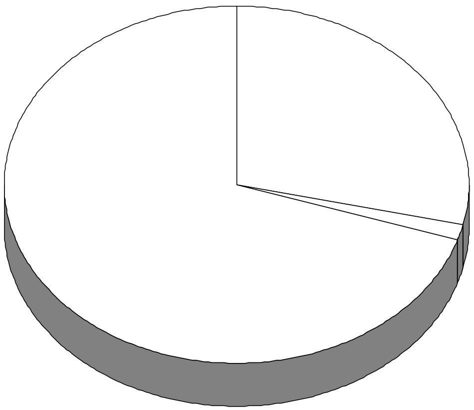
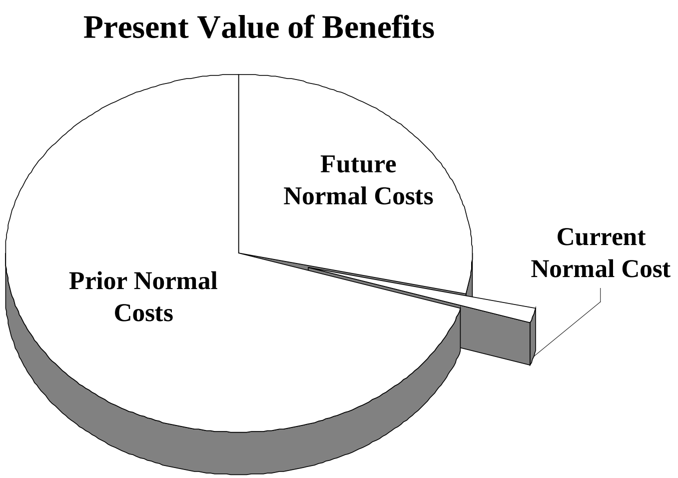
Pension 101

Definitions



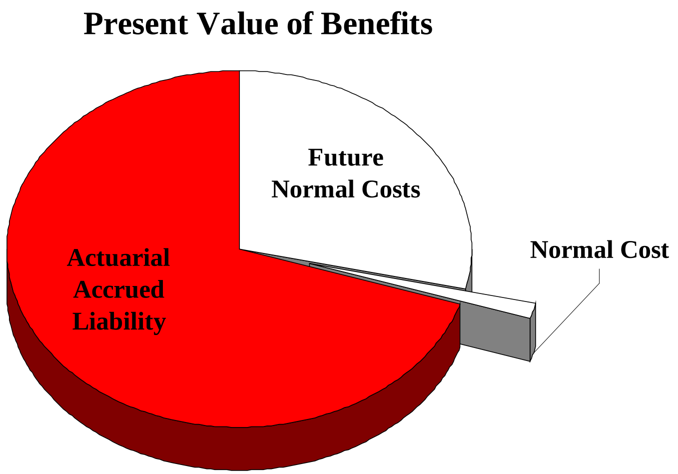
- **PVPB - Present Value of all Projected Benefits:**
  - Discounted value (at valuation date – e.g. 6/30/10), of all future expected benefit payments based on various (actuarial) assumptions
  - Portion of benefits not paid by investment earnings

Definitions



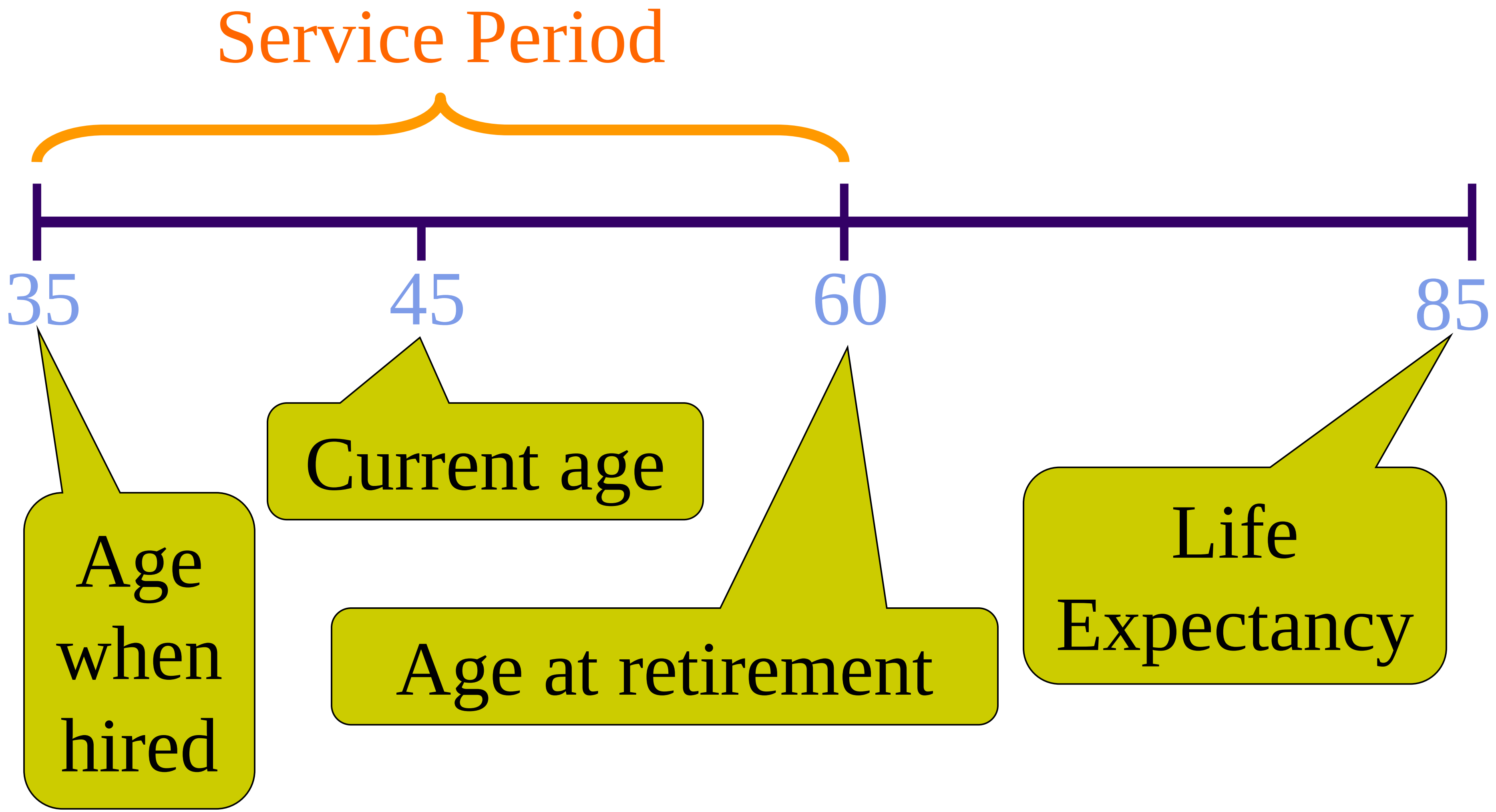
- **PVPB Allocated to each year of service**
  - Allocation based on Actuarial Cost Method
- **Current Normal Cost (NC):**
  - Portion of PVB allocated to (or "earned" during) current year
  - Value of employee and employer current service benefit

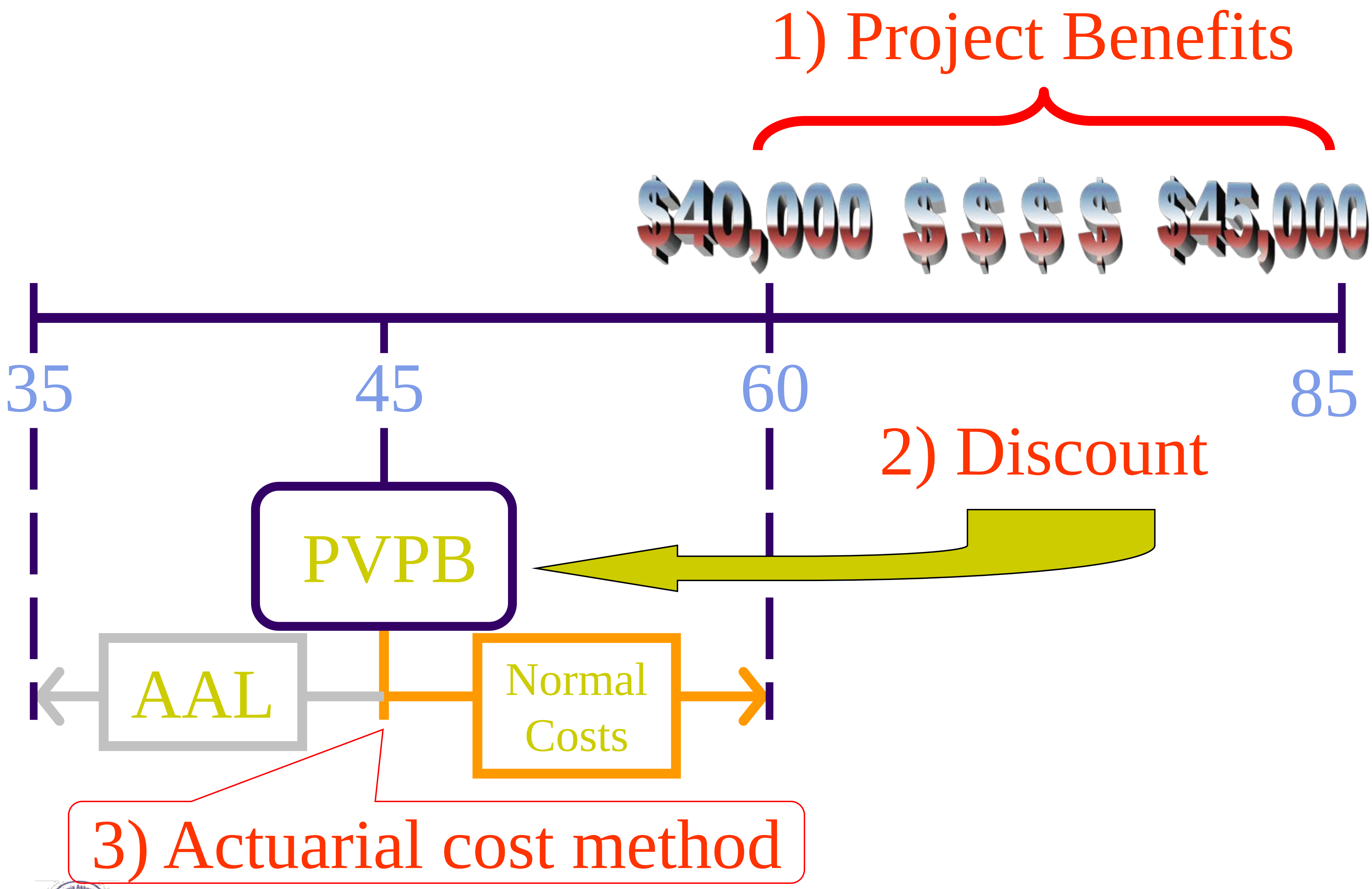
Definitions



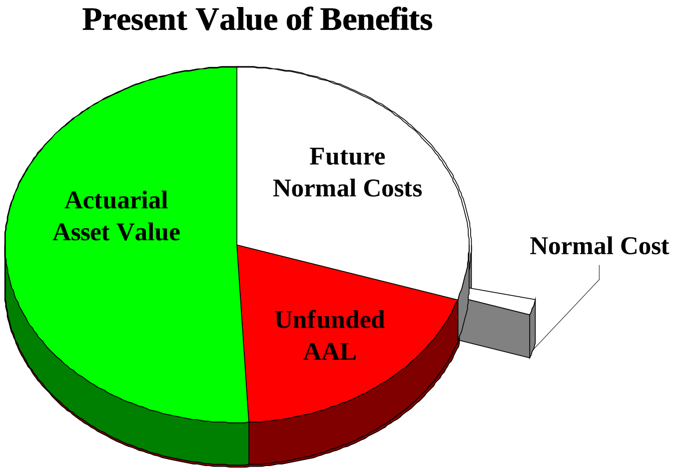
- **Actuarial Accrued Liability (AAL):**
  - PVPB – Present Value of Current and Future Normal Costs
  - Accumulated Normal Costs from Entry Age to Current Age
  - Portion of PVB allocated or “earned” at measurement [value of past service benefit]

Employee Age Timeline




1) Project Benefits
$40,000 $ $ $ $ $45,000
35
45
60
85
2) Discount
PVPB
AAL
Normal Costs
3) Actuarial cost method

Definitions



- **PVPB - Present Value of all Projected Benefits:**
  - Discounted value (at valuation date – e.g. 6/30/10), of all future expected benefit payments based on various (actuarial) assumptions
  - Portion of benefits not paid by investment earnings

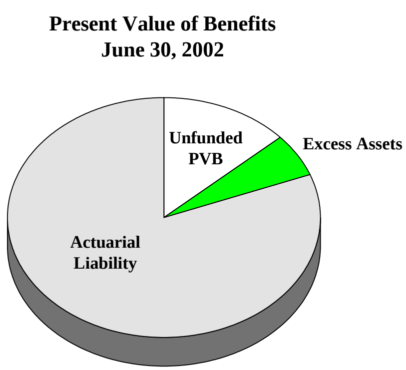
Definitions

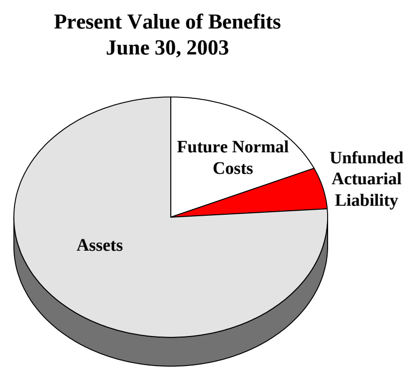
- **Target-** Have money in the bank to cover Actuarial Liability (past service)
- **Unfunded Liability**
  - Money short of target <u>at valuation date</u>
- **Excess Assets / Surplus:**
  - Money over and above target <u>at valuation date</u>
  - Doesn’t mean you’re done contributing

Definitions

- **Market Value of Assets –** Value of assets based on what they could be sold for on valuation date
- **Actuarial Value of Assets**
  - Smoothed market value
  - Mitigates market value volatility
- **Funded Ratio:**
  - Ratio of Assets to AAL
  - Look at on Market and Actuarial basis

Definitions





- Contribution =
  - Normal Cost
  - + Unfunded Liability Amortization

    or

  - - Excess Asset Amortization

Economic Assumptions

- **Inflation**
  - Used as a basis for individual salary increases & discount rate
- **Discount Rate –** Long term expected return on plan assets
  - Should vary based on investment mix
  - Two components
    - Inflation
    - Real rate of return above inflation
  - Example

Example	1	2
Inflation	3.00%	4.25%
Real rate of return	4.50%	3.25%
Discount rate	**7.50%**	**7.50%**

Demographic Assumptions

- Salary increases
- Mortality
- Termination
- Retirement

GASB 68

New Pension Standard

GASB 27
What Was It?

- Recognize Net Pension Obligation (NPO) if Plan Sponsor did not contribute Annual Required Contribution (ARC)
- Pension Expense based on ARC, determined NPO
  - NPO if Contribution < Pension Expense
- Used as contribution out of bounds marker:
  - 30 year amortization

GASB 68
What Is It?

- Changes GASB 27 – Employer accounting
- Exposure Draft issued June 2011
- Final Standards Approved June 25th 2012
- Accounting only, **NOT** Contributions

GASB 68
What Is It?

- Recognize Net Pension Liability (Asset) regardless of contributions
- Net Pension Liability drives Pension Expense
- Systems and plan sponsors will need to look elsewhere for contribution out of bounds markers
  - Actuaries?
  - GFOA?
  - Legislature?
  - Plan Sponsors?
  - Common sense?
  - Some combination!
- Additional note disclosures and RSI

GASB 68
Who Does It Apply To?

- Employers with DB &/or DC pension plans administered through trusts in which assets are:
  - Irrevocable
  - Dedicated and used only to provide pensions to plan members
  - Protected from creditors
- Includes agencies participating in CalPERS & other California retirement systems/plans

GASB 68
Effective Date

- Fiscal years beginning after June 15, 2014
  - Generally FYE 2015
- Earlier adoption encouraged

GASB 68
Three Categories of Plans

- Single Employer pension plan
  - Benefits only employees of one employer
- Agent multiple-employer pension plan
  - Assets pooled for investment purposes
  - Separate accounts maintained for each employer
  - Each employer's share of pooled assets is legally available only to pay pensions of its employees
  - CalPERS non-risk pooled agencies

Types of Plans (continued)

- Cost-sharing multiple-employer pension plan
  - Both assets and obligations to provide pensions are shared (pooled) by all employers
  - Plan assets can be used to pay employee pensions of any plan employer
  - CalPERS Risk Pools

Total Pension Liability

- Measure of benefits deemed earned to date ("past service")
- aka Actuarial Accrued Liability
- "Entry Age Normal" level percent of pay cost method
- Based on:
  - Benefit terms plus any legal agreements in force
  - Anticipated ad hoc COLAs and other changes to the extent considered substantively automatic
  - Reflect effects of significant changes between actuarial valuation date and measurement date

Assumptions

- Generally based on Actuarial Standards of Practice
- Discount rate – single equivalent rate based on:
  - Long term rate of return of plan investments
    - Net of investment but not administrative expenses
    - To the extent:
      - Projected plan assets expected to be available to pay benefits
      - Plan assets expected to be invested using long term strategy
  - 20-year high quality (AA/Aa or higher) tax exempt municipal bond rate:
    - benefit payments without (available projected) plan assets or
    - if plan assets not expected to be invested using long term strategy
    - Currently ≈4%

Total Pension Liability

- GASB 68 Measurement Date:
  - No adjustment to liability between Measurement Date and FYE (unless significant change)
  - Within 12 months of employer fiscal year end
  - OK to roll forward from a valuation date within 30 months of employer fiscal year end

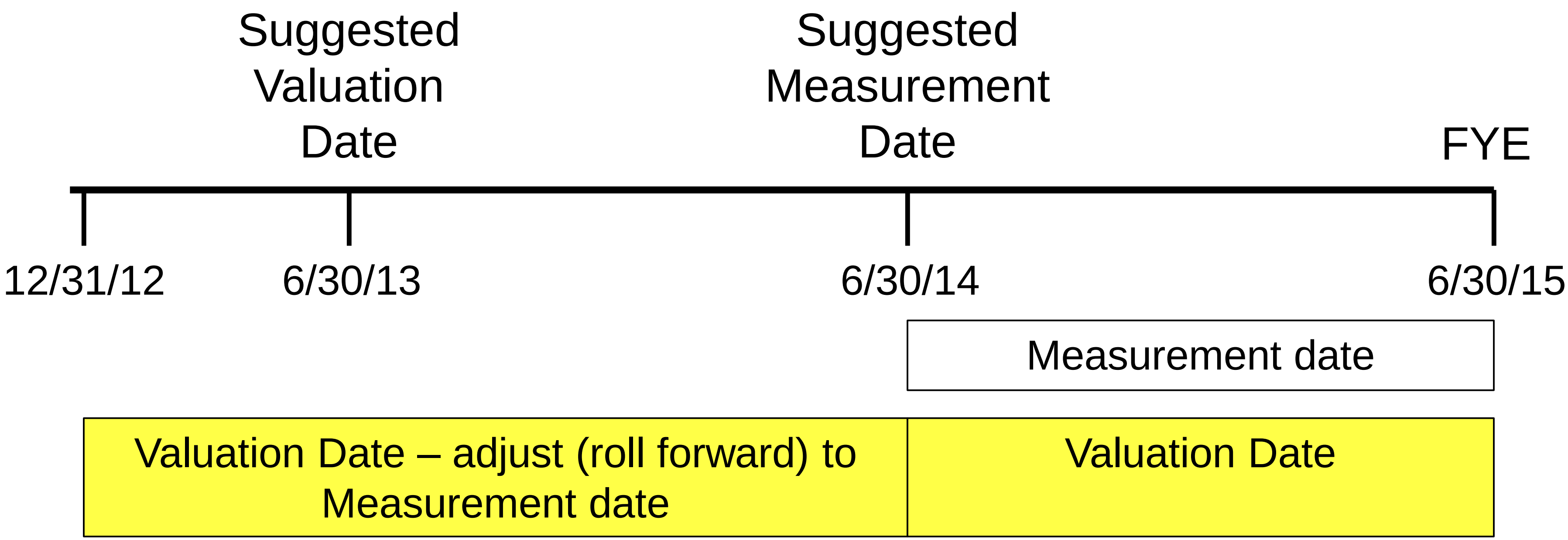
Total Pension Liability

- GASB 68 Measurement Date:
  - For example:

Employer Fiscal Year End	Earliest Measurement Date	Earliest Valuation Date
6/30/15	6/30/14	12/31/12
12/31/15	12/31/14	6/30/13

  - Preference is for Measurement Date = FYE
  - CalPERS will likely use Measurement Date = prior FYE

Total Pension Liability - Timing



Fiduciary Net Position - Assets

- At Measurement Date
- Dedicated to provide pension benefits
- Fair market value, no smoothing
- Adjust for contributions between Measurement Date and FYE
  - Contributions paid to Trust after FYE don’t count unless Legally Enforceable

Single and Agent Employers Recognize Net Pension Liability/Asset*

- In financial statement
- Equal to:
  - Total Pension Liability

    net of
  - Fiduciary Net Position

* Similar for Cost-Sharing Multiple Employer

CalPERS Upcoming Issues

Contribution Policy Changes

- Why Necessary
  - Current Method:
    - Generates volatility with extreme events
    - Slow funded status progress
    - Needs improved transparency
  - GASB 68 encourages faster funding by requiring a lower discount rate for slower funding

Contribution Policy Changes

- Direct rate smoothing based on:
  - 5-year ramp up
  - No asset smoothing
  - Future Gains/losses 25 year amortization period
    - With 5 year ramp up means paid over 30 years
  - Method & Assumption changes 15 year amortization period
    - With 5 year ramp up means paid over 20 years
  - No cap on rate increases each year

Assumption Changes

- No changes to economic assumptions
- Future mortality improvement with 20 years projection
- Earlier retirements for Police Safety and
- Higher future pay increases for Safety

Risk Pools

- Currently:
  - Risk Pool based on formula
  - Unfunded liability contribution
    - based on payroll
    - Made by applying percentage to actual payroll
  - Agencies with low ratio of retirees to actives subsidizing other agencies
  - Agencies with high ratio of retirees to actives being subsidized by other agencies

Recommended Risk Pool Changes

- All Risk Pools combined into two Risk Pools:
  - Miscellaneous
  - Safety
- Unfunded liability contribution
  - Based on liability
  - Dollar amount

Anticipated

New OPEB Standard

New OPEB Accounting Standard

- Similar to GASB 67 & 68
- Timing

Exposure Draft	April 2014
Comments	May-July 2014
Hearing	August 2014
Final	June 2015

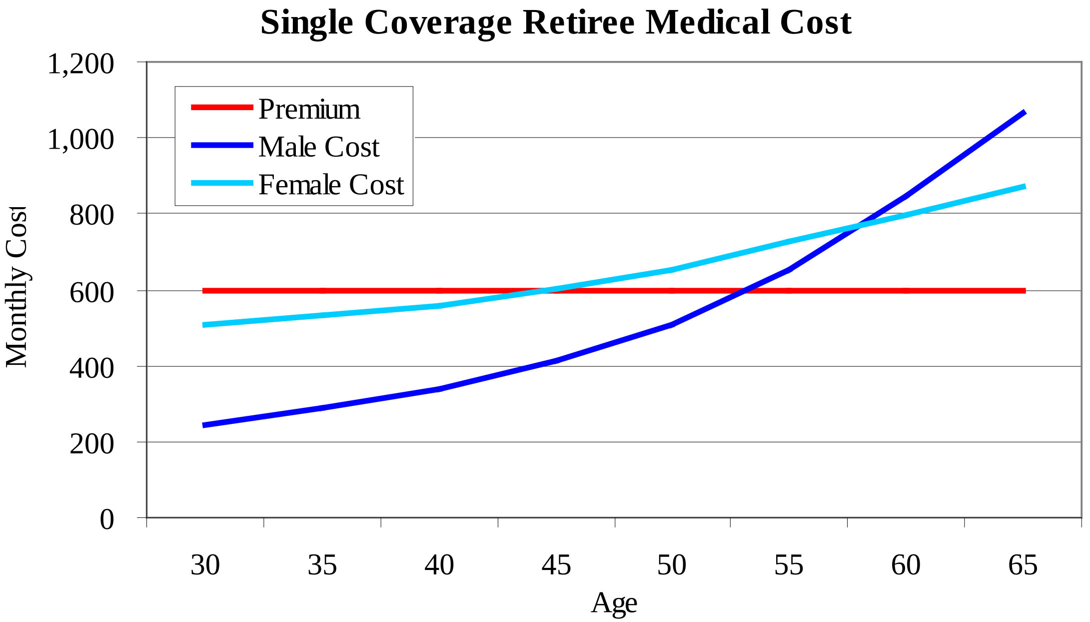
New OPEB Accounting Standard

Entity	Year Beginning After
Plans	December 15, 2015
Plan Sponsors with plans administered through Trusts	December 15, 2016
Plan Sponsors with plans **not** administered through Trusts	June 15, 2016

GASB 45
Implied Subsidy

GASB 45 – Implied Subsidy

- Employer cost for allowing retirees to participate at active premium rates



GASB 45 – Implied Subsidy

- GASB 45 defers to Actuarial Standards of Practice (ASOP) for implied subsidy
- Current ASOP says community-rated medical plans not required to value implied subsidy
  - PEMHCA is, for most participating agencies, considered a community-rated plan
- Comment period for 2nd Exposure Draft expired August 2013

GASB 45 – Implied Subsidy

- Exposure Draft would require
  - Implied subsidy be valued for all plans
  - Based on medical plan's (not agency's) demographics
    - Cross-employer subsidy would be ignored
    - Some agencies will have liability that will not be defeased
    - Others will have liability that will be over defeased
- Final ASOP expected early March
- Actuaries likely must comply with 6/30/15 vals

Appendices

- Bartel Associates www.Bartel-Associates.com:
  - GASB 68 Summary
  - PEPRA Summary
  - Other exciting stuff
- Anthony T. Oliveira, *The Local Challenges of Pension Reform*
  - http://www.tonytoliveira.com/Research.html

Pension 101, GASB 68 (Pension Accounting), and Other Fun Stuff

April 24, 2014

John E. Bartel

Bartel Associates, LLC

Agenda

- Pension 101 1
- GASB 68 Pension Standard 13
- CalPERS Upcoming Issues 28
- Anticipated New OPEB Standard 34
- GASB 45 Implied Subsidy 37