SB 467
NC Retirement Reform

Senate Committee on Pensions and Retirement and Aging

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FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Typical 401(k) Plan of 1990s

- Employee had to go to human resource office and request form to enroll or to change contribution, resulted in low participation rates.
- Few tools available to decide how much to contribute. Employees typically contributed amount to get full match, extra amount they expected to have left over from paycheck, or amount mentioned by friends or magazine article.
- Dozens or hundreds of mutual fund options available, many with fees of 1% to 2% of assets, creating confusion or inaction.
- Many employees had portfolios that were too risky, too safe, or undiversified (e.g. all Internet stocks).
- After separation from service, employee was encouraged or even required to take a full distribution. This could have been a rollover to an IRA, but in many cases was taxable.
- More sophisticated participants used "4% rule", withdrawing 4% of balance in first year and increasing withdrawal with inflation thereafter. This often left substantial assets if they died early and depleted assets if they lived past age 100.

SB 467

- Employee is automatically enrolled when hired.
- Employee contribution is automatically reset each year to amount needed to achieve target replacement rate (e.g. 80% of pre-retirement income), based on:
  - Age
  - Salary
  - Current account balance
  - Target retirement age
  - Other factors established by Board of Trustees
- Account is invested mostly in stocks when young and more in bonds when older. Big drops in stock market or interest rates near retirement should have little impact on the portion expected to be turned into a monthly benefit.
- Uses size of existing State retirement investments to keep fees low.
- Employer matches 100% of employee contribution up to 6% of pay.
- Upon later of separation or target retirement age, retiree begins receiving a monthly payment equal to amount they could receive if they set up lifetime benefit.
- After separation, employee can elect to receive a monthly benefit that is paid by the State for her life and the life of a beneficiary (if elected). This monthly income can automatically increase every year with CPI (inflation) if elected.

1990s 401(k) vs. SB 467

Feature	1990s 401(k)	SB 467
Enrollment	Employee action required	Automatic
Employee Contribution	Little guidance	Automatic to achieve target income
Investments	Overwhelming choices, high fees	Single default, low fees, risk declines with age
Distribution in Retirement	Cash or IRA rollover	Lifetime inflation-indexed monthly benefit paid by State

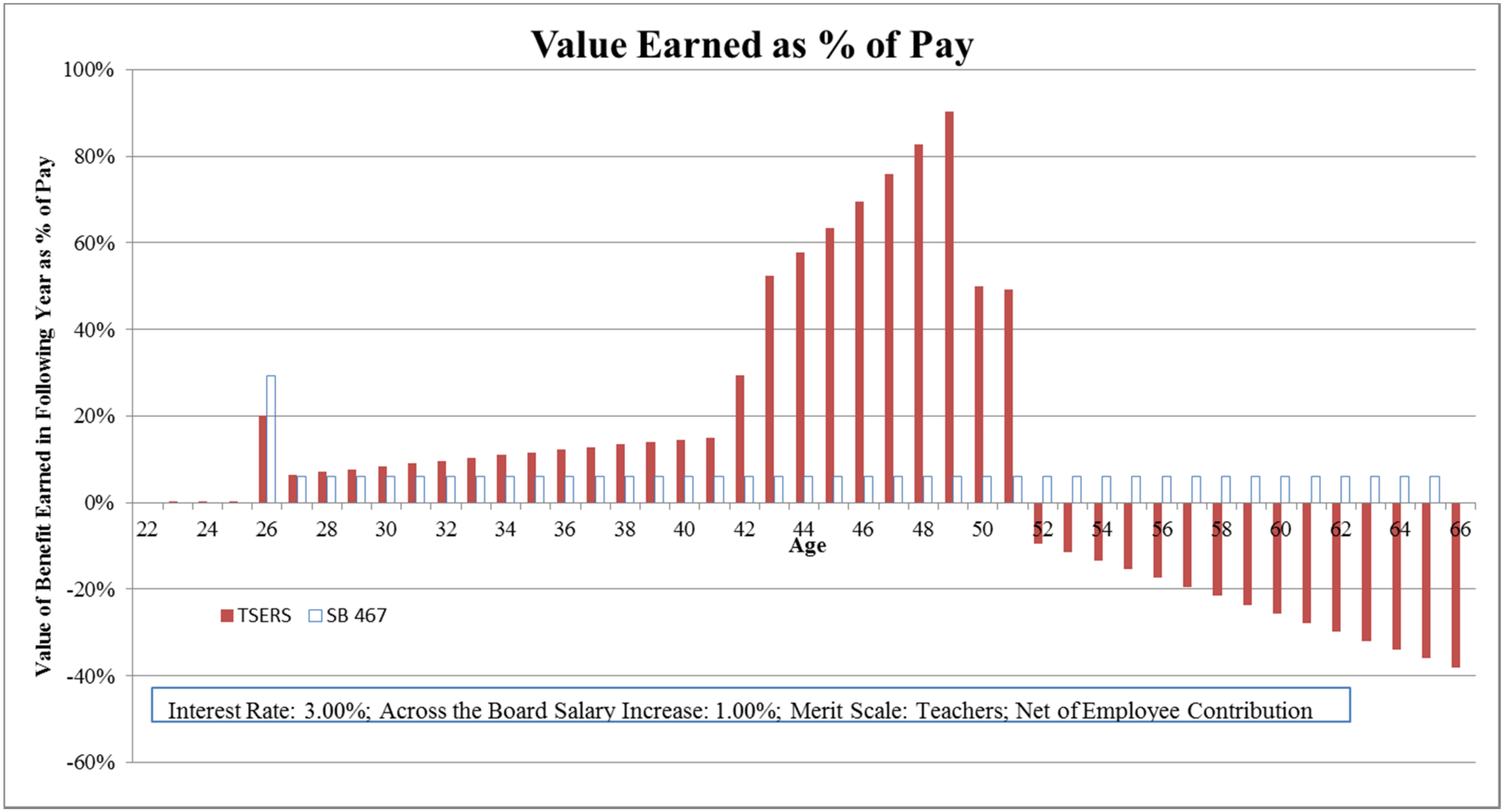
Recruiting and Motivating Millennials

- Millennials are roughly age 20 to 35.
- FRD did literature review of books and articles on recruiting and motivating them.
- None mentioned traditional pension or retiree medical as a factor.
- Some mentioned that Millennials are not attracted or motivated by 401(k) either, but that employers should offer one anyway because employees will thank them later.

Contribution Rate Examples

- Age 25 new hire: 6% of pay
- Age 55 new hire, no other savings: 35% of pay
- Age 45, big drop in stock market (e.g. 2000 or 2008) or pay increase (e.g. double): 5% to 15% increase in contribution rate
- Assumptions:
  - Real interest rate: 2%
  - Equity risk premium: 4%
  - Real salary increases: 1.5%
  - Target retirement age: SSNRA

Attraction/Retention Impact



Contribution Comparison

Component	TSERS	New Hire in 401(k)	Impact on Unfunded Liability
Employee	6% of pay	Up to employee	None
Employer Normal Cost	4.31% of pay	100% match up to 6% of pay	At 7.25% return, contribution exactly matches value of benefits earned, so none. At lower returns, continued TSERS participation increases unfunded liability.
Employer Unfunded Liability	5.67% of pay	5.67% of pay *	Pays off unfunded liability over 12 year amortization
Total	15.98% of pay	Depends on employee choices	

* Section 1(b) does not provide details, but this is one interpretation. This contribution would go to TSERS, not the 401(k).

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