could reach **\$21M** from 2020-2029.

DST estimates administrative costs to implement this rule at **\$196,850** over the next several years.

COMMENTS ON PROPOSED 20 N.C. ADMIN. CODE 02B.0405

Submitted by
Johnston County Board of Education
Wilkes County Board of Education
Union County Board of Education
Cabarrus County Board of Education

April 12 2018

TO THE RULES REVIEW COMMISSION:

The Johnston, Wilkes, Union, and Cabarrus county boards of education submit these comments opposing approval of 20 N.C. Administrative Code 02B.0405 as proposed by the Board of Trustees of the Teachers' and State Employees' Retirement System ("T&SERS").

Introduction

In 2014 the General Assembly enacted a "contribution-based benefit cap" on the retirement benefits to be paid to an individual by T&SERS. For employees who joined the system before 2015 the benefit cap does not affect the amount of the pension the employee will receive upon retirement — based on the retiree's years of employment and average final compensation — but does affect who pays the pension. If the pension to which the retiree is entitled exceeds the new benefit cap, T&SERS will pay only the amount up to the cap and the retiree's last employer must pay the difference. The retirement system assesses an "additional contribution" against the

employer to cover the difference between the pension cap and the retiree's actual pension.

The pension cap is determined by a formula set out in G.S. 135-5(a3) and is based primarily on the retiree's accumulated contributions to T&SERS and the cost of an annuity equal to that contribution. The final step in the formula is to "[m]ultiply the annuity amount . . . by the contribution-based cap factor." The cap factor is set by the T&SERS Board of Trustees. That is the rule now proposed by T&SERS.

The T&SERS trustees have been forced to rulemaking by lawsuits filed by the Johnston, Wilkes, Union, and Cabarrus boards of education. The trustees first adopted the cap factor in October 2014, and again in October 2015, without following the rulemaking procedures of the Administrative Procedure Act ("APA"). In eight separate judgments in lawsuits brought by the four school boards, however, the Wake County Superior Court held that the cap factor is a rule within the meaning of the APA and that T&SERS may not implement the pension cap without adopting the factor as a rule. The retirement system has appealed those decisions — briefs have been submitted to the Court of Appeals but no hearing date has been set yet — but meanwhile has initiated this rulemaking.

Reflecting its begrudging approach to rulemaking, T&SERS has summarily adopted the same cap factor as it previously tried to implement in violation of the APA; has ignored requests to consider the severe economic consequences to employers; has failed to heed its obligation under retirement statutes to "adopt rules and regulations to prevent injustices and inequalities"; and has failed to comply with

APA requirements to seek to reduce the burden on entities subject to the rule, to propose alternatives when a rule has substantial economic impact, and to consider the effect on local governments' budgets

Discretion given to T&SERS and its failure to consider the burden on employers

The statute gives little direction to T&SERS on adoption of the cap factor, the only directive being that the factor be such that the pension cap affects no more than .75 of all retirements in a year. Analysis prepared by the T&SERS actuary shows that the number of retirees affected, and thus the number of employers required to make additional contributions, can vary widely depending on where the cap factor is set within the statutorily acceptable range. A factor of 4.2, for example, would affect three times as many employers, 66, as a factor of 4.9, which would affect only 21. Likewise, a factor of 4.2 might require, say, a \$150,000 "additional contribution" from an employer while a higher factor might result in only a \$50,000 assessment.

Nothing in the fiscal analysis prepared by T&SERS or in the trustees' discussion explains the rationale for selecting the particular factor chosen for the rule, 4.5. The absence of any explanation demonstrates the trustees' neglect of their obligation under G.S. 135-6(f) to adopt rules "to prevent injustices and inequalities which might otherwise arise in the administration of this Chapter." It also demonstrates the failure to comply with the requirement of G.S. 150B-19.1(a)(2) that an agency "shall seek to reduce the burden upon those persons or entities who must comply with the rule."

Even though T&SERS says that the purpose of the pension cap is to address inequity in the retirement system — *i.e.*, some employers paying higher salaries and putting a greater burden on the retirement system than other employers — the Board of Trustees did not consider matters of equity in its rulemaking. There was, for example, no consideration of the difference between employers who intentionally increase employee’s salaries just before retirement to enhance their pension and employers who do not; no consideration of the effect of unexpected, early retirements beyond the control of the employer that trigger the pension cap; no consideration whether the employee’s compensation was or was not within the normal market range for that position.

The trustees are obligated by both the retirement statutes and the APA to attempt to ameliorate inequities in the application of the pension cap, yet they have proposed a rule that is indifferent to the differences in employers’ action and that imposes the same harsh financial penalty to all employers regardless of their individual circumstances. Most significantly, it imposes severe financial burdens on employers for decisions made years in advance of the new law.

Failure to propose alternatives or consider local government budgets

Even though the adoption of the cap factor has a “substantial economic impact” of more than one million dollars in a 12-month period (the definition in G.S. 150B-21.4(b1)) on employers, the trustees have failed to offer two alternatives as required

by G.S. 150B-19.1(f). In fact, the fiscal analysis prepared by T&SERS fails to address at all the economic effect on employers.

There is no question of the severe economic effect of the 4.5 cap factor. We know the impact on many employers because T&SERS has continued to assess “additional contributions” despite the litigation over the failure to follow rulemaking. In 2017, for example, when applying the same 4.5 factor as proposed in the rule T&SERS assessed over \$3.6 million against 40+ employers. The Wilkes County Board of Education alone has been charged a \$590,000 “additional contribution; the Union board nearly half a million dollars; and Johnston more than \$400,000. The January 2018 list of T&SERS employers affected by the pension cap shows over 90 employers who are assessed additional contributions, and of those 30 are for more than \$100,000 each, including six for more than \$200,000, three for more than \$300,000, three for more than \$400,000, and one for over \$500,000.

Despite this obvious substantial economic impact, the T&SERS fiscal analysis of the 4.5 cap factor notes only a sum total of additional contributions likely to be required of T&SERS employers, with no discussion of the effect on those employers, no acknowledgement of the number of positions that might have to be cut or programs discontinued when several hundred thousands of dollars is suddenly taken from a school system’s budget. The analysis fails, as required by G.S. 150B-21.4(b1)(3) to “[d]escribe the persons who would be subject to the proposed rule and the type of expenditures these persons would be required to make.”

Also missing from the T&SERS analysis are the two alternatives to the proposed rule required by G.S. 150B-19.1(f). The “Alternatives to the Rule Making” portion of the analysis (on pages 16-18) does no more than describe how the estimates used by the actuary in 2015 (as part of the trustees’ adoption of the cap factor in violation of the APA) would be recalculated using current data. There is no identification of alternatives to the proposed rule; the section says only that the trustees did not choose a lower cap factor because it would affect more employers and thus generate greater political opposition to the pension cap law.

Finally, the Board of Trustees has failed to comply with G.S. 150B-21.27. The statute requires that an agency adopting a rule that will affect the expenditures of local governments must consider the timing of implementation and whether it will disrupt the local budget process. Because school boards have no taxing authority, the payment of the huge “additional contributions” to T&SERS required by the cap factor rule will necessitate the school board either drastically revising its budget, cutting positions or shutting down programs, or applying for additional funding from the board of county commissioner. This is precisely the kind of situation G.S. 150B-21.27 is intended to address, yet it has been ignored in the rulemaking process.

Conclusions

For the reasons stated above, the Rules Review Commission should not approve the proposed 20 N.C. Admin. Code 02B.0405.

RESPECTFULLY SUBMITTED, this 12th day of April 2018.

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COMMENTS ON PROPOSED 20 N.C. ADMIN. CODE 02B.0405

Submitted by
Henderson County Board of Public Education
Lincoln County Board of Education
Swain County Board of Education

April 12, 2018

TO THE RULES REVIEW COMMISSION:

The Henderson, Lincoln and Swain County Boards of Education submit these comments opposing approval of 20 N.C. Administrative Code 02B.0405 as proposed by the Board of Trustees of the Teachers' and State Employees' Retirement System ("T&SERS").

Introduction

In 2014 the General Assembly enacted a "contribution-based benefit cap" on the retirement benefits to be paid to an individual by T&SERS. For employees who joined the system before 2015 the benefit cap does not affect the amount of the pension the employee will receive upon retirement — based on the retiree's years of employment and average final compensation — but does affect who pays the pension. If the pension to which the retiree is entitled exceeds the new benefit cap, T&SERS will pay only the amount up to the cap and the retiree's last employer must pay the difference. The retirement system assesses an "additional contribution" against the employee's last employer to cover the difference between the pension cap and the retiree's actual pension. The additional contribution is assessed against the last

employer regardless of how many years the employee worked for that employer or whether the employee's salary at the last employer is within the employee's average final compensation.

The pension cap is determined by a formula set out in G.S. 135-5(a3) and is based primarily on the retiree's accumulated contributions to T&SERS and the cost of an annuity equal to that contribution. The final step in the formula is to "[m]ultiply the annuity amount . . . by the contribution-based cap factor." The cap factor is set by the T&SERS Board of Trustees. That is the rule now proposed by T&SERS.

Following a court ruling finding that the "cap factor" must be approved through rule making, T&SERS now proposes the same cap factor as it previously tried to implement in violation of the APA. More importantly, T&SERS has failed to consider the severe economic consequences to local education agency ("LEA") employers; has failed to heed its obligation under the retirement statutes to "adopt rules and regulations to prevent injustices and inequalities"; and has failed to comply with APA requirements to propose alternatives when a rule has substantial economic impact and to consider the effect on local governments' budgets.

The Criteria Used to Select the CAP Factor.

Nothing in the analysis prepared by T&SERS or in the Trustees' discussion explains the criteria used for selecting the specific factor. The absence of a clear rationale demonstrates the Trustees neglect of their obligation under G.S. 135-6(f) to adopt rules "to prevent injustices and inequalities which might otherwise arise in the

administration of this Chapter.” In fact, the Board of Trustees, failed to consider several important issues when selecting the current cap factor, including but not limited to:

- a) Whether the employee’s compensation is within the amount of dollars allotted by the State of North Carolina to the LEA for the specific purpose of paying the employee’s salary;
- b) The difference between employers who intentionally increase employee’s salaries just before retirement to enhance their pension and employers who do not;
- c) The effect of unexpected, early retirements beyond the control of the employer that trigger the pension cap;
- d) Whether the employee’s compensation was or was not within the normal market range for that position;
- e) Consideration of when the employee’s compensation was set and whether it was well before the pension cap was even contemplated or close in time to the new law; and
- f) Whether (and how) the factor will impact hiring practices by LEA’s or job selection by employees.

An August 2017 assessment against the Swain County Board of Education conclusively demonstrates the existence of injustices and inequalities that must be considered by law. There, the School Board was charged an “additional contribution” of \$46,073.57 for an employee whose salary at all times was 100% within the amount

of state funds allotted to the School Board for his specific positions. In other words, the Board implemented the salary directed by the General Assembly. Yet, the Board must use local funds to pay the bill to the state. To repeat, the School Board paid the employee the amount approved by the State and the State now demands an “additional contribution” payable only from local funds due to the proposed cap factor.

In short, there is no evidence that such injustices and inequalities were considered at all. In fact, there is no indication in any of the notices or analysis provided by T&SERS that the selection of the 4.5 cap factor is based on any rational considerations whatsoever. **Simply picking a number and asking this Commission to approve it without any justification is arbitrary and capricious as a matter of law.**

Failure of the Board of Trustees to Follow the Rulemaking Statutes

Although the adoption of the cap factor has a “substantial economic impact” of more than one million dollars in a 12-month period on employers, the Trustees have failed to offer two alternatives as required by G.S. 150B-19.1(f). In fact, the fiscal analysis prepared by T&SERS fails to take into account at all the economic effect on employers.

There is no question of the severe economic effect of the 4.5 cap factor. In 2017, for example, applying the unlawfully implemented cap factor T&SERS assessed over \$3.6 million against 40+ employers.

In addition to the examples provided by other commenters, the Lincoln County Board of Education has been charged over \$320,000 in additional contributions for

two employees. Likewise, the Henderson County Board of Education has been charged for an additional contribution in the amount of \$102,628.62. This amount was assessed even after the employee, prior to retirement, contacted T&SERS to determine if his retirement would create an additional contribution for his employer and was informed that it would not.

Moreover, the Board of Trustees have failed to consider the timing of implementation and whether it will disrupt the local budget process. Because LEA's have no taxing authority, the payment of the huge "additional contributions" to T&SERS required by the cap factor rule will necessitate the school board either drastically revising its budget, cutting positions or shutting down programs, or applying for additional funding from the board of county commissioners.

A significant number of T&SERS members are employed by LEA's or community colleges throughout our State, all of which rely on local government funding – not state funding – to pay any "additional contributions" required under the Pension-Spiking Benefits Act. Because of the unique funding structure for LEA's and community colleges, a cap factor of 4.5 has a significant financial impact on these local entities that is drastically different from the impact it has on other state agencies or universities that may use state funds to pay "additional contributions."

Conclusion

The adoption of the 4.5 cap factor by the Board of Trustees fails to meet the standards of the law. The Board has a) failed to explain how it selected the 4.5 cap

factor or what criteria it used when making the determination; b) failed to consider the significant financial impact on LEA's; and c) failed to consider the two required alternatives when a substantial economic impact exists. Therefore, the above-referenced Boards of Education oppose approval by the Commission of 20 N.C. Admin Code 02B.0405.

RESPECTFULLY SUBMITTED, THIS THE 12TH DAY OF APRIL, 2018 as follows: Via email to rrc.comments@oah.nc.gov; cc: Amanda.reeder@oah.nc.gov and laura.rowe@nctreasurer.com



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April 12, 2018

NC Rules Review Commission
1711 New Hope Church Rd.
Raleigh, NC 27604

Dear Rules Review Commission Members:

The following comments on Proposed Rule — 20 NCAC 02B .0405 ANTI-PENSION SPIKING CONTRIBUTION-BASED BENEFIT CAP FACTOR (TSERS), which is on your agenda for Thursday, April 19, are heretofore respectfully submitted by the North Carolina School Boards Association on behalf of the 115 local boards of education in North Carolina.

- (1) Rulemaking requires agencies to “quantify the costs and benefits of all parties to the proposed rule.” NCGS 150B-19.1(e). If the proposed rule had an aggregated economic impact on all affected parties of more than \$1 million in a 12 month period, then the agency must offer at least two alternatives to the proposed rule (NCGS 150B-19.1(f) and 150B-21.4(b1)). In 2015, TSERS assessed \$1,287,847.67 to members. In 2016, \$3,844,895.99 was assessed to members. In 2017, \$3,645,856.94 was assessed to members. In the first two months of 2018, \$587,105.83 has been assessed to members. See Appendix A (attached) for complete listing. This previous history of assessments clearly demonstrates that the impacted on affected parties in a 12-month period has consistently exceeded the million-dollar threshold. The retirement system has failed to set forth the two alternatives and thus is in plain violation of the statute. Additionally, by not setting forth alternatives, information is not available as to how various cap factors may have a different impact on the amounts owed by member employers, including local boards of education. Alternatives would give the Board of Trustees the opportunity to analyze these impacts and make an informed decision on both the impact to the retirement system and on the affected employers.
- (2) The Board of Trustees are also in violation of NCGS 150B-21.27, which requires that when an agency adopts a rule that will affect local governmental expenditures, the agency must consider the timing of implementation and whether it will disrupt the local budget process. School districts are separate governmental entities that do not have the ability to generate any of their own revenue. Thus, when a school district is assessed a pension spiking charge under the proposed rule resources are taken away from what the board of education budgeted to educate students and shifted over to satisfy the amount owed to the retirement system. Many of the assessments that have been made against school districts are caused by the natural progression of employees as they move up the ladder in roles and responsibilities. Local boards of education incorporate these costs into their local budgets each year and have no way to anticipate when or how much they will be assessed this penalty. The disruption this causes to the local school budget process was not taken into account when the Board of Trustees set the contribution-based benefit cap factor.

In conclusion, the North Carolina School Boards Association respectfully requests that the Rules Review Commission not approve proposed rule 20 NCAC 02B .0405 and ask the retirement system Board of Trustees to put forth two alternative proposals as required by law. The alternatives available should ideally reduce the cap factor to a level that will both keep the pension plan healthy and catch employers and employees who are abusing the system, while avoiding the imposition of penalties on school systems for the natural progression of salary compensation for those who have spent years teaching but are willing and able to take on the leadership roles and responsibilities.

Sincerely,

A handwritten signature in cursive script that reads "Leanne E. Winner".

Leanne E. Winner
Director of Governmental Relations
North Carolina School Boards Association

APPENDIX A

CBCB INVOICE LIST AS OF 01/10/2018				
Prepared by Retirement Systems Division Staff				
RETIREMENT SYSTEM	RETIREMENT DATE	INVOICE AMOUNT	INVOICE STATUS	AGENCY
LGERS	1/1/2015	\$88,318.27	Paid	MECKLENBURG COUNTY
TSERS	1/1/2015	\$252,613.64	Paid	WESTERN CAROLINA UNIVERSITY
TSERS	1/1/2015	\$26,980.68	Paid	NC STATE UNIVERSITY
TSERS	2/1/2015	\$124,684.27	Paid	CAPE FEAR COMMUNITY COLLEGE
LGERS	3/1/2015	\$138,807.73	Paid	BUNCOMBE COUNTY
TSERS	5/1/2015	\$208,405.81	Paid	CABARRUS COUNTY SCHOOLS
LGERS	7/1/2015	\$11,493.47	Paid	GASTON COUNTY
TSERS	7/1/2015	\$18,032.56	Paid	UNC HEALTH CARE SYSTEM
TSERS	7/1/2015	\$248,185.67	Paid	ROBESON COUNTY SCHOOLS
TSERS	7/1/2015	\$9,404.29	Paid	HERTFORD COUNTY SCHOOLS
TSERS	7/1/2015	\$5,857.92	Paid	PAMLICO COUNTY SCHOOLS
TSERS	7/1/2015	\$93,894.42	Paid	EDGEcombe COUNTY SCHOOLS
TSERS	7/1/2015	\$65,682.27	Paid	ALEXANDER COUNTY SCHOOLS
TSERS	8/1/2015	\$151,486.75	Paid	HICKORY CITY SCHOOLS
TSERS	9/1/2015	\$88,567.50	Paid	PENDER COUNTY SCHOOLS
LGERS	9/1/2015	\$8,815.58	Paid	MECKLENBURG COUNTY ABC BOARD
TSERS	10/1/2015	\$17,718.54	Paid	CURRITUCK COUNTY SCHOOLS
TSERS	10/1/2015	\$52,469.91	Paid	EAST CAROLINA UNIVERSITY
TSERS	11/1/2015	\$41,897.45	Paid	UNC HEALTH CARE SYSTEM
TSERS	12/1/2015	\$41,542.68	Paid	UNC CHAPEL HILL
TSERS	1/1/2016	\$79,276.69	Paid	UNC HEALTH CARE SYSTEM
TSERS	1/1/2016	\$65,370.37	Paid	LENOIR COUNTY SCHOOLS
LGERS	1/1/2016	\$72,423.01	Paid	BUNCOMBE COUNTY
TSERS	1/1/2016	\$3,577.09	Paid	DURHAM PUBLIC SCHOOLS
LGERS	1/1/2016	\$90,750.75	Paid	CUMBERLAND COUNTY
TSERS	1/1/2016	\$34,705.21	Paid	PERQUIMANS COUNTY SCHOOLS
LGERS	1/1/2016	\$125,054.42	Paid	CITY OF RALEIGH HOUSING AUTHORITY
TSERS	3/1/2016	\$38,338.84	Paid	ASHEBORO CITY SCHOOLS
LGERS	3/1/2016	\$37,479.21	Paid	CITY OF GREENSBORO
LGERS	3/1/2016	\$70,141.55	Paid	CITY OF HIGH POINT
LGERS	3/1/2016	\$48,343.95	Paid	TOWN OF CARY
TSERS	3/1/2016	\$435,913.54		JOHNSTON COUNTY SCHOOLS
TSERS	3/1/2016	\$590,694.32		WILKES COUNTY SCHOOLS
LGERS	4/1/2016	\$200,545.38	Paid	EASTPOINTE HUMAN SERVICES
TSERS	4/1/2016	\$12,630.22	Paid	COMMUNITY COLLEGES ADMINISTRATION
LGERS	4/1/2016	\$85,823.03	Paid	MECKLENBURG EMER MED SVCS AGCY
TSERS	4/1/2016	\$301,628.59	Paid	UNC GENERAL ADMINISTRATION
TSERS	5/1/2016	\$16,909.15	Paid	EAST CAROLINA UNIVERSITY
TSERS	5/1/2016	\$122,561.48	Paid	APPALACHIAN STATE UNIVERSITY
TSERS	6/1/2016	\$495,114.71		UNION COUNTY SCHOOLS
TSERS	7/1/2016	\$50,594.64	Paid	HEALTH & HUMAN SERVICES
TSERS	7/1/2016	\$76,173.13	Paid	APPALACHIAN STATE UNIVERSITY
TSERS	7/1/2016	\$191,015.54	Paid	ROBESON COMMUNITY COLLEGE
TSERS	7/1/2016	\$159,165.72	Paid	CALDWELL COMMUNITY COLLEGE
TSERS	7/1/2016	\$52,692.36	Paid	ELKIN CITY SCHOOLS
TSERS	7/1/2016	\$5,451.29	Paid	ONslow COUNTY SCHOOLS
TSERS	7/1/2016	\$82,937.54	Paid	HENDERSON COUNTY SCHOOLS
LGERS	7/1/2016	\$29,761.02	Paid	CITY OF HICKORY
TSERS	7/1/2016	\$28,481.33	Paid	UNC ASHEVILLE
TSERS	7/1/2016	\$22,931.89	Paid	MITCHELL COUNTY SCHOOLS
TSERS	7/1/2016	\$118,262.49	Paid	UNC-CHAPEL HILL
TSERS	7/1/2016	\$376,334.59	Paid	NASH TECHNICAL COLLEGE
TSERS	7/1/2016	\$52,919.55	Paid	UNION COUNTY SCHOOLS
LGERS	8/1/2016	\$11,629.19	Paid	CITY OF FAYETTEVILLE
LGERS	8/1/2016	\$8,007.26	Paid	MECKLENBURG COUNTY
TSERS	8/1/2016	\$151,553.84	Paid	WAKE TECHNICAL COLLEGE
TSERS	8/1/2016	\$10,456.59	Paid	UNC CHAPEL HILL
LGERS	9/1/2016	\$48,591.20	Paid	BUNCOMBE COUNTY
TSERS	10/1/2016	\$47,359.67	Paid	HEALTH & HUMAN SERVICES
TSERS	10/1/2016	\$2,606.05	Paid	ENVIRONMENT AND NATURAL RESOURCES
TSERS	10/1/2016	\$186,967.09	Paid	LENOIR COUNTY COMMUNITY COLLEGE
TSERS	10/1/2016	\$32,272.47	Paid	UNC CHAPEL HILL
LGERS	11/1/2016	\$60,156.26	Paid	JOHNSTON COUNTY
LGERS	11/1/2016	\$29,243.82	Paid	CARTERET COUNTY
LGERS	11/1/2016	\$123,147.40	Paid	TOWN OF MOCKSVILLE
LGERS	11/1/2016	\$120,286.72	Paid	CITY OF CHARLOTTE
LGERS	12/1/2016	\$48,927.52	Paid	MECKLENBURG COUNTY
TSERS	1/1/2017	\$235,143.99	Paid	N C SCHOOL OF THE ARTS
TSERS	1/1/2017	\$7,055.49	Paid	UNC GENERAL ADMINISTRATION
LGERS	1/1/2017	\$9,911.77	Paid	TOWN OF HIGHLANDS
LGERS	1/1/2017	\$59,915.30	Paid	CITY OF FAYETTEVILLE
TSERS	1/1/2017	\$184,493.41	Partial Payment	PERSON COUNTY SCHOOLS
LGERS	1/1/2017	\$58,046.28	Paid	ONslow WATER & SEWER AUTHORITY
TSERS	1/1/2017	\$42,573.35	Paid	DEPARTMENT OF PUBLIC SAFETY
LGERS	1/1/2017	\$90,263.42	Paid	MECKLENBURG EMER MED SVCS AGCY
TSERS	1/1/2017	\$52,459.90	Paid	APPALACHIAN STATE UNIVERSITY
TSERS	2/1/2017	\$40,942.76	Paid	UNC CHAPEL HILL
TSERS	2/1/2017	\$197,805.61	Paid	HARNETT COUNTY SCHOOLS
TSERS	2/1/2017	\$28,333.90	Paid	NC CENTRAL UNIVERSITY
TSERS	2/1/2017	\$9,866.22	Paid	UNC PEMBROKE
LGERS	2/1/2017	\$35,842.70	Paid	CITY OF CONCORD
TSERS	2/1/2017	\$40,170.18	Paid	DEPARTMENT OF NATURAL & CULTURAL RESOURCES
TSERS	2/1/2017	\$40,183.42	Paid	DEPARTMENT OF PUBLIC SAFETY

Note: If the Retirement Systems Division (RSD) determines that a member's retirement benefit is in excess of the contribution-based benefit cap (CBCB) and the member entered the Retirement System from which he or she retires before January 1, 2015, the employer is required to make an additional employer contribution to fund the increased cost to the Retirement System. The RSD processes applications for retirement as far as 120 days in advance of the member's retirement. The additional employer contribution is considered a "pending" liability up until the member's effective retirement date.

All invoices on the attached list are payable to the RSD no later than the fifth State government working day of the month following the month of the member's effective retirement date. Certain factors can result in a change to either the status of the invoice (i.e., the subsequent cancelling of a retirement by the member, thus voiding the invoice altogether) or the amount of the invoice (i.e., a standard recalculation of the retirement based on salary and compensation information received by the Retirement System after the effective date of retirement). As a result, the invoice amount and invoice type are subject to change and/or cancellation depending on the individual circumstances of a member's retirement.

LGERS	3/1/2017	\$11,866.01	Paid	CITY OF ASHEVILLE			
TSERS	3/1/2017	\$49,658.58	Paid	SAMPSON COMMUNITY COLLEGE			
LGERS	3/1/2017	\$95,986.73	Paid	MECKLENBURG COUNTY			
TSERS	4/1/2017	\$105,832.97		JOHNSTON COUNTY SCHOOLS			
TSERS	4/1/2017	\$107,951.74		ROBESON COUNTY SCHOOLS			
TSERS	4/1/2017	\$14,263.32	Paid	DEPARTMENT OF PUBLIC INSTRUCTION			
TSERS	5/1/2017	\$183,083.08	Paid	FAYETTEVILLE STATE UNIVERSITY			
LGERS	5/1/2017	\$94,399.77	Paid	CITY OF CHARLOTTE			
TSERS	5/1/2017	\$71,620.04	Paid	DEPARTMENT OF PUBLIC SAFETY			
TSERS	5/1/2017	\$64,723.19	Paid	CAMDEN COUNTY SCHOOLS			
LGERS	5/1/2017	\$119,783.84	Paid	CITY OF BURLINGTON			
TSERS	5/1/2017	\$72,910.90		MADISON COUNTY SCHOOLS			
LGERS	6/1/2017	\$5,823.38	Paid	CITY OF WILSON			
TSERS	7/1/2017	\$177,748.11	Partial Payment	GRANVILLE COUNTY SCHOOLS & OXFORD ORPHANAGE			
TSERS	7/1/2017	\$307,464.99		LINCOLN COUNTY SCHOOLS			
TSERS	7/1/2017	\$27,334.35	Paid	YADKIN COUNTY SCHOOLS			
TSERS	7/1/2017	\$21,174.88	Paid	NC STATE UNIVERSITY			
TSERS	7/1/2017	\$22,176.06	Paid	NEWTON-CONOVER CITY SCHOOLS			
TSERS	7/1/2017	\$5,138.36	Paid	GRANVILLE COUNTY SCHOOLS & OXFORD ORPHANAGE			
LGERS	7/1/2017	\$163,282.57	Paid	BUNCOMBE COUNTY			
TSERS	7/1/2017	\$245,117.04	Paid	CHARLOTTE-MECKLENBURG COUNTY SCHOOLS			
TSERS	7/1/2017	\$91,216.08	Partial Payment	CUMBERLAND COUNTY SCHOOLS			
TSERS	7/1/2017	\$62,737.75	Partial Payment	BLUE RIDGE COMMUNITY COLLEGE			
TSERS	8/1/2017	\$29,130.20	Paid	WINSTON-SALEM-FORSYTH COUNTY SCHOOLS			
TSERS	8/1/2017	\$120,565.96	Paid	EAST CAROLINA UNIVERSITY			
TSERS	8/1/2017	\$61,504.79	Paid	WINSTON-SALEM-FORSYTH COUNTY SCHOOLS			
TSERS	9/1/2017	\$28,630.84	Paid	DEPARTMENT OF COMMERCE			
TSERS	9/1/2017	\$175,680.93	Paid	ONSLOW COUNTY SCHOOLS			
LGERS	9/1/2017	\$187,493.80	Paid	CITY OF WINSTON-SALEM			
TSERS	9/1/2017	\$37,013.90	Paid	HIGHWAY - ADMINISTRATIVE			
LGERS	9/1/2017	\$41,523.90	Paid	COUNTY OF HENDERSON			
TSERS	10/1/2017	\$15,069.58		PENDER COUNTY SCHOOLS			
TSERS	10/1/2017	\$96,498.04	Paid	NC STATE UNIVERSITY			
LGERS	10/1/2017	\$34,138.30	Paid	CITY OF WINSTON-SALEM			
TSERS	10/1/2017	\$46,073.57		SWAIN COUNTY SCHOOLS			
TSERS	11/1/2017	\$210,462.32	Paid	DEPARTMENT OF PUBLIC SAFETY			
TSERS	12/1/2017	\$37,818.46	Paid	UNC HEALTH CARE SYSTEM			
TSERS	12/1/2017	\$156,809.09		HIGHWAY - ADMINISTRATIVE			
LGERS	12/1/2017	\$40,081.33	Paid	CITY OF CHARLOTTE			
LGERS	12/1/2017	\$2,740.08	Paid	CITY OF RALEIGH			
LGERS	12/1/2017	\$108,363.29		JOHNSTON COUNTY			
TSERS	12/1/2017	\$30,710.97	Paid	WAKE TECHNICAL COLLEGE			
TSERS	12/1/2017	\$94,708.62	Paid	UNC HEALTH CARE SYSTEM			
TSERS	1/1/2018	\$11,264.68		DEPARTMENT OF PUBLIC SAFETY			
LGERS	1/1/2018	\$121,432.87	Paid	BUNCOMBE COUNTY			
LGERS	1/1/2018	\$25,315.10		CITY OF DURHAM			
LGERS	1/1/2018	\$20,276.97		CITY OF ROCKY MOUNT			
LGERS	1/1/2018	\$23,806.46	Paid	CITY OF RALEIGH			
TSERS	1/1/2018	\$20,362.06		DEPT OF AGRICULTURE & CONSUMER SVCS			
TSERS	1/1/2018	\$407,292.39		WILSON COUNTY SCHOOLS			
LGERS	1/1/2018	\$39,935.53		TOWN OF WEAVERVILLE			
LGERS	1/1/2018	\$73,898.00	Paid	DUPLIN COUNTY			
TSERS	1/1/2018	\$45,092.53		HIGHWAY - ADMINISTRATIVE			
TSERS	2/1/2018	\$12,830.55		LINCOLN COUNTY SCHOOLS			
LGERS	2/1/2018	\$71,896.86		GREENVILLE UTILITIES COMMISSION			
TSERS	2/1/2018	\$90,263.62		COMMUNITY COLLEGES ADMINISTRATION			
LGERS	3/1/2018	\$47,837.89		NEW HANOVER COUNTY			

COMMENTS ON PROPOSED 20 N.C. ADMIN. CODE 02B.0405

**Submitted by
Person County Board of Education
Wake County Board of Education
Chapel Hill-Carrboro City Schools Board of Education**

April 12, 2018

TO THE RULES REVIEW COMMISSION:

The Person County, Wake County, and Chapel Hill-Carrboro City Schools boards of education submit these comments opposing approval of 20 N.C. Administrative Code 02B.0405 as proposed by the Board of Trustees of the Teachers' and State Employees' Retirement System ("T&SERS").

Introduction

In 2014 the General Assembly enacted a "contribution-based benefit cap" on the retirement benefits to be paid to an individual by T&SERS. For employees who joined the system before 2015 the benefit cap does not affect the amount of the pension the employee will receive upon retirement — based on the retiree's years of employment and average final compensation — but does affect who pays the pension. If the pension to which the retiree is entitled exceeds the new benefit cap, T&SERS will pay only the amount up to the cap and the retiree's last employer must pay the difference. The retirement system assesses an "additional contribution" against the employer to cover the difference between the pension cap and the retiree's actual pension.

The pension cap is determined by a formula set out in G.S. 135-5(a3) and is based primarily on the retiree's accumulated contributions to T&SERS and the cost of an annuity equal to that contribution. The final step in the formula is to “[m]ultiply the annuity amount . . . by the contribution-based cap factor.” The cap factor is set by the T&SERS Board of Trustees. That is the rule now proposed by T&SERS.

The T&SERS trustees have been forced to rulemaking by lawsuits filed by the Johnston, Wilkes, Union, and Cabarrus county boards of education. The trustees first adopted the cap factor in October 2014, and again in October 2015, without following the rulemaking procedures of the Administrative Procedure Act (“APA”). In eight separate judgments in lawsuits brought by the four school boards, however, the Wake County Superior Court held that the cap factor is a rule within the meaning of the APA and that T&SERS may not implement the pension cap without adopting the factor as a rule. The retirement system has appealed those decisions — briefs have been submitted to the Court of Appeals but no hearing date has been set yet — but meanwhile has initiated this rulemaking.

Reflecting its begrudging approach to rulemaking, T&SERS has summarily adopted the same cap factor as it previously tried to implement in violation of the APA; has ignored requests to consider the severe economic consequences to employers; has failed to heed its obligation under retirement statutes to “adopt rules and regulations to prevent injustices and inequalities”; and has failed to comply with APA requirements to propose alternatives when a rule has substantial economic impact and to consider the effect on local governments' budgets.

Background on the discretion given to the T&SERS trustees

The statute gives little direction to T&SERS on adoption of the cap factor, the only directive being that the factor be such that the pension cap affects no more than .75 of all retirements in a year. Analysis prepared by the T&SERS actuary shows that the number of retirees affected, and thus the number of employers required to make additional contributions, can vary widely depending on where the cap factor is set within the statutorily acceptable range. A factor of 4.2, for example, would affect three times as many employers, 66, as a factor of 4.9, which would affect only 21. Likewise, a factor of 4.2 might require a \$200,000 “additional contribution” from an employer while a higher factor might result in only a \$50,000 assessment.

Nothing in the analysis prepared by T&SERS or in the trustees’ discussion explains the rationale for selecting the particular factor chosen for the rule, 4.5. The absence of any explanation demonstrates the trustees’ neglect of their obligation under G.S. 135-6(f) to adopt rules “to prevent injustices and inequalities which might otherwise arise in the administration of this Chapter.” Although T&SERS says that the purpose of the pension cap is to address inequity in the retirement system — *i.e.*, some employers paying higher salaries and putting a greater burden on the retirement system than other employers — the Board of Trustees did not consider matters of equity in its rulemaking. There was no consideration of the difference between employers who intentionally increase employee’s salaries just before retirement to enhance their pension and employers who do not; no consideration of the effect of unexpected, early retirements beyond the control of the employer that

trigger the pension cap; no consideration of whether the employee's compensation was or was not within the normal market range for that position; and no consideration of when the employee's compensation was set, whether it was well before the pension cap was even contemplated or close in time to the new law.

Although the stated legislative purpose of the pension cap statute is to affect and alter the behavior of employers in setting salaries, and the trustees are obligated to attempt to ameliorate inequities in the application of the pension cap, the trustees have proposed a rule that is indifferent to the differences in employers' action and that imposes the same harsh financial penalty to all employers regardless of their individual circumstances. Most significantly, it imposes severe financial burdens on employers for decisions made years in advance of the new law.

Failure of the Board of Trustees to follow the rulemaking statutes

Even though the adoption of the cap factor has a "substantial economic impact" of more than one million dollars in a 12-month period (the definition in G.S. 150B-21.4(b1)) on employers, the trustees have failed to offer two alternatives as required by G.S. 150B-19.1(f). In fact, the fiscal analysis prepared by T&SERS fails to address at all the economic effect on employers.

There is no question of the severe economic effect of the 4.5 cap factor. In 2017, for example, when applying the unlawfully implemented cap factor (the same 4.5 factor as proposed in the rule) T&SERS assessed over \$3.6 million against 40+ employers. The January 2018 list of T&SERS employers affected by the pension cap

shows over 90 employers who are assessed additional contributions, and of those, 30 are for more than \$100,000 each. The Wake County Board of Education alone has been charged a \$349,714.37 “additional contribution”; the Person County Board of Education \$184,493.41; and Chapel Hill-Carrboro City Schools \$88,995.48.

Despite this obvious substantial economic impact, the T&SERS fiscal analysis of the 4.5 cap factor notes only a sum total of additional contributions likely to be required of T&SERS employers, with no discussion of the effect on those employers, no acknowledgement of the number of positions that might have to be cut or programs discontinued when several hundred thousands of dollars is suddenly taken from a school system’s budget. The analysis fails, as required by G.S. 150B-21.4(b1)(3) to “[d]escribe the persons who would be subject to the proposed rule and the type of expenditures these persons would be required to make.”

Also missing from the T&SERS analysis are the two alternatives to the proposed rule required by G.S. 150B-19.1(f). The “Alternatives to the Rule Making” portion of the analysis (on pages 16-18) does no more than describe how the estimates used by the actuary in 2015 as part of the trustees’ adoption of the cap factor in violation of the APA would be recalculated using current data. There is no identification of alternatives to the proposed rule; all the section says is that the trustees did not choose a lower cap factor because it would affect more employers and thus generate greater political opposition to the pension cap law.

Finally, the Board of Trustees has failed to comply with G.S. 150B-21.27. The statute requires that an agency adopting a rule that will affect the expenditures of

local governments must consider the timing of implementation and whether it will disrupt the local budget process. Because school boards have no taxing authority, the payment of a huge “additional contribution” to T&SERS required by the cap factor rule will necessitate a school board either drastically revising its budget, cutting positions or shutting down programs, or applying for additional funding from the board of county commissioners. This is precisely the kind of situation G.S. 150B-21.27 is intended to address, yet it has been ignored in the rulemaking process.

Conclusion

For the reasons stated above, the Rules Review Commission should not approve the proposed 20 N.C. Admin. Code 02B.0405.

RESPECTFULLY SUBMITTED, this 12th day of April 2018.

/s/ Deborah R. Stagner
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Submitted via email to rrc.comments@oah.nc.gov with copies to amanda.reeder@oah.nc.gov and laura.rowe@nctreasurer.com.

COMMENTS ON PROPOSED 20 N.C. ADMINISTRATIVE CODE 02B.0405**Submitted by****DARE, PENDER, & WILSON COUNTY BOARDS OF EDUCATION****Introduction**

On March 7, 2018, at a special called meeting of the Board of Trustees for the Teachers' and State Employees' Retirement System (TSERS), the rule entitled "20 NCAC 02B.0405, ANTI-PENSION SPIKING CONTRIBUTION-BASED BENEFIT CAP FACTOR" was adopted, despite the comments submitted to TSERS by the Dare, Pender, and Wilson County Boards of Education. In response to the rule adopted by TSERS on March 7, 2018, the following comments are submitted electronically to the Rules Review Commission on April 12, 2018.

The local boards of education request that the proposed rule be rejected based on the following:

(1) Violation of N.C. Constitution

The Constitution of the State of North Carolina guarantees that "the people have a right to the privilege of education, and it is the duty of the State to guard and maintain that right." N.C. Const. art. I, Sect. 15. Local boards of education have the fundamental duty to "provide students with the opportunity to receive a sound basic education and to make all policy decisions with that objective in mind, including employment decisions, budget development, and other administrative actions, within their local school administrative units, as directed by law." N.C. Gen. Stat. § 115C-47(1). At a minimum, the proposed rule prevents local boards of education from making employment decisions or developing fiscally sound budgets from year to year. The

impact of the rule is extremely costly, unpredictable, and restricts local boards from annual employment and budgetary decisions without any alternative.

To more clearly illustrate the problem, Wilson County Schools has been assessed \$407,292.39 because one school district employee retired much earlier than anticipated. On average, the annual state-paid salary for a teacher in the 2014-15 school year was \$47,792. Paying that assessment for Wilson County Schools equates to laying off 9 teachers for the school year. Stated differently, the annual per student local expenditure in Wilson County in 2015-16 was \$1409 per student. For Wilson County Schools to pay \$407,292.39, the local funding for 289 students is simply lost.

Pender County Schools is currently experiencing a similar problem. Pender County Schools has been assessed \$15,069.58 because one school district employee retired after more than 38 years of State service. Paying that assessment for Pender County Schools equates to laying off at least one teacher for the school year. Stated differently, the annual per student local expenditure in Pender County in 2015-16 was \$1,874 per student. For Pender County Schools to pay \$15,069.58, funding for eight students is simply lost. The impact is unreasonable and intolerable; made more so by the arbitrary application of a Cap Factor selected without rhyme or reason.

The Board of Trustees for TSERS has proposed a rule that has a devastating impact on budgets, recruiting, and retention for local boards of education that cannot be avoided and cannot be anticipated with any certainty. A proposed rule must include the ability for local boards to estimate with reasonable certainty the amount of additional assessments owed to TSERS. However, the local boards cannot be depleted of their annual operating budgets to fund their core mission of providing all children with the opportunity for a sound basic education.

(2) Violation of U.S. Constitution

The U.S. Constitution prohibits states from enacting any law that retroactively impairs contractual rights (Contracts Clause). U.S. Const. Art I, Sect. 10. Despite the clear mandate placed upon the State and its local boards of education to provide a “sound basic education” to public school children, N.C. Gen. Stat. §135-5(a3) is retroactively interfering with contracts established between local boards and their employees. The local board is retroactively expected to absorb the huge additional liabilities imposed by TSERS well after the negotiation process has concluded and the employment contracts executed.

Further, because the local boards of education are not state entities, but rather separate local employers, the law interferes with the contract between the local boards of education and TSERS, the state agency. The law unilaterally alters the established contract between the local board of education and its budgeted contributions to the retirement system. For employees hired before 2015, any liabilities over the contribution-based benefits cap amount must be paid by the employer. This additional burden assessed to the employer substantially impairs the employer’s contract with TSERS from the time the employer-employee contract was negotiated and executed. Several years after the local boards entered into a contract with an employee, TSERS is now punitively assessing the employer with a huge financial burden by shifting the costs of retirement contribution entirely to the employer.

(3) No Constitutional Authority to Adopt the Cap Factor Rule

The plain language of N.C. Gen. Stat. § 135-5(a3) directs the TSERS’ Board of Trustees to “adopt a contribution-based benefit cap factor” and “modify such factors every five years.” However, neither the statute nor the proposed rule establishing a cap factor may enable the

unconstitutional impairment of contract as previously discussed in Section (2) of these comments.

(4) The Absence of an Explanation as to the Board's Choice

The proposed rule sets the “Cap Factor” at 4.5 for retirees in the TSERS. While the Board of Trustees for TSERS has the legal authority to set the Cap Factor as stated in N.C. Gen. Stat. §135-5(a3), the Fiscal Note for this proposed rule makes clear that the Cap Factor selected is arbitrary. The Cap Factor does not take into account any individual facts and circumstances of employment situations that may trigger the Contribution-Based Benefits Cap (Pension Spiking) calculation. The Board of Trustees relies entirely on the opinion provided by a private actuary without evaluating other options or fulfilling its statutory duty to consider alternatives.

By law, the Board of Trustees for TSERS is to set the Cap Factor so that “no more than three quarters of one percent (0.75%) of retirement allowances” are impacted. N.C. Gen. Stat. §135-5(a3). However, the notion of impacting “no more than” 0.75% of retirees does not establish clarity for any local board of education for annual budgeting purposes. Limiting the number impacted based on an arbitrary range of percentages between 0.00% and 0.75% of retirees does nothing to inform local boards of education or their local funding agents (Boards of County Commissioners) nor does it enable them to budget or plan to absorb or prevent huge financial assessments.

(5) No Indication of Criteria Considered

Local boards are wholly unable and without any authority to determine which employees may in fact retire, when they may choose to do so, or their age or accumulated creditable service at the time of retirement; factors that potentially cause enormous swings in the potential adverse

impact resulting from the application of this law. The manner in which anywhere from zero to 0.75% of retirees is calculated with respect to each local board of education is at best unclear and, at most, devastating to sound budgeting or fiscal management practices for a public school system.

(6) No Attention Paid to the Impact on the Employer

With respect to the annual budgeting process, each local board of education's budget is entirely dependent on federal, state and local funds as approved annually by the U.S. Congress, General Assembly and County Commissioners, respectively. Local school boards (with limited exceptions) lack taxation authority to raise their own revenues. Put simply, they cannot meet unforeseen or unpredictable expenditures by raising their own revenue. Each year, a local board of education is unable to accurately request and plan for unforeseeable assessments of its hypothetical or potential retirees. Since the enactment of Session Law 2014-88, assessments related to pension spiking have been the direct result of employee-made decisions regarding when to retire and not the result of intentional "pension spiking" by the local board-employer.

(7) Failing to Consider Alternatives – Substantial Economic Impact

The effects of the proposed rule are arbitrary, unpredictable and extremely harmful to local boards of education and their appropriations as determined by County Commissioners. Initially, the absence of a rule led to litigation by local boards of education which could not clearly determine or even reasonably estimate their potential liability. The proposed rule on the Cap Factor, based on one actuarial recommendation provided without any guidelines, and adopted without any stated rationale, does not adequately address the issue essential to those it

impacts: How can local boards of education prepare for liability for pension spiking resulting from their employees' unpredictable retirements?

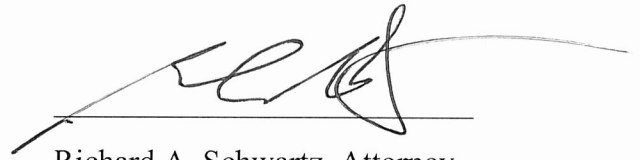
A local board employer has no authority to mandate a retirement date of an employee for any reason, even if the reason is to avoid the huge financial liability imposed by the Cap Factor set in this proposed rule. Local boards are required to enter into employment contracts, by law, and must compete with each other and with public, private and charter schools, within and outside of North Carolina, for talented educators. Local boards of education will continue to be assessed hundreds of thousands of dollars by TSERS for largely unforeseeable and unpredictable financial liabilities beyond their control.

Conclusion

The Board of Trustees has failed to comply with state and federal constitutional, statutory and regulatory requirements in selecting the Cap Factor in the following manner: (1) Violation of N.C. Constitution; (2) Violation of U.S. Constitution; (3) The absence of authority to adopt a cap factor rule; (4) The absence of an explanation as to the Board's choice; (5) No indication of criteria considered; (6) No attention paid to the impact on the employer; and (7) Failing to comply with Administrative Procedure Act provisions pursuant to G.S. 150B-19.1(f) in considering alternatives where a substantial economic impact exists. In addition to these errors and omissions, the Board of Trustees has failed to undertake an independent assessment in setting the Cap Factor under the Administrative Procedure Act.

RESPECTFULLY SUBMITTED, this 2 day of April, 2018.

DARE COUNTY BOARD OF EDUCATION
PENDER COUNTY BOARD OF EDUCATION
WILSON COUNTY BOARD OF EDUCATION



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