October 11, 2023

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By Email to angelica.figueroa@unchealth.unc.edu

Dr. Philip G. Rogers
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East Carolina University
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RE: Comments on Sections 4.10.(a)-(dd) of 2023 Appropriations Act (S.L. 2023-134)

Dear Dr. Burks and Dr. Rogers:

This letter is to make you aware of three primary concerns of the Retirement Systems Division ("RSD") of the Department of State Treasurer ("DST") regarding Sections 4.10.(a)-(dd) of the recently enacted 2023 Appropriations Act (S.L. 2023-134, House Bill 259). These sections generally afford operational and personnel flexibility to UNC Health Care ("UNCHC") and the health care operations of East Carolina University ("ECU"). In addition to this letter about policy concerns, RSD expects to send a second letter to legislative staff with technical questions.

To summarize, RSD is deeply concerned that S.L. 2023-134 seems to provide for:

(1) Creation of an impermissible cash-or-deferred arrangement ("CODA") in the Teachers' and State Employees' Retirement System ("TSERS") with devastating tax implications for TSERS members, State employers, and North Carolina taxpayers.

(2) More than $1 billion in health care liabilities for UNCHC's and ECU's retirees potentially shifted to other State employers.

(3) Mergers or other structural changes that could make UNCHC a non-governmental entity under federal law pertaining to retirement plans, and therefore make UNCHC subject to a very large TSERS withdrawal liability.

In addition, we have two overarching questions:

- How do you intend to communicate these changes to your employees?
- What are your plans for addressing the various liabilities that may be created, including the retiree health care liability and the TSERS withdrawal liability?

Preliminary Observations

Before elaborating on the three primary concerns, we would like to share our preliminary observations that Sections 4.10.(a)-(dd) may cause significant problems for some of UNCHC's and ECU's current or prospective employees. Based on our understanding of the provisions, there could be many such problems, but here are a few examples:

- Any individuals that UNCHC or the identified areas of ECU may wish to hire on or after January 1, 2024, from State agencies, parts of UNC-Chapel Hill ("UNC-CH") or ECU not encompassed by S.L. 2023-134, any other UNC constituent institutions, community colleges, or school systems, who had been earning benefits under TSERS, will be prevented from continuing to earn benefits under TSERS. Any of them who elect the "similar plan" that UNCHC or ECU may establish, or who are in the UNC Optional Retirement Program ("ORP") and were first hired on or after January 1, 2021, will also be prevented from having their future UNCHC or ECU employment recognized by TSERS for purposes of attaining eligibility conditions for retirement.

  For example, this would include employees that UNCHC or the identified areas of ECU may wish to hire from the Department of Health and Human Services ("DHHS"), the UNC System office, administrators (non-health care) from any UNC institution including UNC-CH or ECU, school nurses, school psychologists, or university or community college instructors, to name a few. To take a specific scenario, a DHHS employee who is 37 years old with 15 years of State service would seem to have a disincentive from going to work for UNCHC. If they could have remained under TSERS, they would have been eligible for a full retirement at age 52 calculated based on a full 30 years of service; but since their new job at UNCHC would force them out of TSERS, their full retirement benefit from TSERS will be a much lesser benefit, and may be delayed until age 65.

- Any full-time, permanent law enforcement officers ("LEOs") prospectively employed by UNCHC or the identified areas of ECU would be, to our knowledge, the only State-employed LEOs to be prevented from participating in TSERS and the ancillary benefits it provides to LEOs.

- It is unclear what disability or death benefits would be payable to employees under the "similar plan" that may be offered by UNCHC or ECU. It would seem to depend on the UNCHC Board of Directors and the Chancellor of ECU adopting benefit plans in those areas. Those employees will not be eligible to participate in the Disability Income Plan of North Carolina ("DIPNC") or certain death benefit plans that require being in a position eligible for membership in TSERS.

Related to our first overarching question above, if RSD receives employee complaints about these or similar consequences, RSD will only be able to direct them to UNCHC or ECU as appropriate (unless, of course, such questions relate to a decision or action by RSD).

Concern #1: Employee Choice Between Retirement Plans

Under the law prior to S.L. 2023-134, eligible full-time, permanent employees of UNCHC and ECU may choose as part of their hiring process to participate in the ORP under G.S. 135-5.1, a defined contribution retirement plan administered by the UNC System. If they do not choose the ORP, they must participate in TSERS. TSERS is a defined benefit retirement plan administered by RSD that covers all eligible employees of public school units, UNC institutions, community colleges, and State agencies. Whether a UNCHC or ECU employee is under TSERS or the ORP, they must contribute 6% of their compensation, as defined in G.S. 135-1(7a), to their retirement plan. As we will describe, the equal employee contribution is a key aspect of the arrangement.

S.L. 2023-134 provides that employees hired by UNCHC or the identified areas of ECU on or after January 1, 2024, may not participate in TSERS. Instead, UNCHC or ECU will offer those employees "any of the following": (1) participation in the ORP; (2) participation in a "similar plan" to the ORP; or (3) a choice of the ORP or the "similar plan." The legislation does not specify terms of the "similar plan." The legislation appears to provide that employees of UNCHC or identified areas of ECU immediately prior to January 1, 2024, who are participating in TSERS or the ORP, will be allowed to make a one-time irrevocable election to cease their participation in their plan and enroll in the "similar plan"; but they would not be allowed to change from TSERS to the ORP, or vice-versa.

RSD is required to administer TSERS as a "governmental plan within the meaning of Section 414(d) of the Internal Revenue Code" (G.S. 135-2). This means TSERS must adhere to all the federal requirements for tax-qualified defined benefit plans, generally located in Section 401(a) of the Internal Revenue Code and in Internal Revenue Service ("IRS") regulations. S.L. 2023-134 poses a specific problem with respect to one of the many IRS requirements for tax-qualified plans of public employers, namely, a prohibition on impermissible CODAs. Employees generally cannot be allowed to choose between retirement plans that require different amounts of employee contributions. There are certain exceptions known as "qualified CODAs," but RSD does not believe those exceptions come into play with either the current TSERS/ORP arrangement or the arrangement allowed by S.L. 2023-134.

In addition to RSD's obligation under G.S. 135-2 to follow IRS requirements, its tax qualification status is essential to TSERS and its stakeholders. Without tax-preferred treatment, there would be enormous consequences for TSERS members, State employers, and all taxpayers in North Carolina. The start of these consequences (but only the tip of the iceberg) would be that all teachers and State employees would be required to immediately pay income taxes on all the salary-based contributions they make into TSERS each year. If the many IRS requirements are not followed strictly, the State will not be able to stand behind any assurances of tax protection made in current or future legislation. For example, under the Constitution of North Carolina, Article I, Section 5, "no law or ordinance of the State in contravention or subversion of [the Constitution and government of the United

States] can have any binding force."

Consequently, RSD believes its duty under G.S. 135-2 to administer TSERS as a tax-qualified plan overrides any provisions of S.L. 2023-134 that would cause violations of the IRS' tax qualification rules.

Based on RSD's understanding of federal requirements, employees in TSERS cannot be allowed to choose to leave TSERS for a "similar plan," unless a plan document for the "similar plan" has been adopted before the choice is offered, requiring employee contributions equal to the amounts under TSERS.

Accordingly, unless such a plan document has been adopted before the choice is offered, RSD will not be able to recognize any choice of an employee enrolled in TSERS immediately prior to January 1, 2024, to cease participation in TSERS. UNCHC and ECU will be required to continue reporting such employees as members of TSERS, with the required employee and employer contributions.

Strictly speaking, RSD's administrative responsibility is to prevent impermissible CODAs for members of TSERS, not for members of the ORP. However, RSD retains an interest in the ORP also meeting tax qualification requirements, because there are various statutory provisions connecting the ORP with TSERS. Therefore, although RSD's primary concern is with any choice offered between TSERS and the "similar plan," RSD would also be concerned about any choice offered between the ORP and the "similar plan."

Concern #2: Shifting of Potential $1 Billion Plus Liability for Retiree Health Care

On April 24, 2023, Segal Consulting ("Segal"), the consulting actuary for the State Health Plan for Teachers and State Employees, issued an actuarial note studying the impact of the proposed Senate Bill 743, "Transformational Investments in NC Health." This study contemplated provisions similar to those ultimately enacted in S.L. 2023-134, but only for UNCHC, not ECU.

In their actuarial note discussing the effect on the State's promised health care benefits to retirees, Segal noted that UNCHC's share of Net Other Post-Employment Benefit Liability ("NOL") measured as of June 30, 2022, was in excess of $1 billion. If UNCHC were allowed to avoid making contributions to the Retiree Health Benefit Trust Fund because its employees are no longer in the category for which employers are required to make contributions, that liability potentially exceeding $1 billion would be transferred from UNCHC to other State employers. The analogous figure for the health care operations of ECU is more than $40 million.

DST believes it is appropriate to prevent the shifting of this liability to all other State employers, which would force their budgets to pay for the cost of health care for UNCHC's and ECU's retirees. To do so, DST believes employees who eventually choose the "similar plan" (assuming Concern #1, above, is somehow addressed) should be treated as if they

were in TSERS or the ORP for purposes of determining employer contributions to the Retiree Health Benefit Trust Fund. This would require UNCHC and ECU to report employees in the "similar plan" to RSD's administrative system (ORBIT) each payroll period and pay the retiree health share of the employer contribution rate on their behalf. Alternately, the legislature could create another arrangement whereby UNCHC and ECU would pay their share of NOL to the Retiree Health Benefit Trust Fund on an accelerated basis.

Concern #3: Consequences of Future Mergers or Other Restructuring

S.L. 2023-134 appears to expand the conditions under which mergers with nonprofit corporations, or sales or leases of hospital facilities, can occur. Regardless of this new latitude, an employer must be a governmental entity to be part of TSERS. This is a facts-and-circumstances evaluation of many criteria based on IRS guidance.

We particularly want to avoid any false assurance that may come from S.L. 2023-134 specifying that UNCHC or UNC Hospitals must be the surviving entity in any merger with a nonprofit corporation. When it comes to retirement plans, the IRS evaluation extends beyond the determination of which organization is the surviving entity.

If an employer ceases to be governmental based on IRS guidance, then it can no longer participate in TSERS. The employing entity would be required to go through the applicable procedure to cease participation in TSERS under G.S. 135-8(i), including paying a withdrawal liability calculated pursuant to G.S. 135-8(i)(5). The amount of withdrawal liability is dependent on a particular point in time, as well as many other details, and is therefore impossible to predict with specificity. However, as a rule of thumb from observing much smaller organizations, the withdrawal liability has typically been equal to multiple years' worth of employee payroll.

Conclusion

RSD is deeply concerned that the relevant provisions of S.L. 2023-134 could be interpreted to create an impermissible CODA with devastating tax consequences; expose other State employers to health care liabilities in excess of $1 billion for UNCHC's and ECU's own retirees; and lead to very large TSERS withdrawal liabilities for UNCHC should it engage in certain merger or restructuring activity.

If you would like to discuss any of these concerns, please contact me and I will arrange for the subject matter experts to be available based on the items you would like to discuss. We will also send you a copy of the more technical questions we plan to send to legislative staff regarding Sections 4.10.(a)-(dd) of S.L. 2023-134.

Thank you for your time and consideration.

Regards,

Thomas G. Causey
Executive Director
Retirement Systems Division

CC:

- The Hon. Tim Moore, Speaker of the North Carolina House of Representatives, by email to tim.moore@ncleg.gov
- The Hon. Phil Berger, President Pro Tempore of the North Carolina Senate, by email to phil.berger@ncleg.gov
- Greg J. Wessling, Chair, UNC Health Care Board of Directors, 101 Manning Drive, Chapel Hill, NC 27514
- Mark Muse, UNCHC Manager of Board Relations, by email to mark.muse@unchealth.unc.edu
- Scott Doak, UNCHC Chief Human Resources Officer, by email to samantha.kemper@unchealth.unc.edu
- Angela Montgomery, UNCHC System Benefits Manager, by email to angela.montgomery@unchealth.unc.edu
- Jason Poole, Chair, ECU Board of Trustees, 202 Spilman Building, Greenville, NC 27858
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