Treasurer Folwell and Retirement Boards Lower Assumed Rate of Return to 6.5%

Only 2nd Treasurer in 60 years to Lower the Assumed Rate of Return

Feb 2, 2021

(Raleigh, N.C.) – North Carolina State Treasurer Dale R. Folwell, CPA, and the Retirement Systems Division announced today that the investment return assumption or rate of return (RoR) for the principal North Carolina Retirement Systems (Fund) will be lowered 50 basis points from 7.0% to 6.5% per year. The change will be recognized immediately for financial reporting and calculating the funded percentage level, but for the purpose of determining employer contribution rates, the effect will be phased in over a period of five years.

The rate changes were unanimously approved by the Teachers' and State Employees' Retirement System and Local Government Employees' Retirement System Boards of Trustees (Boards) at their meeting on Jan. 28. The rate has been lowered twice previously in the past four years. In 2017, it was lowered from 7.25% to 7.20% and in 2018 the rate was lowered further to 7.0%. The changes during the Folwell Administration were only the second lowering of the rates in almost 60 years even though both plans have failed to achieve their assumed rates of return, on average, for the last 20 years.

The move was made as part of a number of recommendations made by the Fund's actuarial consultants Cavanaugh Macdonald Consulting, LLC (CMC). At least once every five years the Fund conducts an actuarial experience study that reviews the differences between a plan's assumed and actual experience over multiple years with the goal of examining the trends related to actual experience and recommending any needed changes to assumptions.

CMC recommended reducing the RoR to 6.5% based primarily on the fact that they believed the previous assumption for inflation underlying the investment returns (3.0% per year) should be reduced by at least 50 basis points. CMC recommended that the total investment return assumption be set at 2.5% (inflation) plus 4.0% (investment returns exceeding inflation), or 6.5% per year.

"The North Carolina pension fund is one of the best funded in the country," said Treasurer Folwell. "However, we need to make realistic assumptions regarding our ability to achieve expected returns in the future. We owe it to the General Assembly, taxpayers, public employees and future generations to be transparent and realistic about the true valuation of the pension plans. Lowering this assumption will provide the best opportunity to meet the state's long-term obligations as well as maintain its AAA bond rating. I want to thank the Boards for making this decision."

The stability of the Fund relies on maintaining both adequate employer and employee contributions and achieving long-term investment goals. However, on average the Fund has not earned its RoR for the past 20 years. In fact, the estimated 20-year return on the Fund is 6.28% driven by the market declines after 9/11 and the great financial crisis. The new assumption of 6.5% per year represents the Boards' best estimate assumption of long-term future returns.

The Boards' action comes as many states are lowering their expected assumed rate of return to better reflect realistic future investment gains. However, many states remain underfunded despite the change. For example, in 2016, the California Public Employees Retirement System (CalPERS)—
(https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2018/state-retirement-fiscal-health-and-funding-discipline#/state-profiles/california?year=2018)
the nation's largest public pension plan—announced it would decrease its assumed rate of return incrementally from 7.5 percent in 2017 to 7 percent by 2021 yet is only 69% funded with a funding gap of $184 billion.

North Carolina's reduction to 6.5% will occur immediately with respect to the actuarial valuations as of Dec. 31, 2020, which determines contribution rates effective July 1, 2022. However, the impact of the change on actuarially recommended employer contribution rates will be recognized gradually over time.

Contributions to pension plans have three sources of funds: contributions made by employees (6%), contributions made by employers (state agencies, school systems and local governments) and investment gains. When a retirement system lowers its expected investment gains, additional funding for the pension system must come from other sources like the General Assembly and local governments in the form of employer contributions.

North Carolina's conservative pension funding policy has allowed government employers to move beyond the funding requirements that resulted from the 2008-2009 recession, so that those historical requirements do not compound the adjustment to the new actuarial assumptions. The actuarially required contributions to fund currently promised benefits are expected to remain consistent with current levels in the coming years, as a percentage of employee pay, if the new assumed return of 6.5% per year is achieved.

Contribution rates are set by annual actuarial valuations in combination with the Boards of Trustees' funding policies. These funding policies may call for additional contributions beyond actuarially required amounts in order to ensure long-term budgeting stability for the state and local governments.

Folwell praised the North Carolina League of Municipalities, North Carolina Association of County Commissioners, the Governor and the General Assembly for their support. "We look forward to working with the league and commissioners and others to preserve and protect the pension plans," said Treasurer Folwell said. "They have been great partners in the past. Together we can make sure the pension plans remain solvent for current and future public service workers."

The North Carolina Retirement Systems, the formal name for the pension fund, is the 9th largest public pension fund in the country and is currently valued at almost $116 billion. It provides retirement benefits and savings for more than 950,000 North Carolinians, including teachers, state employees, local governments, firefighters, police officers and other public workers.

For more information, visit www.myncretirement.com (http://www.myncretirement.com) .

Contact Information

Press Line
press@nctreasurer.com (mailto:press@nctreasurer.com)
866-622-2741