

NOTES TO THE FINANCIAL STATEMENTS

NOTE 14: OTHER POSTEMPLOYMENT BENEFITS

The State administers two postemployment benefit plans, the Retiree Health Benefit Fund and the Disability Income Plan, as pension and other employee benefit trust funds. Although the assets of the administered plans are commingled for investment purposes, each plan’s assets may be used only for payment of benefits to members of that plan and for administrative costs in accordance with the terms of the plan. The plans in this note do not issue separate financial statements. The financial statements and other required disclosures are presented in Note 16 and in the *Required Supplementary Information* section of this Comprehensive Annual Financial Report (CAFR).

A. Summary of Significant Accounting Policies and Plan Asset Matters

BASIS OF ACCOUNTING

The financial statements of these plans are prepared using the accrual basis of accounting. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits are recognized when due and payable in accordance with the terms of each plan.

INVESTMENTS / SECURITIES LENDING

Pursuant to North Carolina General Statutes, the State Treasurer is the custodian and administrator of the other postemployment benefits funds. The State Treasurer maintains various investment portfolios in its Investment Pool. Detailed descriptions of the methods and significant assumptions used to estimate the fair value of investments when fair value is based on other than quoted market prices are provided in Note 3. The investment balance of the Disability Income Plan and the Retiree Health Benefit Fund are invested in the State Treasurer external investment pool.

Additionally, the securities lending balance represents assets occurring from securities lending transactions that result from the funds’ participation in the pool. The investments of the State Treasurer and securities lending are fully discussed in Note 3.

B. Plan Descriptions and Contribution Information

1. HEALTH BENEFITS

Pursuant to North Carolina General Statutes, the State makes available the North Carolina State Health Plan for Teachers and State Employees, referred to as the State Health Plan (the Plan), a cost-sharing, multiple-employer, defined benefit healthcare plan, exclusively for the benefit of employees and former employees of the State, the University of North Carolina System, community colleges, and certain other component units. In addition, Local Education Agencies (LEAs), charter schools, and some select local governments that are not part of the financial reporting entity also participate. At June 30, 2015, the number of participating employers was as follows:

State of North Carolina.....	1
LEAs.....	116
Charter Schools.....	80
Community Colleges.....	58
University of North Carolina System.....	19
Other Component Units.....	5
Local governments.....	<u>18</u>
Total.....	<u>297</u>

The Plan is reported as a major component unit. It is administered by the State Treasurer, the Board of Trustees, and the Executive Administrator. Health benefit programs and premium rates are determined by the State Treasurer upon approval of the Board of Trustees. Plan benefits received by retired employees and disabled employees are other postemployment benefits (OPEB). The healthcare benefits for retired and disabled employees who are not eligible for Medicare are the same as for active employees as described in Note 15. The plan options change when former employees become eligible for Medicare. Medicare retirees have the option of selecting one of four fully-insured Medicare Advantage/Prescription Drug Plan (MA-PDP) options or the self-funded Traditional 70/30 Preferred Provider Organization (PPO) plan option that is also offered to non-Medicare members. If the Traditional 70/30 Plan is selected by a Medicare retiree, the self-funded State Health Plan coverage is secondary to Medicare.

NOTES TO THE FINANCIAL STATEMENTS

Those former employees who are eligible to receive medical benefits are long-term disability beneficiaries of the Disability Income Plan of North Carolina (DIPNC) and retirees of the Teachers' and State Employees' Retirement System (TSERS), the Consolidated Judicial Retirement System (CJRS), the Legislative Retirement System (LRS), the University Employees' Optional Retirement Program (ORP), and a small number of local governments, with five or more years of contributory membership service in their retirement system prior to disability or retirement, with the following exceptions: for employees first hired on or after October 1, 2006, and members of the General Assembly first taking office on or after February 1, 2007, future coverage as retired employees and retired members of the General Assembly is subject to the requirement that the future retiree have 20 or more years of retirement service credit in order to receive coverage on a noncontributory basis. Employees first hired on or after October 1, 2006 and members of the General Assembly first taking office on or after February 1, 2007 with 10 but less than 20 years of retirement service credit are eligible for coverage on a partially contributory basis. For such future retirees, the State will pay 50% of the State Health Plan's total noncontributory premium.

The Plan's benefit and contribution provisions are established by Chapter 135-7, Article 1, and Chapter 135, Article 3B of the General Statutes and may be amended only by the North Carolina General Assembly. The plan does not provide for automatic post-retirement benefit increases.

By General Statute, a Retiree Health Benefit Fund (the Fund) has been established as a fund in which accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and their applicable beneficiaries. By statute, the Fund is administered by the Board of Trustees of the Teachers' and State Employees' Retirement System and contributions to the Fund are irrevocable. Also by law, Fund assets are dedicated to providing benefits to retired and disabled employees and their applicable beneficiaries and are not subject to the claims of creditors of the employers making contributions to the Fund. However, Fund assets may be used for reasonable expenses to administer the Fund, including costs to conduct required actuarial valuations of state-supported retired employees' health benefits. Contribution rates to the Fund, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are determined by the General Assembly in the Appropriations Bill.

For the current fiscal year, the State and the other employers contributed the legislatively mandated 5.49% of active employee salaries. The Fund is reported as an employee benefit trust fund. The State's total payments are shown in the table on page 156. Actuarially required contributions and the percentage received from all employers can be found in the *Required Supplementary Information* section of this report.

2. *DISABILITY INCOME*

As discussed in Note 15, short-term and long-term disability benefits are provided through the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer defined benefit plan, to the eligible members of the Teachers' and State Employees' Retirement System which includes employees of the State, the University of North Carolina system, community colleges, certain participating proprietary component units and Local Education Agencies (LEAs) which are not part of the reporting entity, and the University Employees' Optional Retirement Program. Long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. An employee is eligible to receive long-term disability benefits provided the following requirements are met: (1) the employee has five or more years of contributing membership service in the Teachers' and State Employees' Retirement System (TSERS) or the University Employees' Optional Retirement Program, earned within 96 months prior to the end of the short-term disability period or cessation of salary continuation payments, whichever is later; (2) the employee must make application to receive long-term benefits within 180 days after the conclusion of the short-term disability period or after salary continuation payments cease or after monthly payments for Workers' Compensation cease (excluding monthly payments for permanent partial benefits), whichever is later; (3) the employee must be certified by the Medical Board to be mentally or physically disabled for the further performance of his/her usual occupation; (4) the disability must have been continuous, likely to be permanent, and incurred at the time of active employment; (5) the employee must not be eligible to receive an unreduced retirement benefit from the TSERS; and (6) the employee must terminate employment as a permanent, full-time employee. An employee is eligible to receive an unreduced retirement benefit from the TSERS after (1) reaching the age of 65 and completing five years of membership service, or (2) reaching the age of 60 and completing 25 years of creditable service, or (3) completing 30 years of creditable service, at any age.

For employees who had five or more years of membership service as of July 31, 2007, during the first 36 months of the long-term disability period, the monthly long-term disability benefit is equal to 65% of one-twelfth of an employee's annual base rate of compensation last payable to the participant or beneficiary prior to the beginning of the short-term disability period, plus the like percentage of one-twelfth of the annual longevity payment and local supplements to which the participant or beneficiary would be eligible. The monthly benefits are subject to a maximum of \$3,900 per month reduced by any primary Social Security disability benefits and by monthly payments for Workers' Compensation to which the participant or beneficiary may be entitled, but the benefits payable shall be no less than \$10 a month. After the first 36 months of the long-term disability, the long-term benefit is calculated in the same manner as described above except the monthly benefit is reduced by an amount equal to a monthly primary Social Security disability benefit to which the participant or beneficiary might be entitled had Social Security disability benefits been awarded. When an employee qualifies for an unreduced service retirement

NOTES TO THE FINANCIAL STATEMENTS

allowance from the TSERS, the benefits payable from DIPNC will cease, and the employee will commence retirement under the Teachers' and State Employees' Retirement System or the University Employees' Optional Retirement Program.

For employees who had less than five years of membership service as of July 31, 2007, and meet the requirements for long-term disability on or after August 1, 2007, during the first 36 months of the long-term disability period, the monthly long-term benefit shall be reduced by an amount equal to the monthly primary Social Security retirement benefit to which the employee might be entitled should the employee become age 62 during the first 36 months. This reduction becomes effective as of the first day of the month following the month of initial entitlement to Social Security benefits. After the first 36 months of the long-term disability, no further benefits are payable under the terms of this section unless the employee has been approved and is in receipt of primary Social Security disability benefits.

Although the DIPNC operates on a calendar year, disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the General Assembly and coincide with the state fiscal year. For the fiscal year ended June 30, 2015, the State and the other employers made a statutory contribution of 0.41% of covered payroll. This was equal to the actuarially required contribution. The State's total payments are shown in the table on page 156. Actuarially required contributions and the percentage received from all employers can be found in the *Required Supplementary Information* of this CAFR.

The contributions cannot be separated between the amounts that relate to other postemployment benefits and employment benefits for active employees. Those individuals who are receiving extended short-term disability benefit payments cannot be separated from the number of members currently eligible to receive disability benefits as an other postemployment benefit.

Benefit and contribution provisions are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly. By statute, the DIPNC is administered by the Department of State Treasurer and the Board of Trustees of the Teachers' and State Employees' Retirement System. The plan does not provide for automatic post-retirement benefit increases.

The following table presents the three year trend of the contractually required contributions for the Retiree Health Benefit Plan and the annual required contributions (ARC) for the Disability Income Plan for the State and its component units made to the plans. For the Retiree Health Benefit Plan, the contractually required contribution is determined by the General Assembly and does not reflect the actuary-based ARC. For the Disability Income Plan, the ARC equals the State's OPEB cost as an employer.

Required Contributions as an Employer
For the Years Ended June 30, 2013 through June 30, 2015
(dollars in thousands)

	Retiree Health Benefit	Disability Income
Primary Government:		
2015	\$ 182,167	\$ 13,604
2014	176,765	14,403
2013	175,722	14,588
Component units:		
Universities:		
2015	\$ 206,262	\$ 15,404
2014	197,870	16,123
2013	189,556	15,737
Community Colleges:		
2015	\$ 47,511	\$ 3,548
2014	46,083	3,755
2013	44,958	3,732
Other Component Units:		
2015	\$ 426	\$ 32
2014	415	34
2013	397	33
Percentage Contributed:		
2015	100%	100%
2014	100%	100%
2013	100%	100%

For 2015 and the two preceding years, the primary government and component units together contributed 100% of the required contributions for Retiree Health Benefit and Disability Income.

NOTES TO THE FINANCIAL STATEMENTS

The following table summarizes membership information by plan at the actuarial valuation date:

	<u>Retiree Health Benefit</u>	<u>Disability Income</u>
Retirees and beneficiaries currently receiving benefits	201,212	N/A
Disabled members receiving long term disability benefits	N/A	6,900
Terminated employees entitled to benefits but not yet receiving them	34,150	-
Active plan members	<u>346,964</u>	<u>323,579</u>
Total	<u>582,326</u>	<u>330,479</u>
 Date of valuation	 12/31/14	 12/31/14

The funding status of each plan as of the most recent actuarial valuation date is presented below (dollars in thousands):

	<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) (b)</u>	<u>Unfunded AAL (UAAL) (b-a)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c) (3)</u>	<u>UAAL as a Percentage of Covered Payroll ((b-a)/c)</u>
Retiree Health (1)	12/31/14	\$ 944,955	\$ 27,559,481	\$ 26,614,526	3.4%	\$ 15,642,890	170.1%
Disability Income (2)	12/31/14	\$ 450,599	\$ 503,060	\$ 52,461	89.6%	\$ 14,459,667	0.4%

(1) The AAL has been prepared using the projected unit credit cost method.

(2) The AAL has been prepared using the entry age actuarial cost method. The information presented is intended to approximate the funding progress of the plan as required by GASB Statements 43 and 45.

(3) Buck Consulting reported the unadjusted covered payroll for the DIPNC long-term disability benefits. The Segal Company reported the adjusted, annualized payroll for postemployment health benefits.

Multiyear trend information on funding progress is presented in the *Required Supplementary Information* (RSI) section of this CAFR. These schedules indicate whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

C. Actuarial Methods and Assumptions

Actuarial valuations of the plans involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The latest actuarial valuation for Retiree Health is dated December 31, 2014. The latest actuarial valuation for DIPNC is dated December 31, 2014. The schedules of funding progress, presented as required supplementary information following the notes to the financial statements, present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

The actuarial assumptions used for the Retiree Health Benefit are consistent with those used to value the pension benefits of the TSERS where appropriate. These assumptions are based on the most recent pension valuations available. The discount rate used for Retiree Health reflects a pay-as-you-go approach.

NOTES TO THE FINANCIAL STATEMENTS

Projections of benefits for financial reporting purposes of the plans are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. Historically, the benefits funded solely by employer contributions applied equally to all retirees. Currently, as described earlier in the note, benefits are dependent on membership requirements.

The actuarial methods and assumptions used for DIPNC include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

Below are listed the actuarial methods and significant assumptions for these valuations that will be used to determine future annual required contributions.

	<u>Retiree Health Benefit</u>	<u>Disability Income</u>
Valuation Date	12/31/14	12/31/14
Actuarial Cost Method	Projected Unit Credit	Aggregate
Amortization Method	Level percent of pay	Level percent
Remaining Amortization Period	30 years	(1)
Period Open/Closed	Open	(1)
Asset Valuation Method	Market Value of Assets	5 year smoothed with 80%/120% corridor
Actuarial Assumptions:		
Investment Rate of Return (2)	4.25%	5.75%
Healthcare Cost Trend Rate (2)	7% graded to 5% over 8 years	N/A
Projected Salary Increases (3)	Vary by group and years of service	4.3% - 9.1%

(1) The aggregate cost method does not identify or separately amortize unfunded liabilities, thus information about the plan's funded status and funding progress has been prepared using the entry age actuarial cost method. The information presented is intended to approximate the funding progress of the plan.

(2) For the Retiree Health Benefit, the investment rate of return includes an inflation and productivity rate of 3.5%. The healthcare cost trend rate includes only inflation of 3%. For the DIPNC, the investment rate of return includes an inflation rate of 3%.

(3) For the DIPNC, the projected salary increases include an inflation and productivity rate of 3.5%.

N/A Not Applicable