

MEMORANDUM

TO: Teachers' and State Employees' Retirement System Board of Trustees (TSERS Board)
Local Governmental Employees' Retirement System Board of Trustees (LGERS Board)

FROM: Patrick Kinlaw, Director of Policy, Planning, and Compliance

DATE: October 30, 2025

RE: Contribution-Based Benefit Cap Factor – Staff Recommendation

Gallagher has recommended an adjustment to the “cap factor” for contribution-based benefit cap (CBBC) calculations, for both TSERS and LGERS. **Staff recommends that the Boards adopt Gallagher’s recommendations effective for retirements January 1, 2026.**

What is the cap factor?

The cap factor defines how large a retiree’s benefit must be, relative to the accumulated value of their own (6% of pay) contributions, for the retirement to possibly be subject to CBBC provisions. For retirements from 2016 to 2025, the cap factors have been 4.5 for TSERS, and 4.7 for LGERS. This means, for example, a TSERS retirement may be subject to the CBBC if the retirement benefit is more than 4.5 times what would have been funded by the accumulated value of the retiree’s own contributions.

What is the recommended change?

Gallagher recommends that the cap factor for TSERS be increased from 4.5 to 5.2. They recommend that the cap factor for LGERS be increased from 4.7 to 5.8.

What will it mean if the cap factor is increased?

An increase in the cap factor will mean that (1) fewer retirements will become subject to the CBBC, and (2) for those subject to it, the impact of the CBBC provision will be less significant.

- Every retirement subject to CBBC provisions so far has involved an employee who joined the Retirement Systems before January 1, 2015. For these retirements, employers are required to pay an amount to the Retirement System. With an increased cap factor, these requirements will be less frequent, and less in amount.
- There has not yet been a retirement subject to CBBC provisions involving an employee who joined the Retirement Systems on or after January 1, 2015. When these begin occurring, the retiree’s benefit will be reduced to a “capped” amount, unless the retiree and/or employer pays the Retirement System a lump sum for the full actuarial cost of restoring it to the “uncapped” amount. With an increased cap factor, these occurrences will be less frequent; the reduction to a “capped” amount will be less significant; and the cost for restoring it to the “uncapped” amount will be less.

Why is this recommendation occurring now?

The cap factor is being reviewed because of the quinquennial actuarial experience study.

- G.S. 135-6(n)(1) for TSERS, and G.S. 128-28(o)(1) for LGERS, require the Boards to adopt “any necessary contribution-based benefit cap factors” as part of considering the experience study.

- G.S. 135-5(a3) for TSERS, and G.S. 128-27(a3) for LGERS, require the Boards to adopt a cap factor “recommended by the actuary, based upon actual experience,” so that the CBBC provisions are not expected to affect more than 0.75% of retirement allowances.
- The experience study occurs at least once every five years. The last one occurred in 2020. The new experience study report is being provided to the Boards for their October 30 meeting.

Why is Gallagher recommending a significant increase in the cap factors?

In their experience study, Gallagher has found that an adjustment to the cap factors is necessary, because average salary increases for both TSERS and LGERS members during the past five years have been significantly greater than indicated by previous assumptions. This means a larger-than-expected percentage of future retirees would be poised to be affected by CBBC provisions if the cap factor were not increased. Without action, the anticipated percentage could exceed the 0.75% threshold set by law.

Why is staff recommending the Boards adopt this change before the rest of the experience study?

The Boards have always established cap factor effective dates to correspond with calendar years, and this is also how the Retirement Systems’ administrative systems have been designed. There are two reasons staff recommends the Boards adopt the cap factor changes at their October 30 meeting.

- Adopting cap factors in January 2026, with the rest of the experience study, but trying to make the cap factors retroactively applicable to retirements effective January 1, 2026, would cause administrative disruption. Adopting such factors in October 2025 minimizes the disruption.
- The Boards could choose to adopt the factors in January 2026, with the rest of the experience study, and have the factors not take effect until January 1, 2027. However, then, the current cap factors would have to be used all through 2026, after Gallagher will have already recommended the use of cap factors that would have had a more beneficial effect on retirees and employers. In other words, it could create a perception of the Retirement Systems charging employers more than necessary, or reducing retirees’ benefits more than necessary, during 2026.

How did Gallagher arrive at their recommendation?

As in the 2015 and 2020 reviews, the actuary has identified the **midpoint** of a range of reasonable cap factors, for each of TSERS and LGERS.

- The lower end of the range is the lowest cap factor (to one decimal place) for which CBBC provisions would be expected to apply to no more than 0.75% of retirements.
- The upper end of the range is the highest cap factor (to one decimal place) for which CBBC provisions would be expected to apply to at least 0.10% of retirements. The 0.10% figure is not in statute, but has been used by the Boards in prior processes to make sure the Boards are giving effect to the legislature’s intent in enacting the CBBC provisions.
- The midpoint is the average of the lower and upper ends of the range. It is possible the average will not be a round number (to one decimal place). In a previous process, the Boards resolved the “tiebreaker” by leaving the cap factor where it had already been in place, rather than moving it by 0.1. However, if both of the possible candidates (to one decimal place) would result in a change in the cap factor anyway, staff would suggest adopting the greater of the two candidates, which results in a lesser impact on affected employers and retirees.