

House Select Committee on Legacy Costs from the
State Health Plan, Pensions & ESC

October 16, 2012

The House Select Committee on Legacy Costs from the State Health Plan, Pensions & ESC meeting was held on October 16, 2012 in Room 605 of the Legislative Office Building at 12:00 noon. Representative McGee presided as Chair. Members present were: Representatives McGee (Cochair), Folwell (Cochair), Hamilton, Jackson, L. Johnson, Moffitt and Pierce. Sergeant-at-Arms present were: John Brandon and Jesse Hayes. (See attachment 1) A Visitors Sheet is attached. (See attachment 2)

Representative McGee called the meeting to order at 12:01 pm and said the scope of the meeting would be the same as the first meeting held last year with updates on previous information and new information that has been attained since then. He also added that this is one of the most important committees in existence now and that the business done in this committee affects all taxpayers in North Carolina. Representative McGee then read the committee mission statement for emphasis on the State's ability to afford these costs.

Representative McGee introduced Dr. Barry Boardman of Fiscal Research to present his interpretation of a State and National economic forecast over the next five years. (See attachment 3) At the conclusion of the presentation, Cochairman Folwell asked for more information at future meetings on the following:

1. Inflation and medical expenses
2. 7 ¼ % investment goal for pensions
3. Percentage rate risks/US charging a higher interest rate
4. Proliferation of non-profits-expenses as relate to the State (no property or corporate taxes)

Dr. Boardman responded that he would work on his requests. Representative McGee asked what would happen to long bonds if held in the Treasurers' portfolio. Representative McGee then further stated that in a period of rising interest rates the principle value would decline to reflect the higher interest rate environment. With a high proportion of interest rate sensitive holdings, it will be difficult to meet the 7.25% return expected when interest rates are as low as they are now.

The Chair introduced David Vanderweide to give an overview of the States' long-term liabilities and retired employee health benefits. (See attachment 4) Mr. Vanderweide stated that the State has an unfunded liability at present of \$29b and by 2021, as funded now, is projected to be \$44b. He made comparisons in eligibility, Medicare, retiree premiums with other states and concluded that North Carolina has the 9th highest liability in the United States. Representative Folwell commented that the vested but not yet drawing retirement was a large part of the liability (\$5 or \$6b) and Mr. Vanderweide agreed and added that it impacts the health plan also. In relation to paying down the

States' liability, Representative McGee asked if normal costs are not a better measure. Mr. Vanderweide agreed and stated that it would take \$2.5 billion to pay off the liability in 30 years, more if in less years. Representative Folwell asked questions regarding taxation in other states of North Carolina retirees' incomes who have established residencies in other states while drawing retirement and health benefits. He followed up with a question about the health plan calendar year and how it had affected the military.

Representative McGee introduced Stanley Moore to give an overview of pension benefits. (See attachment 5) Mr. Moore stated that in the last few years, contributions have gone down while retirees are going up because of budget cuts. Mr. Moore also stated that Representative McGee was correct when he spoke earlier to the loss of \$16b due to downfall of equities in the plan in 2008.

In reference to Representative Folwell's question about out of state retirees, Mr. Moore said the \$4,000 exemption was not a drain on the income tax system that the five year health insurance does kick in but only from 60-65 then Medicare comes in and the State makes money on it. Representative Linda Johnson asked again if retirees from out of state were a drain on the State by avoiding paying income taxes. Mr. Moore replied that they are not but "double-dippers" in their 50's were the biggest drain.

Representative McGee asked if underfunding raised the States' liability regarding the pension plan. Mr. Moore responded that in 2001 when Governor Easley took office, he directed all the employers to send all of the money to the budget office, the budget office intercepted 130m from the teachers and state employees and used it to balance the budget. That legislature passed a bill to pay back the funds with interest over the next five years. The principle was repaid, but not the interest.

Representative Jackson asked Mr. Moore to address "spiking" of salaries. Mr. Moore said that the spiking of salaries for a desired outcome was largely considered an extraordinary event. Representative Jackson asked if there had been legislation addressing the problem. Representative McGee responded that a bill was offered by Representative Folwell, but after much investigation and discussion, it was deemed that "spiking" was not a widespread problem in the normal course of TSERs retirement beneficiaries and the legislature did not want to hurt those going through a normal progression in salary during their careers. Representative Folwell added that 10% a year or 40% in 4 years was added to alleviate any problem of people knowing people in power.

Representative Linda Johnson asked since there is no committee for Legacy Costs, only a study committee, how does the legislature know when a problem such as this comes up, that they need to act to solve it. Mr. Moore said the Treasurers' Department sees these problems when they come up, send it on to the Board and they ask for legislation.

Representative McGee recognized Mr. Steve Toole of the Treasurer's Department to address the committee. Mr. Toole stated that their Department is always using analysis to work with the legislature and staff to protect the system for the long term.

Ms. Kristen Walker of Fiscal Research gave an overview of Unemployment Debt owed to the Federal Government. (See attachment 6) She gave an explanation of North Carolina's unemployment insurance debt and compared North Carolina's debt to other states with North Carolina being 3rd behind California and New York.

Mark Bondo of Fiscal Research addressed the committee about the State Debt and explained the benefits and drawbacks of debt service, and the types of State Debt and bonds. (See attachment 7)

Representative McGee recognized Mr. Sam Watts of the Retirement System who said he will have more data regarding the funded ratio. Mr. Watts responded that they will have that number next week. He added that the State is the 4th lowest on state plans.

Representative Folwell asked if there is anything in the Affordable Health Care Act that prevents the State from abdicating its' responsibilities to provide health care for its' employees. David Vanderweide responded that there is a penalty for not covering active employees, but not for retirees. Representative Folwell asked if the State is doing an analysis, as businesses are, to see what the penalties of not covering employees would cost the State versus covering them. Ms. Mona Moon (Department of the State Treasurer/State Health Plan) was recognized to answer Representative Folwells' question to staff. Ms. Moon said due to the complexity of the affect the Affordable Health Act will have on the State, it is their plan to look at these numbers with their Board of Trustees and with the Treasurer at a later date in order to make recommendations to the Legislature.

Paul Meyer of the North Carolina League of Municipalities was recognized and stated that their organization has a lot of smaller employers that will be eligible for this sooner. He added that some of those calculations are occurring now, and he expects to see some of the smaller cities making those decisions earlier than the larger ones.

Representative McGee thanked the members, staff and visitors, and asked the members if they had any questions for the next meeting, to give them to the Chairs or staff. The meeting adjourned at 1:40 pm.

Representative William C. McGee,
CoChair (presiding)

Jayne A. Nelson,
Committee Assistant

Representative Dale Folwell,
CoChair