

## RETIREMENT SYSTEMS DIVISION

STEVEN C. TOOLE  
EXECUTIVE DIRECTOR

### MEMORANDUM

TO: Supplemental Retirement Board of Trustees

FROM: Reid Chisholm, Assistant General Counsel

DATE: April 10, 2019

SUBJECT: Approval of proposed rules for administrative fees and fiscal analysis

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The Board and the Department do not receive any appropriations to operate the NC 401(k) Plan, the NC 457 Plan or the NC 403(b) Program. Instead, the operational expenses of the board and the Department have historically been funded through administrative fees charged to participants. As part of a review of the need for formal administrative rules, departmental staff proposed that the administrative fees be established through the rulemaking process.

At the December 13, 2018 Board of Trustees meeting, staff proposed rules for the administrative fees (Attachment 1), an accompanying fiscal analysis (Attachment 2) and a projected timeline for the rulemaking process (Attachment 3). The Board approved the (1) the proposed rules and the fiscal analysis for publication in the *North Carolina Register*, and (2) the Department's and Board's actions in the projected timeline. Likewise, the Department formally approved the publication of the rules and the timeline.

A Notice of Text for the rules was published in the January 15, 2019 issue of the *North Carolina Register*. The Notice of Text included the rules, a notice of the fiscal analysis, the process for requesting a public hearing and submitting comments and a link to the Department's webpage. The Department's rules webpage included a copy of the Notice of Text and the fiscal analysis. The deadline to request a public hearing was January 30, 2019, and no public hearing was requested. The deadline to submit comments was March 18, 2019, and no comments were submitted.

Also, on January 15, 2019, a fee consultation request was sent to the Joint Legislative Commission on Governmental Operations. The fee is deemed approved by the commission if no response is received by April 15, 2019. If no response is received by April 15, 2019, then staff will recommend at the April 16, 2019 special board meeting that the Board:

1. Adopt as final the rules as published in the *North Carolina Register* (Attachment 1) and the accompanying fiscal analysis (Attachment 2); and
2. Authorize the Department to take all additional measures required to complete the rulemaking process in accordance with the Administrative Procedure Act.

If final rules are adopted on April 16, 2019, then the Department will formally adopt the rules and submit them to the Rules Review Commission for consideration at its May 16, 2019 meeting.

The earliest effective date of the rules is June 1, 2019.

The proposed rules in Attachment 1 codify the current annual fees charged by the Department and the Board to administer the plans – 0.025 percent (2.5 basis points) of a participant's account balance in the NC 401(k) and NC 457 plans and 0.050 percent (5 basis points) of a participant's account balance in the NC 403(b) Program. The rules also include a process for waiving the fees for up to 12 months at a time.

The fiscal analysis that was required for the proposed rules is in Attachment 2. The fiscal analysis, which was approved by the Office of State Budget and Management, includes the costs and benefits of the rules as well as alternatives to the rules.

The projected timeline for the rulemaking process is in Attachment 3.



## **Attachment 1: Proposed Rules**

### **CHAPTER 11 – SUPPLEMENTAL RETIREMENT PLANS**

#### **SECTION .0100 – ADMINISTRATIVE FEES**

##### **20 NCAC 11 .0101 ADMINISTRATIVE FEES: NC 401(K) AND NC 457 PLANS**

- (a) The Board and the Department shall charge an administrative fee at an annual rate of 0.025 percent of the assets in each account in the Supplemental Retirement Income Plan of North Carolina and in each account in the North Carolina Public Employee Deferred Compensation Plan.
- (b) The Board and Department may waive the administrative fee in Paragraph (a) for a period of up to 12 months based upon the following factors:
1. The balance of the administrative expense account for the plans;
  2. Department projections of future expenses to administer the plans; and
  3. Department projections of future receipts available for the administration of the plans.
- (c) The Board and the Department shall provide notice of a fee waiver on the plans' website and on participants' quarterly statements.

*History Note:* Authority G.S. 135-91(e); 143B-426.24(h2);  
Eff. \_\_\_\_\_;

##### **20 NCAC 11 .0102 ADMINISTRATIVE FEES: NC 403(B) PROGRAM**

- (a) The Board and the Department shall charge an administrative fee at an annual rate of 0.050 percent of the assets in each account in the North Carolina Public School Teachers' and Professional Educators' Investment Plan.
- (b) The Board may waive the administrative fee in Paragraph (a) for a period of up to 12 months based upon the following factors:
1. The balance of the administrative expense account for the plans;
  2. Department projections of future expenses to administer the plan; and
  3. Department projections of future receipts available for the administration of the plan.
- (c) The Board and the Department shall provide notice of a fee waiver on the plan's website and on participants' quarterly statements.

*History Note:* Authority G.S. 115C-341.2(c);  
Eff. \_\_\_\_\_;



**North Carolina**  
 Total Retirement Plans  
**401k | 457 | 403b**



*Dale R. Folwell, CPA*  
 STATE TREASURER OF NORTH CAROLINA  
 DALE R. FOLWELL, CPA

## Attachment 2 – Fiscal Analysis

# NORTH CAROLINA SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES FISCAL ANALYSIS OF PROPOSED RULES

### Rule Information

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#### *Authority and Citation*

Statutory authority ..... N.C.G.S. §§ 135-91(c) and (e), 143B-426.24(h2), and 115C-341.2(c)

Rule citation (proposed) ..... 20 NCAC 11 .0101, *et. seq.*

#### *Statements of Impact*

State government ..... Yes  
 Local Government ..... No  
 Private sector ..... Yes  
 Substantial impact ..... Yes

### Contact Information

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For additional information about this analysis, please contact:

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## Background

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The North Carolina Supplemental Retirement Plans are voluntary defined contribution retirement plans that are offered as an optional employment benefit to state and local governmental employees. The Plans, which are tax-advantaged under various provisions of the Internal Revenue Code (the “Code”), consist of the Supplemental Retirement Income Plan of North Carolina (the “NC 401(k) Plan”), the North Carolina Public Employee Deferred Compensation Plan (the “NC 457 Plan”), and the North Carolina Public School Teachers' and Professional Educators' Investment Plan (the “NC 403(b) Program”).

The NC 401(k) Plan, established in 1985, is a State-sponsored, qualified defined contribution plan under Internal Revenue Code Section 401(k) that is available to members of the Teachers' and State Employees' Retirement System, the Local Governmental Employees' Retirement System, and certain other governmental defined benefit plans, as well as state and local law enforcement officers. Participation in the NC 401(k) Plan is voluntary, and – with the exception of certain statutory employer contributions for law enforcement officers – employers and employees have the discretion to determine the amounts they contribute to the plan. Employers must contribute five percent of a law enforcement officer's monthly compensation to the NC 401(k) Plan. In addition, law enforcement officers, except for sheriffs, receive a share of court costs collected.

The NC 457 Plan, established in 1974, is a State-sponsored, eligible defined contribution plan under Code Section 457(b) that is available to the employees of the State and participating community colleges, local governments, and political subdivisions. Participation in, and contributions to, the plan are voluntary for employers and employees.

The investment options are the same in the NC 401(k) and NC 457 Plans, and the assets of the two plans are commingled in a group trust for purposes of investment.

The NC 403(b) Program, launched in 2014, provides investment options and recordkeeping services for Code 403(b) defined contribution plans sponsored by school districts and community colleges. In addition, the NC 403(b) Program offers a plan document for adoption by school districts and community colleges. The program can be used by employers as a stand-alone 403(b) plan or as one component of its larger, multi-offering 403(b) plan.

Eligible employees are permitted to participate in more than one Plan.

The North Carolina Supplemental Retirement Board of Trustees (the “Board”) and the North Carolina Department of State Treasurer (the “Department”) administer the Plans pursuant to the

Code, the North Carolina General Statutes, and the policies and plan documents adopted by the Board, as well as the Board-authorized contracts with external vendors, most notably investment managers, the recordkeeper, and the custodian. In addition, the Board has the responsibility and authority to hire, or cause to be hired, individual investment managers to execute the various investment mandates described in the Plans' *Statement of Investment Policy*.

The Board, and the Investment and Audit Subcommittees established by the Board, are structured and conduct their business according to the charter adopted by the Board, as well as North Carolina's Open Meetings Law (Chapter 143, Article 33C of the North Carolina General Statutes). The agenda, minutes, and Board materials (except those for which a Public Records Act exemption applies) for each meeting are posted on the Department's website, and plan participants and members of the public have the opportunity to provide comments at each meeting.

## Summary of Proposed Rules

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The Board and the Department do not receive any appropriations to operate the NC 401(k) Plan, the NC 457 Plan, or the NC 401(k) Program. Instead, to the knowledge of the Department, the operational expenses of the Board and the Department have historically been funded through an administrative fee charged to participants who opt to enroll in the Supplemental Retirement Plans. However, the Board desires to codify its administrative fee through the rulemaking process. The proposed rules reflect the Board's commitment to transparency and procedure.

In addition, the current rulemaking is consistent with recent statutory changes. The Board's authority to charge an administrative fee for the NC 457 Plan and the NC 403(b) Program were clarified by the General Assembly this year with the enactment of Session Law 2018-84, which added fee provisions to the NC 457 Plan's statute (N.C.G.S. § 143B-426.24) and the NC 403(b) Program's statute (N.C.G.S. § 115C-341.2(c)). The Board was established by the NC 401(k) Plan's statute, which already included a fee provision.

The Board establishes the administrative fee and adopts the budget for the use of the receipts. For participants in the NC 401(k) and NC 457 Plans, the annual administrative fee is 0.025% (2.5 basis points) of a participant's account balance. For participants in the NC 403(b) Program, the annual administrative fee is 0.050% (5.0 basis points) of a participant's account balance. The fee is charged quarterly. The administrative fee in the proposed rules is a continuation of the current fee, so participants will not experience a change in costs as a result of the rules.

## Benefits

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The Supplemental Retirement Plans help state and local governmental employees prepare financially for retirement and help state and local governments attract and retain employees. More than 275,000 current and former state and local governmental employees, representing more than 1,000 employers, participate in one or more of the Supplemental Retirement Plans, with total assets exceeding \$11 billion. As of December 31, 2017, approximately 72% of active employees in the Supplemental Retirement Plans were "retirement ready," compared with 46% of state and local

governmental employees who were not participating in the plans. “Retirement readiness” is defined as the ability to replace 80% of income from retirement through age 85.

The Board and the Department use the administrative fee receipts to fund the administration of the Plans, including Departmental personnel costs and investment consulting and auditing fees. Table 1, below, shows the actual administrative fees collected for 2016 and 2017, the estimated fees for 2018, and the projected fees for 2019 and 2020.

## Costs

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### *Administrative Fee*

As noted above, the annual administrative fee is 0.025% (2.5 basis points) of a participant’s account balance in the NC 401(k) and NC 457 Plans and 0.050% (5.0 basis points) of a participant’s account balance in the NC 403(b) Program. The administrative fee in the proposed rules is a continuation of the current fee, so participants will not experience a change in costs as a result of the rules.

Table 1 shows the actual administrative fees collected for 2016 and 2017, the estimated fees for 2018, and the projected fees for 2019 and 2020. Recent asset growth in the NC 401(k) and NC 457 Plans has resulted mostly from earnings, while both net contributions and earnings have contributed significantly to asset growth in the NC 403(b) Program. Therefore, the estimated and projected fees for 2018-20 assume that the assets in the NC 401(k) and NC 457 Plans grow at the rate of a portfolio of 65% domestic equities and 35% domestic fixed income. For the NC 403(b) Program, the 2018 estimated fee is based on the actual receipts for January-September, and the projected fees for 2019-20 assume asset growth in the program that is comparable to, though slightly lower, than recent rates of growth.

The Board approved a fee waiver for 2019, so actual fee receipts for 2019 will be \$0. However, the forecasted amount assuming no fee waiver is included in Table 1 to illustrate the trend in fee receipts.

<b>Plan</b>	<b><u>2016</u></b>	<b><u>2017</u></b>	<b><u>2018 (Est.)</u></b>	<b><u>2019 (For.)</u></b>	<b><u>2020 (For.)</u></b>
NC 401(k) Plan	\$1,971,103	\$2,233,815	\$2,499,426	\$2,625,147	\$2,757,192
NC 457 Plan	\$347,842	\$394,203	\$441,075	\$463,261	\$486,563
NC 403(b) Program	\$1,200	\$4,175	\$7,031	\$9,140	\$11,882

### *Opportunity Cost*

The costs of the rule include the forgone returns that could have been earned from investing the amount paid by participants for the administrative fee. Table 2 shows the estimated returns from investing the administrative fees in Table 1 under the following assumptions:

- The alternative administrative fee is \$0 (*i.e.*, the entire amount in Table 1 is invested); and

- The fee is invested in portfolio of 65% domestic equities and 35% domestic fixed income.

<b>TABLE 2: OPPORTUNITY COSTS FOR CY 2016 - CY 2020</b>						
<b>Plan</b>	<b><u>2016</u></b>	<b><u>2017</u></b>	<b><u>2018 (Est.)</u></b>	<b><u>2019 (For.)</u></b>	<b><u>2020 (For.)</u></b>	<b><u>Total*</u></b>
NC 401(k) Plan	\$166,686	\$345,348	\$158,701	\$132,045	\$138,687	\$1,083,378
NC 457 Plan	\$29,415	\$60,944	\$28,006	\$23,302	\$24,474	\$191,184
NC 403(b) Program	\$101	\$646	\$446	\$460	\$598	\$2,468

\*Includes compounding.

## Alternatives

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Eliminating administrative fees is not a feasible alternative. The Board and the Department do not receive any appropriations to operate the NC 401(k) Plan, the NC 457 Plan, or the NC 401(k) Program; therefore, unless appropriations are made in the future, the Board must continue to charge an administrative fee to operate the Supplemental Retirement Plans.

The Board and the Department chose not to propose higher or lower administrative fees to operate the Supplemental Retirement Plans. Higher administrative fees would be unnecessarily costly to participants.

Receipts have exceeded expenses for the past several years due to increased asset balances in the Supplemental Retirement Plans. The Board's reserve account currently holds between two and three times annual expenses, which exceeds the Board's target balance of one year of annual expenses. However, the Board and the Department do not propose lowering the fees because receipts could decrease or increase slower than expenses if net contributions slow or asset markets soften.

The Board and Department instead propose to use their discretion to issue fee waivers to reduce participants' costs when collections consistently exceed expenses. The Board has the discretion to waive the fee for a certain period of time – a procedure codified by the proposed rules – and the Board recently adopted a fee waiver for all of 2019, which will significantly decrease the reserve balance.

## Text of Proposed Rules

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- (c) The Board and the Department shall provide notice of a fee waiver on the plans' website and on participants' quarterly statements.

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**North Carolina**  
Total Retirement Plans  
401k | 457 | 403b



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## Attachment 3 – Proposed Timeline

The following proposed timeline for the rulemaking process is contingent upon any comments received from the Rules Review Commission and/or the Joint Legislative Commission on Governmental Operations.

- December 19, 2018: Deadline to submit the draft rule and fiscal analysis to the Office of Administrative Hearings for publication in the January 15, 2019, issue of the *North Carolina Register*
- Draft rule, fiscal analysis and other information posted on the Department's website
- Draft rule and fiscal analysis sent to stakeholders and interested parties
- January 15, 2019: Publication in the *North Carolina Register*
- Fee consultation request sent to the Joint Legislative Commission on Governmental Operations
- January 30, 2019: Earliest date to hold a public hearing if the Department receives a written request for a public hearing within 15 days of publication in the *North Carolina Register*
- March 18, 2019: End of the public comment period
- April 15, 2019: Fee deemed approved by the Joint Legislative Commission on Governmental Operations if no response
- April 16, 2019: Special Board meeting to consider comments and adopt the final rule
- April 22, 2019: Deadline to submit the final rule to the Rules Review Commission for consideration at the May 16, 2019, meeting
- May 16, 2019: Consideration of the rule by the Rules Review Commission
- June 1, 2019: Earliest effective date of the rule