Pension Session

California Society of Municipal Analysts

Presenters:

David A. Vaudt, GASB Chair

Chuck Reed, Retirement Security Initiative

Moderator: Les Richmond, VP & Actuary, BAM

November 3, 2016

Agenda

- Today's public-sector pension funding landscape

- Current and Upcoming GASB Statements

- Pension Reform

Today's Public-Sector Pension Funding Landscape

- U.S. public pensions face historically large unfunded liabilities
  - Current underfunding has been driven by multiple intersecting trends, including:
    - Poor investment performance
    - Insufficient contributions
    - Demographic trends
    - Benefit enhancements
    - High expenses

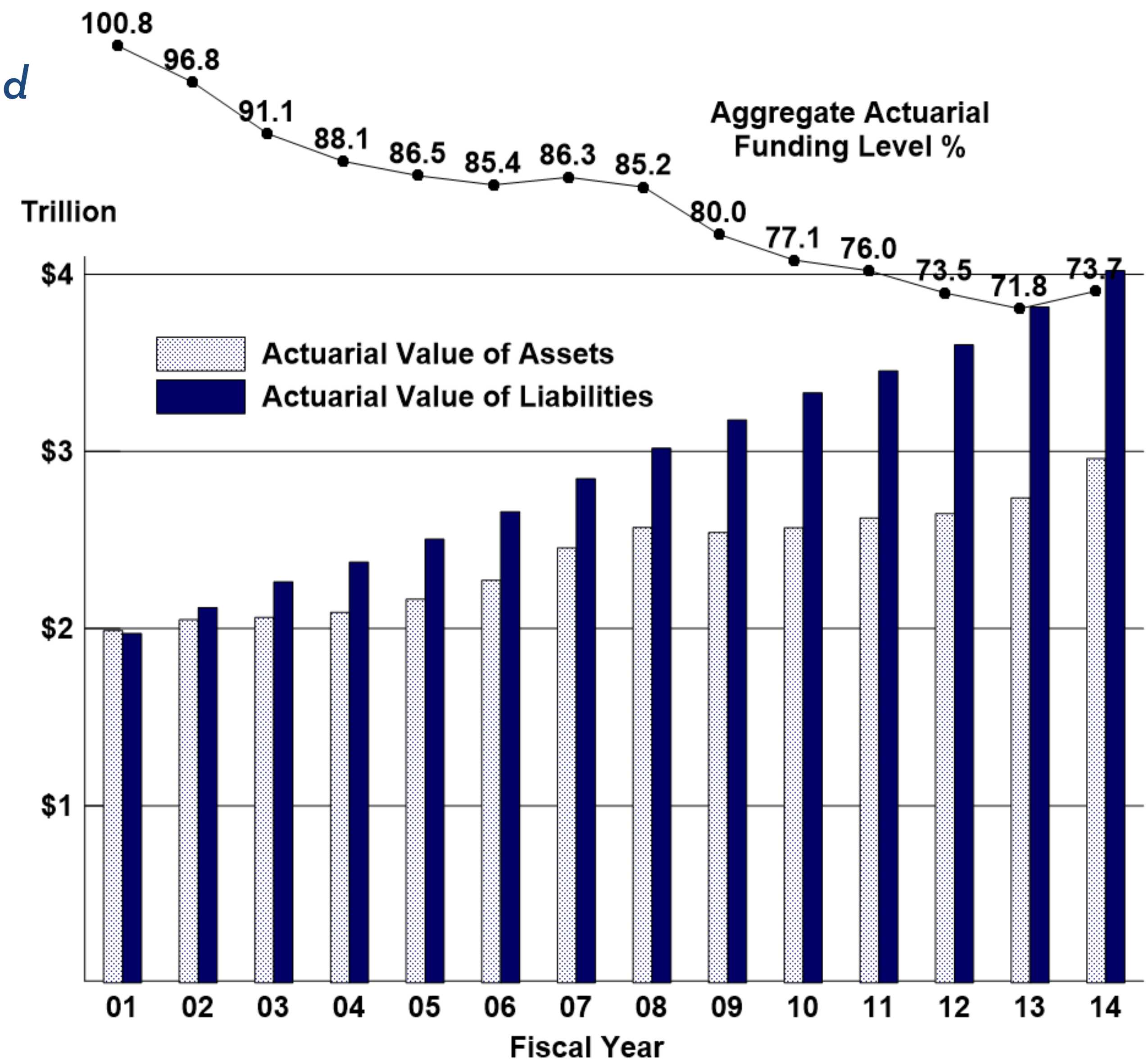
- Estimates for the total unfunded liability vary widely, from $1 trillion to more than $4 trillion, with updated views ranging up to $6 trillion
  - Wide range of outcomes is primarily due to the choice of investment return assumptions

- With unfunded liabilities historically large, actuarially determined contribution requirements far exceed those of the past and are causing unprecedented budget strains

Fiscal 2014: The Eye of the Storm

Funding Ratios Benefitted From Market Gains

California Pensions Follow Similar Pattern

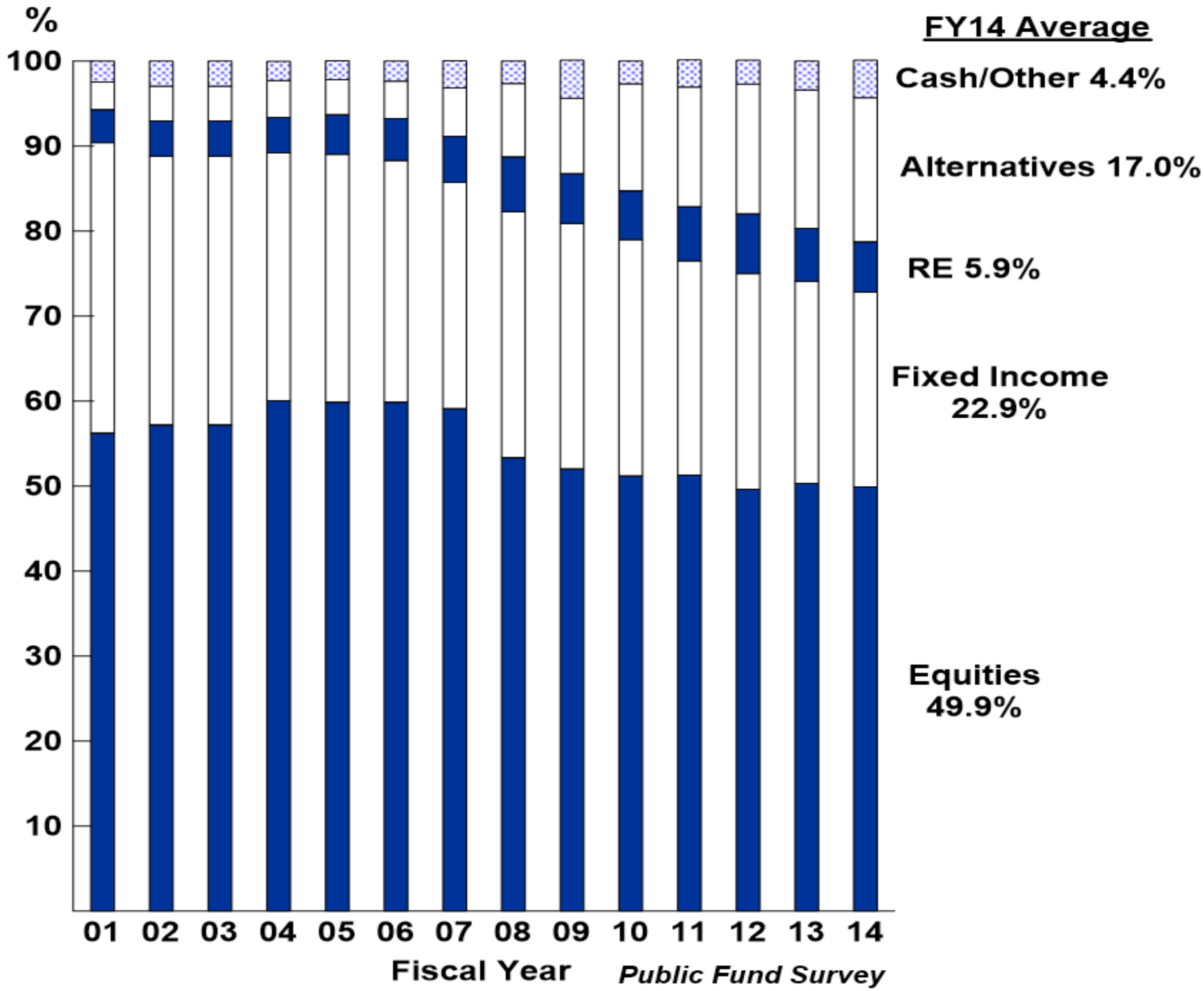


Source: Public Fund Survey March 2016

Today's Public-Sector Pension Funding Landscape

Asset allocations are shifting to boost returns, and in doing so are increasing risk

California state pension systems taking steps to reduce risk

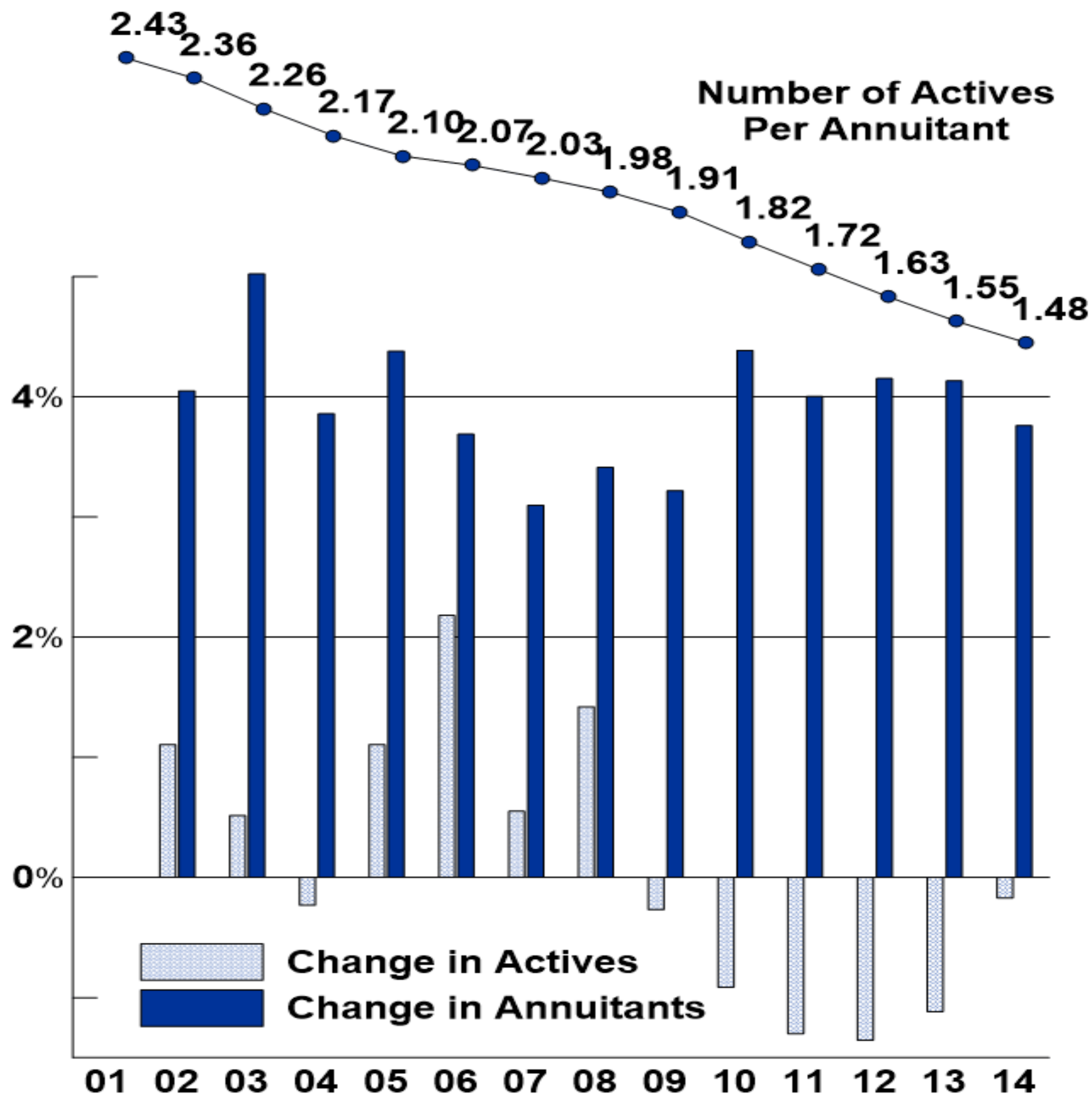


Public Fund Survey
March 2016

Today's Public-Sector Pension Funding Landscape

Plan demographics are becoming less favorable for change

California pension plan demographics follow similar pattern



Public Fund Survey
March 2016

Retirement Systems in California

- CalPERS
- CalSTRS
- University of California Retirement Plan (UCRP)
- 57 local retirement funds, including large cities like Los Angeles, San Francisco, and San Diego

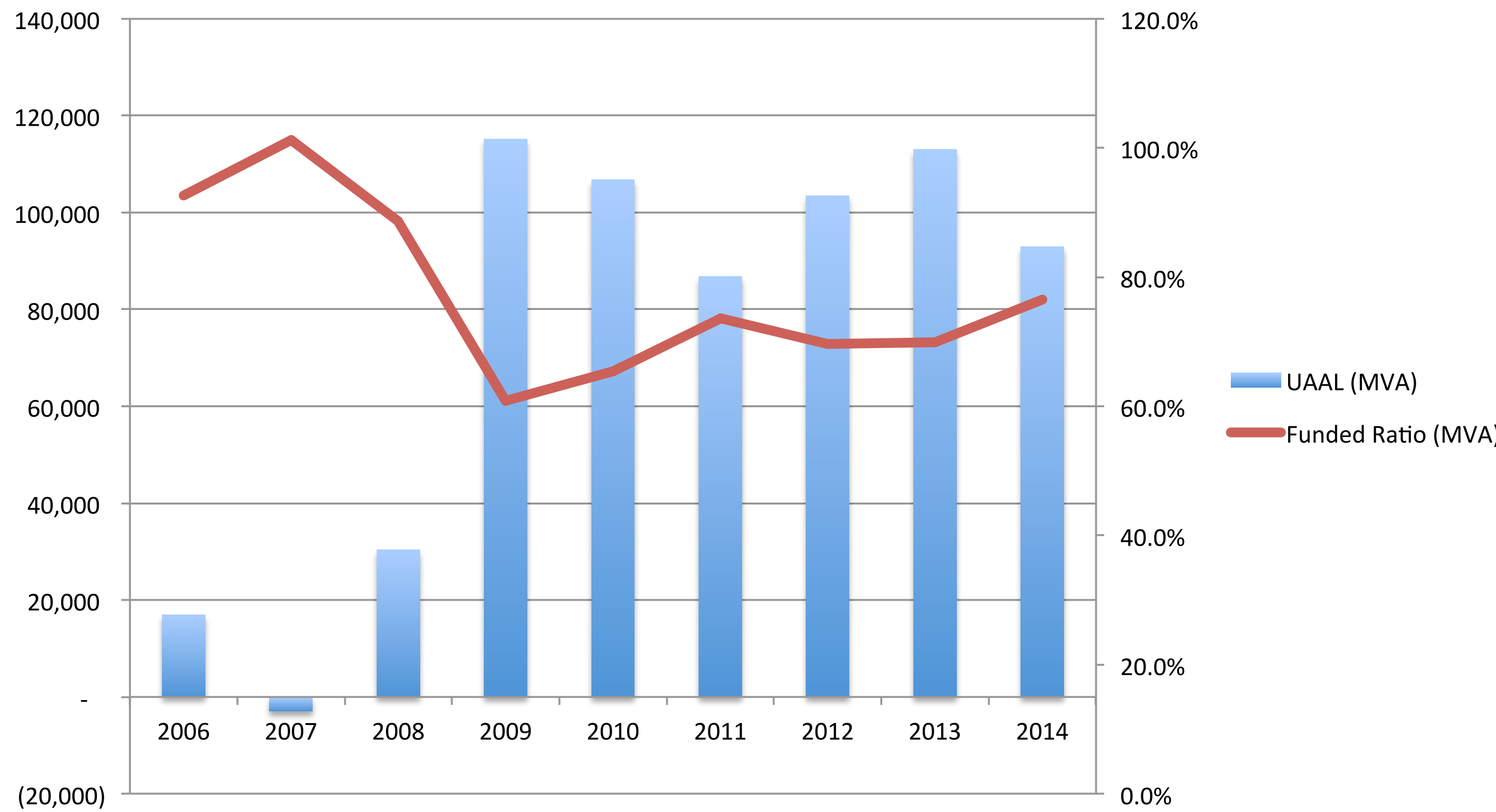
Nearly all the California credits we consider at BAM participate in CalPERS and/or CalSTRS, so the remainder of this discussion will focus on them

CalPERS: Funding

- Employers are required to fund 100% of the actuarially determined contribution
- Cost-sharing vs. agent multiple employer plans
- Local employer can terminate its contract with CalPERS by paying CalPERS difference between MVA and "termination liability." For example, Citrus Pest Control District No. 2 of Riverside County Miscellaneous at 6/30/13:
  - Plan funding liability @ 7.5%: $1.418 million
  - Market value of assets: $1.993 million
  - Hypothetical termination liability @ 3.72%: $2.191 million
  - Cost of termination: $0.198 million (note: at 6/30/12, when interest rate was 2.98%, the bill would have been $0.541 million)
  - 3.72% is yield on 30-year Treasury STRIPs at 6/30/13

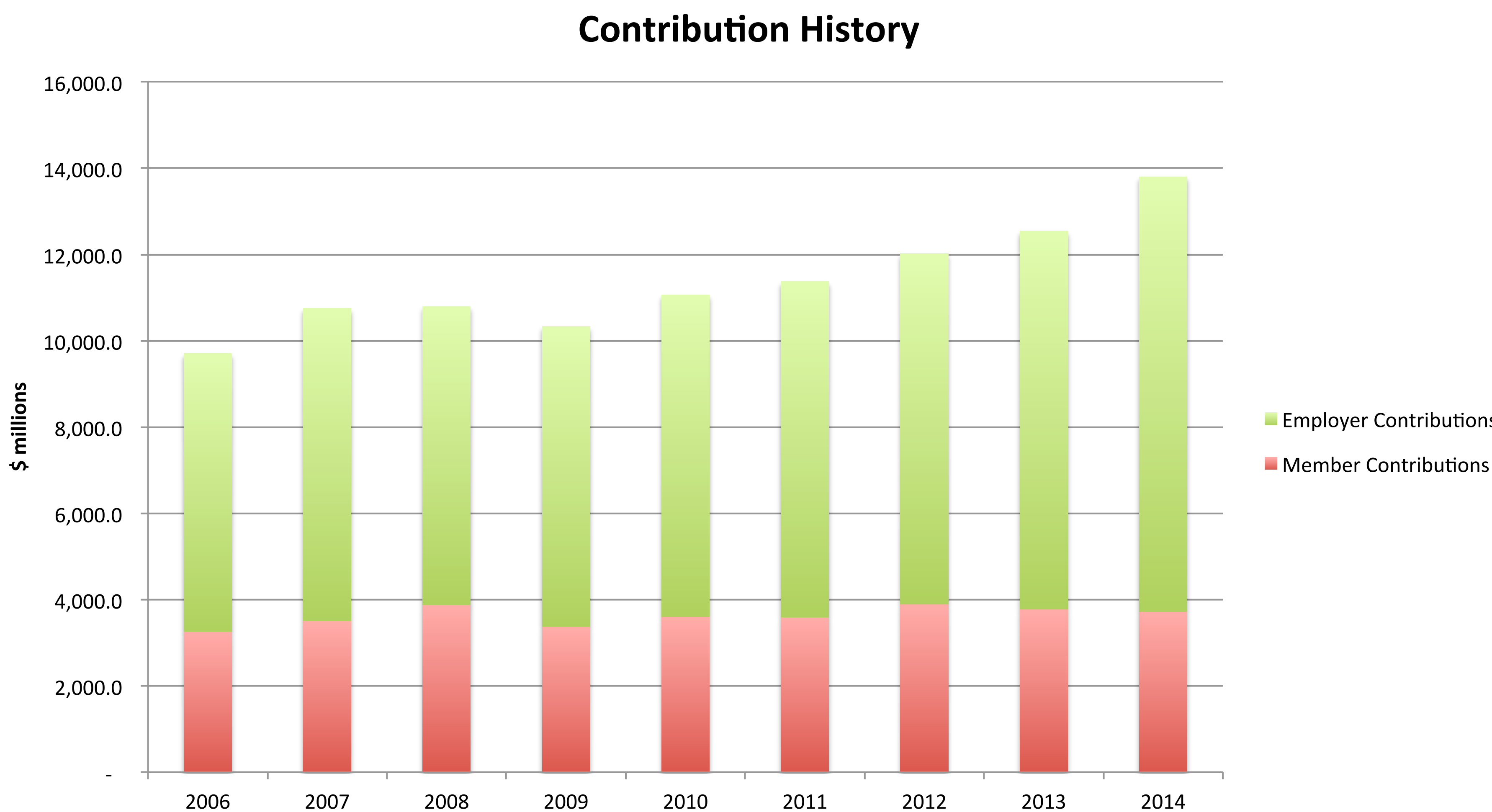
CalPERS: Funding

- PERF only (excludes legislators and judges): Recent unfunded actuarial accrued liabilities and funded ratios ($ millions)



CalPERS: Funding

- PERF only (excludes legislators and judges): Recent employer and member contribution history



CalPERS: A Whole Lot of Attitude…and Risk

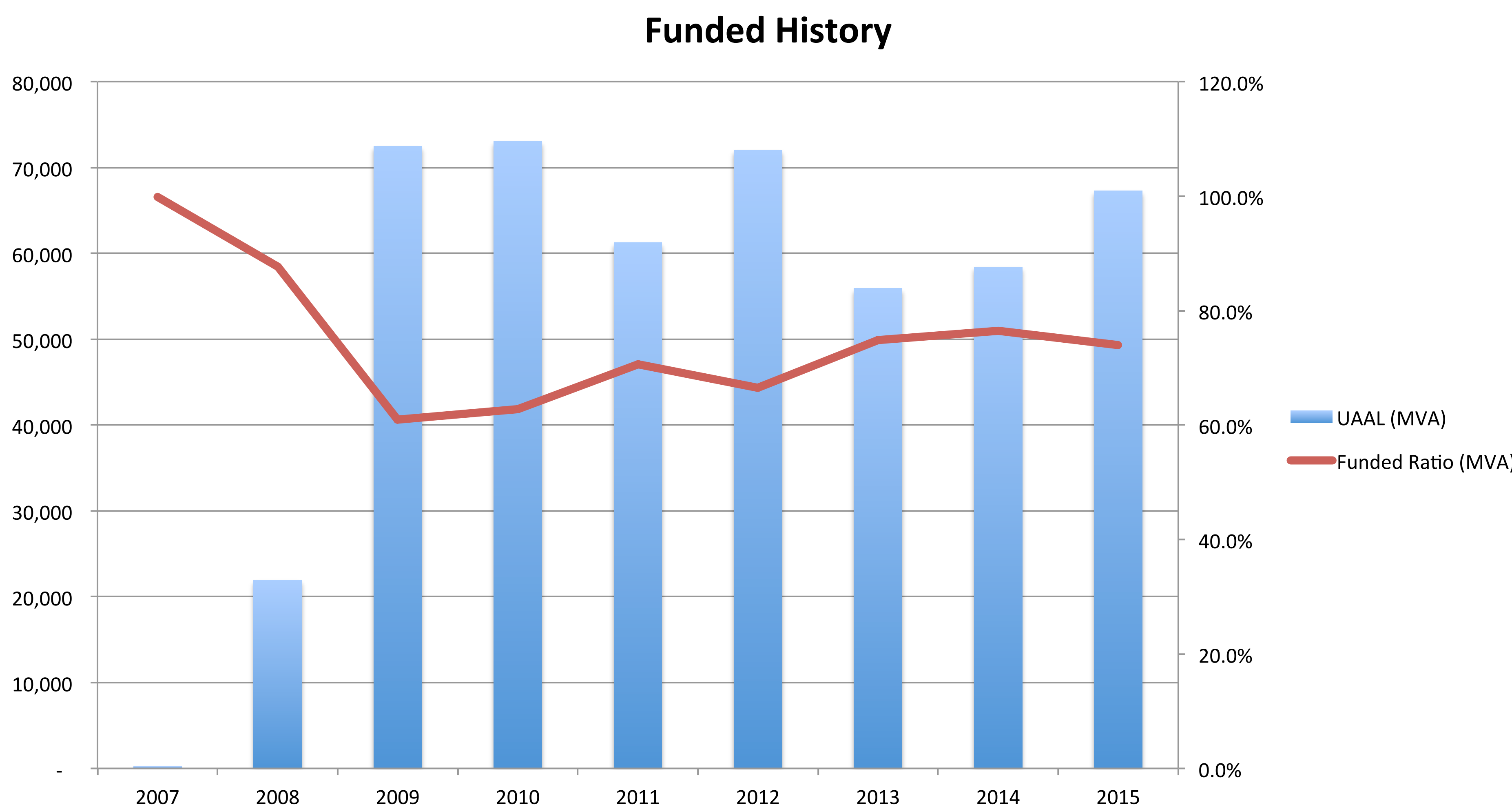
- CalPERS is a fiduciary charged with protecting the interests of its members and upholding the laws of the State of California
- In that capacity, it strenuously defends benefit levels for members, and contribution requirements
- Deep pockets to carry out its mission
- No sympathy for participating employers struggling to pay their bills
- Risk that pension bills may become too burdensome:
  - No flexibility around paying 100% of the ARC
  - Events, such as another financial downturn, could increase already high contributions
  - Fixed amortization periods, while preferable actuarially, may lead to sharply increasing contributions
  - More San Bernardinos?

CalSTRS: Funding

- Cost-sharing multiple employer plan
- Responsibility for contributing to CalSTRS is shared by the State, the employers and the members
- In FYE 6/30/13, contributions expressed as a percentage of employer payroll were State (about 5.2%), employer (8.25%) and members (8.0%)
- Contributions as a percentage of payroll are legislated and are not actuarially determined
- In its 6/30/13 CAFR, CalSTRS stated that if funding continued on its current path, the fund would be depleted in about 30 years
- AB 1469: beginning 7/1/14, gradually raises employer contributions to 19.1% of payroll in FY 2021, and State contribution rate rises to 8.828% by FY 2017,with limited authority for CalSTRS Board to raise rates further if necessary to keep funding plan on track to eliminate 7/1/14 unfunded liability by 2046

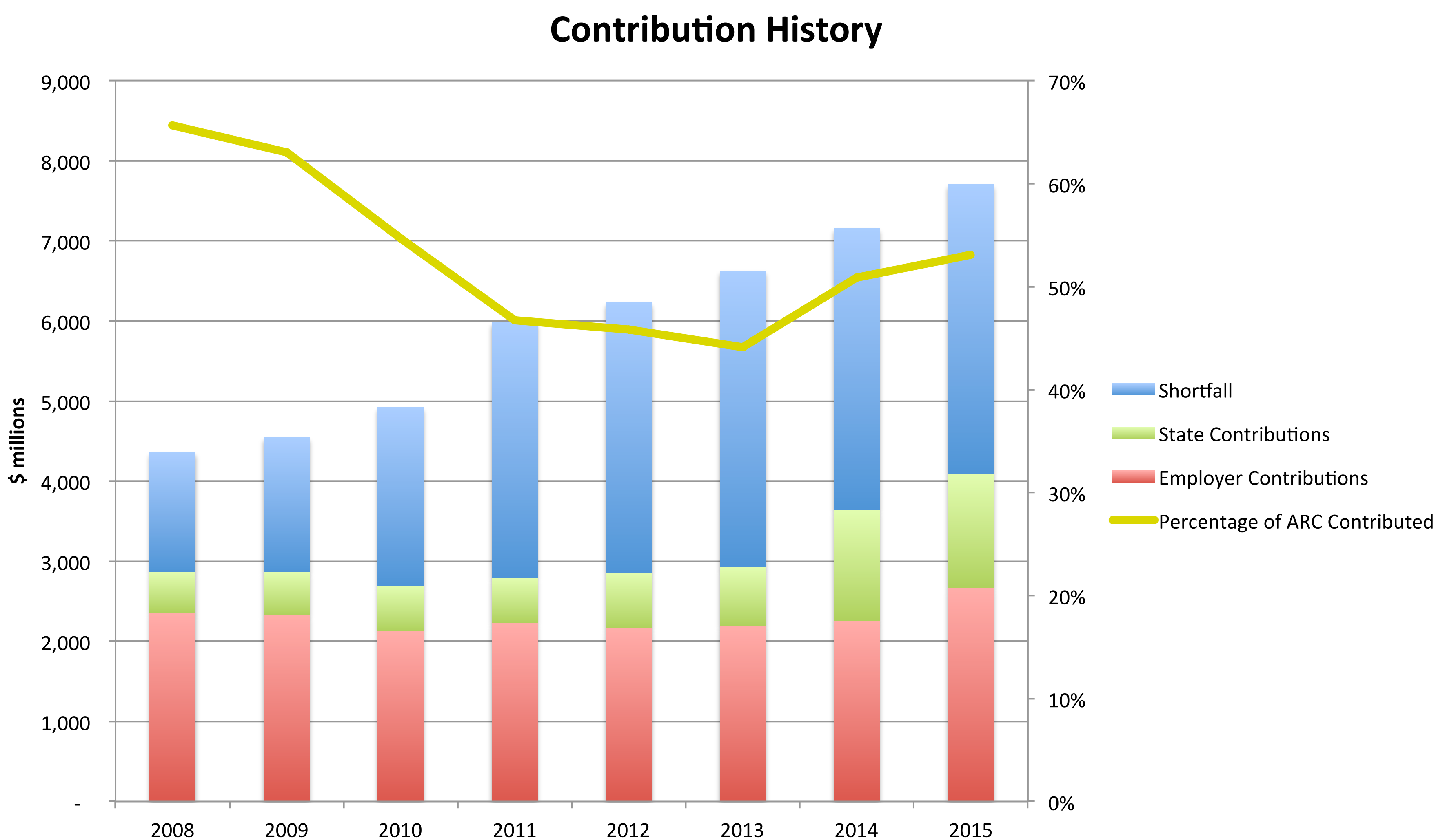
CalSTRS: Funding

- Recent unfunded actuarial accrued liabilities and funded ratios ($ millions)



CalSTRS: Funding

- Recent employer and State contribution history



CalSTRS: Risks

- Further revisions to funding schedule may be needed in light of subpar asset performance in FY 15 and 16
- Shift of contribution costs to districts
  - BAM analysis of California school districts assumes that the state continues at its current share of overall contributions
  - Based on this assumption, typical metrics based on BAM adjustments are typically manageable
  - Reducing state share could significantly increase pension metrics into the unacceptable range, though some might argue that state aid would increase as well

New GASB Pension Standards

- Statement 67: Financial Reporting for Pension Plans, effective for Plan fiscal years beginning after June 15, 2013
- Statement 68: Accounting and Reporting for (Employer) Pensions, effective for Employer fiscal years beginning after June 15, 2014
- Intended to enhance comparability and transparency of financial statements
  - New rules standardize many calculations and balance sheet treatment of pension plans
  - However, issuers will retain flexibility in setting investment return assumptions, so financial statements will still lack comparability
- Similar OPEB standards are on the way (Statements 74 and 75, effective for fiscal years beginning after 6/15/16 and 6/15/17, respectively)
- Impact on BAM pension analysis: increase to both accuracy and comparability

2016 Fall Conference
California Society of Municipal Analysts

GASB

Pension Panel

David A. Vaudt—GASB Chair

The views expressed in this presentation are those of Mr. Vaudt. Official positions of the GASB on accounting and financial reporting matters are determined only after extensive due process and deliberation.

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GASB Postemployment Benefit Standards

What: significantly revises postretirement accounting & financial reporting standards.

Why: review of effectiveness found significant room for improvement

When:

- Pensions—issued in 2012
  - Plans—fiscal years ending ***June 30, 2014*** & later
  - Employers—fiscal years ending ***June 30, 2015*** & later
- OPEB—issued in 2015
  - Plans—fiscal years ending ***June 30, 2017*** & later
  - Employers—fiscal years ending ***June 30, 2018*** & later

Fundamentals of the New Postemployment Benefit Standards

- Views the cost within the context of an ongoing, career-long employment relationship
- Uses an accounting-based versus funding-based approach to measure/report any net pension or OPEB liability on the statement of net position
- Means policy makers must work with their actuaries to determine the proper level of funding—accounting standards do not provide funding answers
- Allows an evaluation of the extent to which promises have been funded

Postemployment Benefit Standards - The Big Changes

- Portion of the total liability not covered by plan assets will be recognized as a liability on the face of the financial statements—the net pension or OPEB liability.
- Cost-sharing plans—participating employers/nonemployer contributing entities report proportional share of the collective net pension or OPEB liability
- Discounting at the long-term expected rate of return is <u>limited</u> to the extent that assets are expected to be available to cover future benefit payments—remainder discounted at the municipal bond rate
- Now only <u>one</u> actuarial valuation approach permitted (entry age, as a level percentage of payroll)

Postemployment Benefit Standards - The Big Changes

- Asset smoothing is eliminated from the measurement of the liability
- Amortization is eliminated for most changes in the liability and greatly shortened for others
- More robust note disclosures
- Much more extensive required supplementary information (RSI) schedules

Key Information in the Financial Statements

- Liabilities to the pension plan (payables)
- Liabilities to employees for pensions
  - Net pension liability (NPL) = total pension liability (TPL), net of pension plan's fiduciary net position
  - Cost-sharing employers recognize proportionate shares of collective NPL
- Changes in NPL
  - <u>Recognized as expense immediately</u>: service cost, interest on the TPL, changes in benefit terms, projected investment earnings
  - <u>Recognized as expense over time</u>: changes in assumptions, difference between assumed and actual demographic and economic factors, and difference between projected and actual investment earnings

Key Note Disclosures

- Discount rate information, including:
  - Long-term expected rate of return and how it was determined
  - Assumed asset allocation of the pension plan's portfolio and the long-term expected real rate of return for each major asset class
  - NPL measured at a discount rate 1 percentage point higher and 1 percentage point lower:

	1% Decrease (6.75%)	Discount Rate (7.75%)	1% Increase (8.75%)
County's net pension liability	$826,928	$751,753	$661,543

New RSI: NPL Components and Ratios

	20X9	20X8	20X7	20X6	20X5
Total pension liability	$ 3,182,228	$ 3,045,893	$ 2,888,832	$ 2,643,090	$ 2,443,871
Plan net position	(2,512,987)	(2,283,333)	(2,167,168)	(2,152,638)	(1,971,007)
Net pension liability	$ 669,241	$ 762,560	$ 721,664	$ 490,452	$ 472,864
Ratio of plan net position to total pension liability	78.97%	74.96%	75.02%	81.44%	80.65%
Covered-employee payroll	$ 435,373	$ 432,256	$ 426,939	$ 412,280	$ 387,055
Net pension liability as a percentage of covered-employee payroll	153.72%	176.41%	169.03%	118.96%	122.17%

Note: Only 5 years are presented here;
10 years of information will be required

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New RSI: Contributions

	20X9	20X8	20X7	20X6	20X5
Actuarially calculated employer contribution	$ 109,544	$ 107,028	$ 105,755	$ 103,089	$ 89,054
Actual employer contributions	(109,544)	(107,028)	(105,755)	(103,089)	(89,054)
Annual contribution deficiency (excess)	$ -	$ -	$ -	$ -	$ -
Covered-employee payroll	$ 435,373	$ 432,256	$ 426,939	$ 412,280	$ 387,055
Actual contributions as a percentage of covered-employee payroll	25.16%	24.76%	24.77%	25.00%	23.01%

Note: Only 5 years are presented here;
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Fundamentals of the New Postemployment Benefit Standards

- The actuarially required contribution (ARC) has not disappeared, it is the actuarially determined contribution (ADC)—it will continue to be the basis for determining *funding policy* for many governments
- It is no longer the basis for calculating expense for *accounting and financial reporting* purposes
- Be cautious regarding the ARC/ADC
- Consider the relevance of the ARC/ADC for a cost-sharing employer

GASB Resources for Analysts

- Variety of resources at www.gasb.org
- Technical inquiry hotline
- New edition of the User Guide for Analysts coming soon
- Specially tailored sessions designed specifically for municipal analysts led by the GASB Research Manager

Overview of Sessions for Analysts

- Basic pension terminology
- How a pension obligation is measured
- Examples of how the pension liability and other pension information are being reported

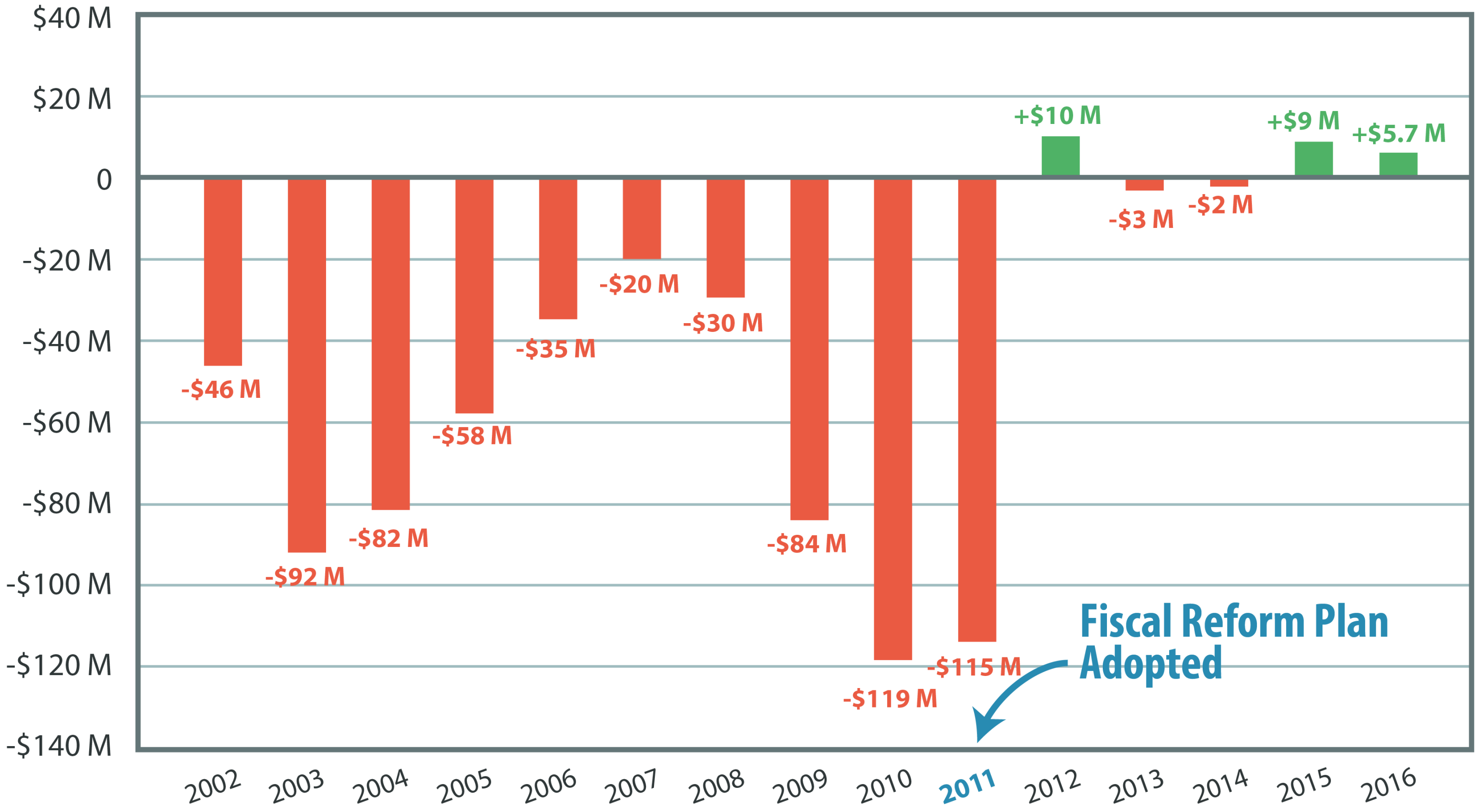
RETIREMENT SECURITY INITIATIVE

Bipartisan advocacy for fair and sustainable pensions

RSI Reform Principles

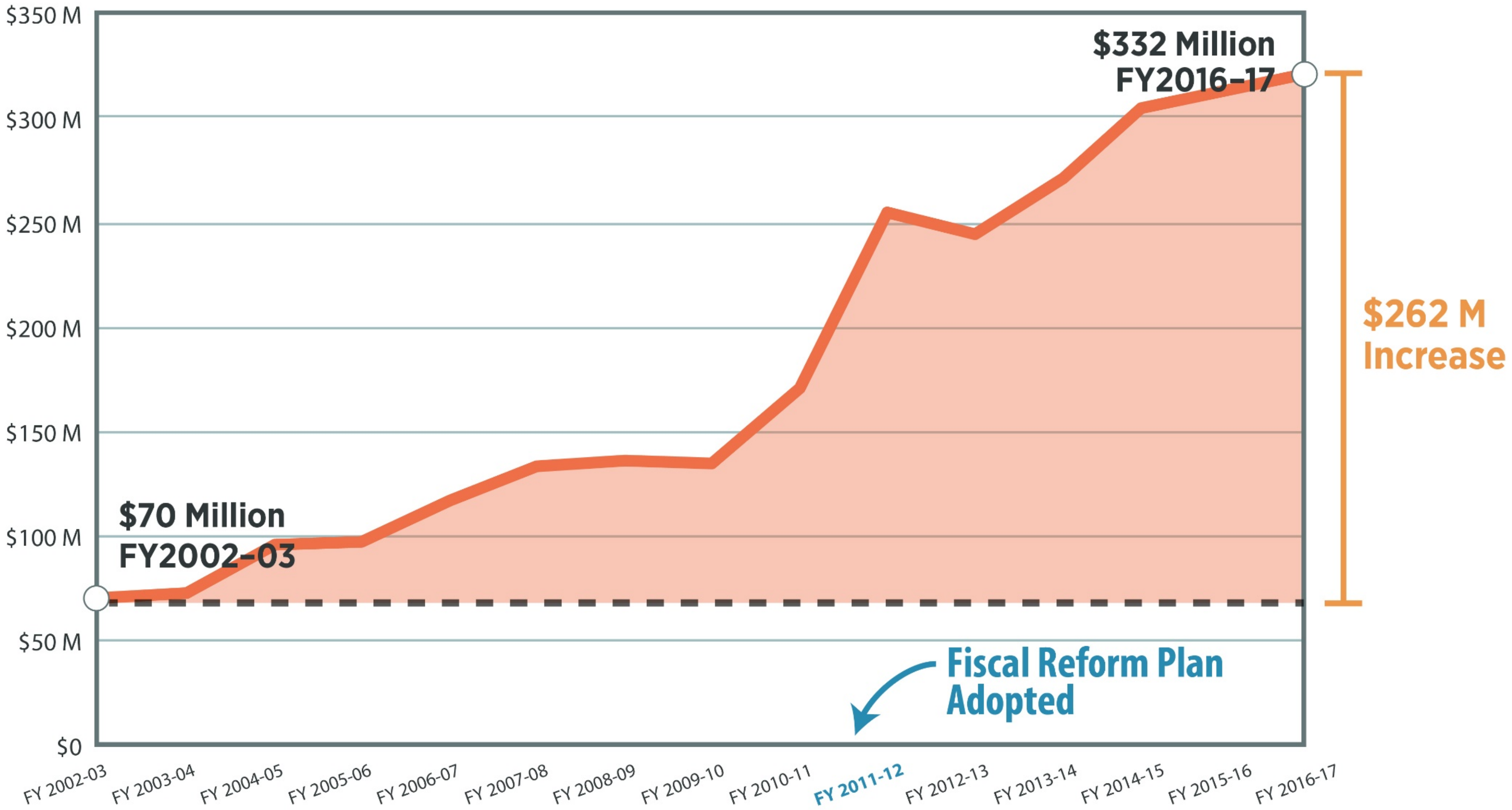
- Retirement should be safe and secure
- Benefits and costs should be fair, sustainable and predictable
- Benefits should be funded as they are earned; incentives to underfund commitments should be eliminated
- Unfunded liabilities should be paid down
- Management should be open, transparent and non-political
- No single solution will work everywhere

San Jose General Fund Deficits



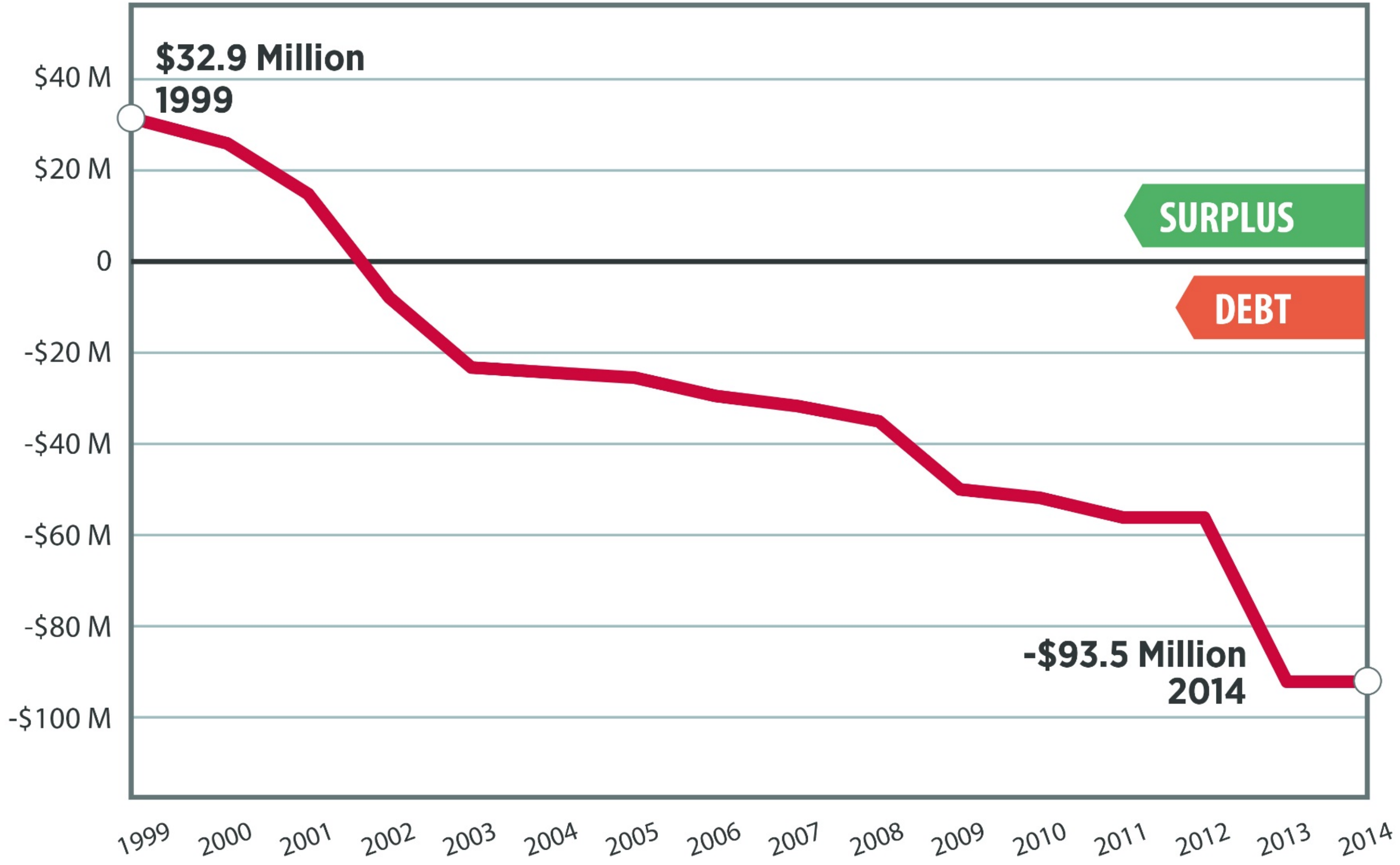
Sources: *"9/3/2013 Presentation—City Council Study Session: City Service Restoration and Revenue Measures," City Managers 2014–2015 Operating Budget, City Manager's 2015 and 2016 Budget Requests.*

The Crushing Burden of San Jose Retirement Costs



Notes: *In FY10–11 and FY11–12, some employee bargaining groups agreed to pick up part of the city's cost for the unfunded liability.*
Sources: *San Jose Retirement Systems 2002–2014 Comprehensive Annual Financial Reports and City Manager's 2015 and 2016 Budget Requests.*

CalPERS: 17 Years of Systemic Failure



Sources: *Comprehensive Annual Financial Reports*

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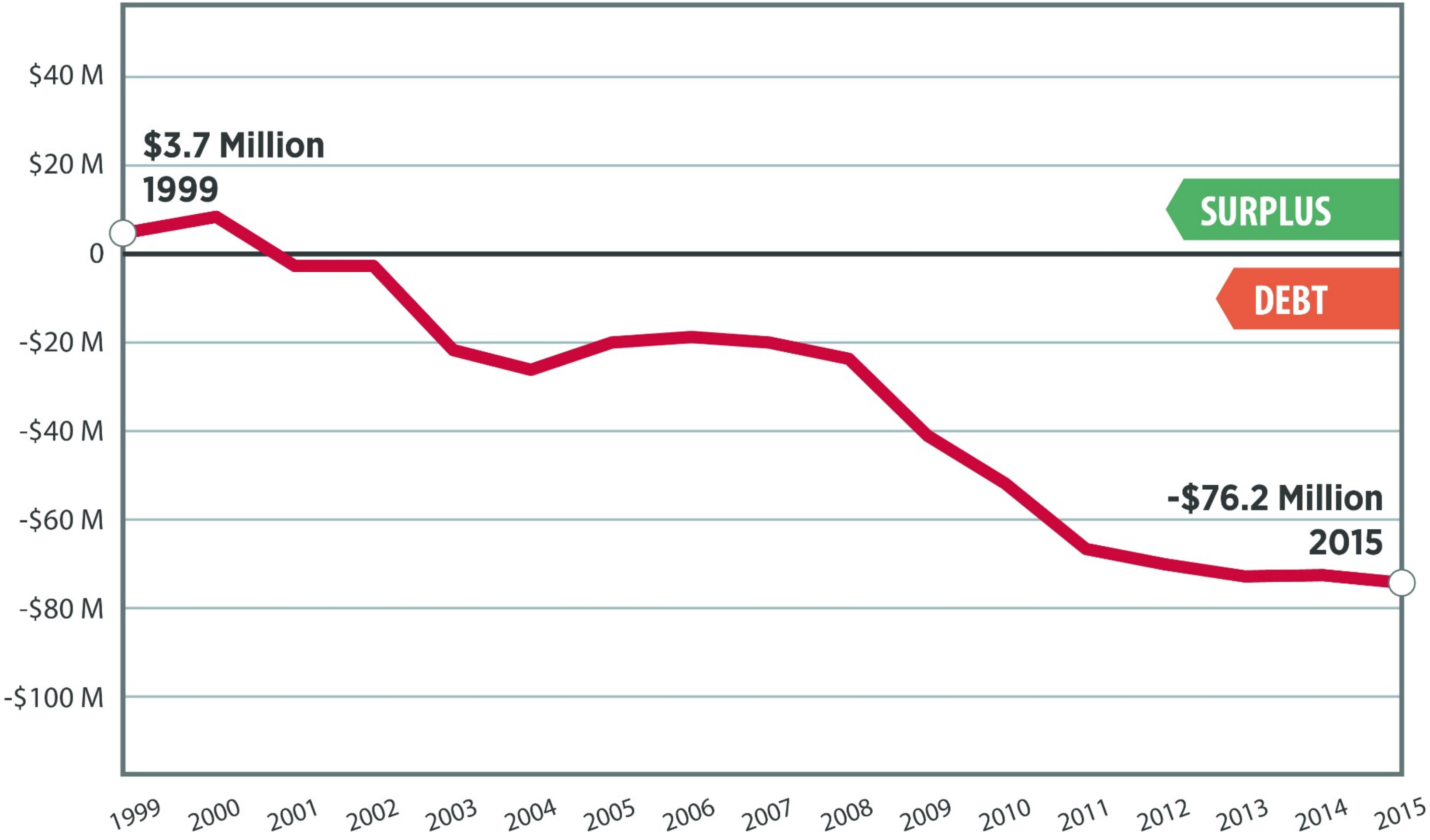

Sources: *2015 CAFR and multiple annual Actuarial Valuation Reports*

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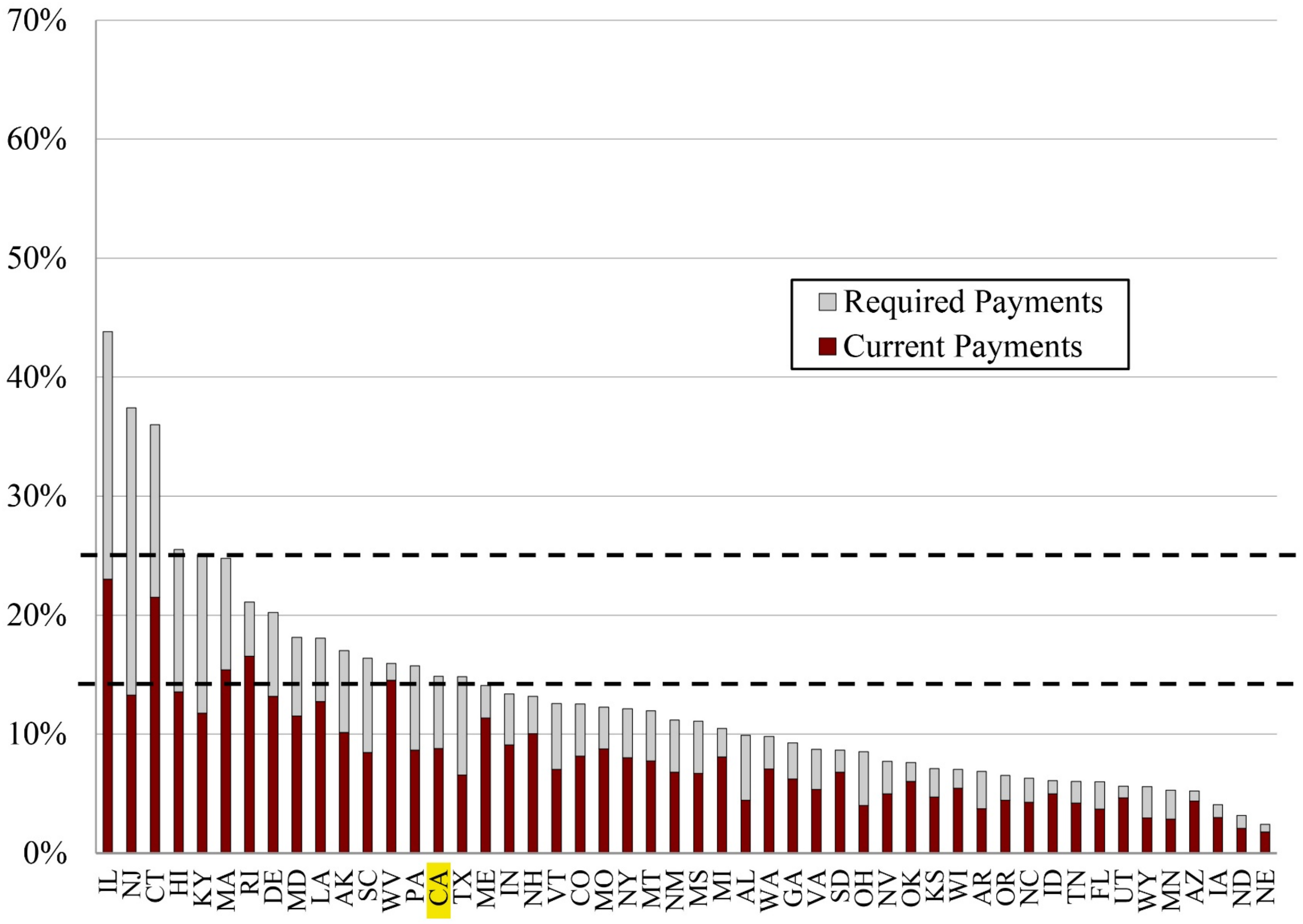
States: Current and Required Pension, OPEB and Interest Payments as a Percentage of Own-Source Revenue, 2014



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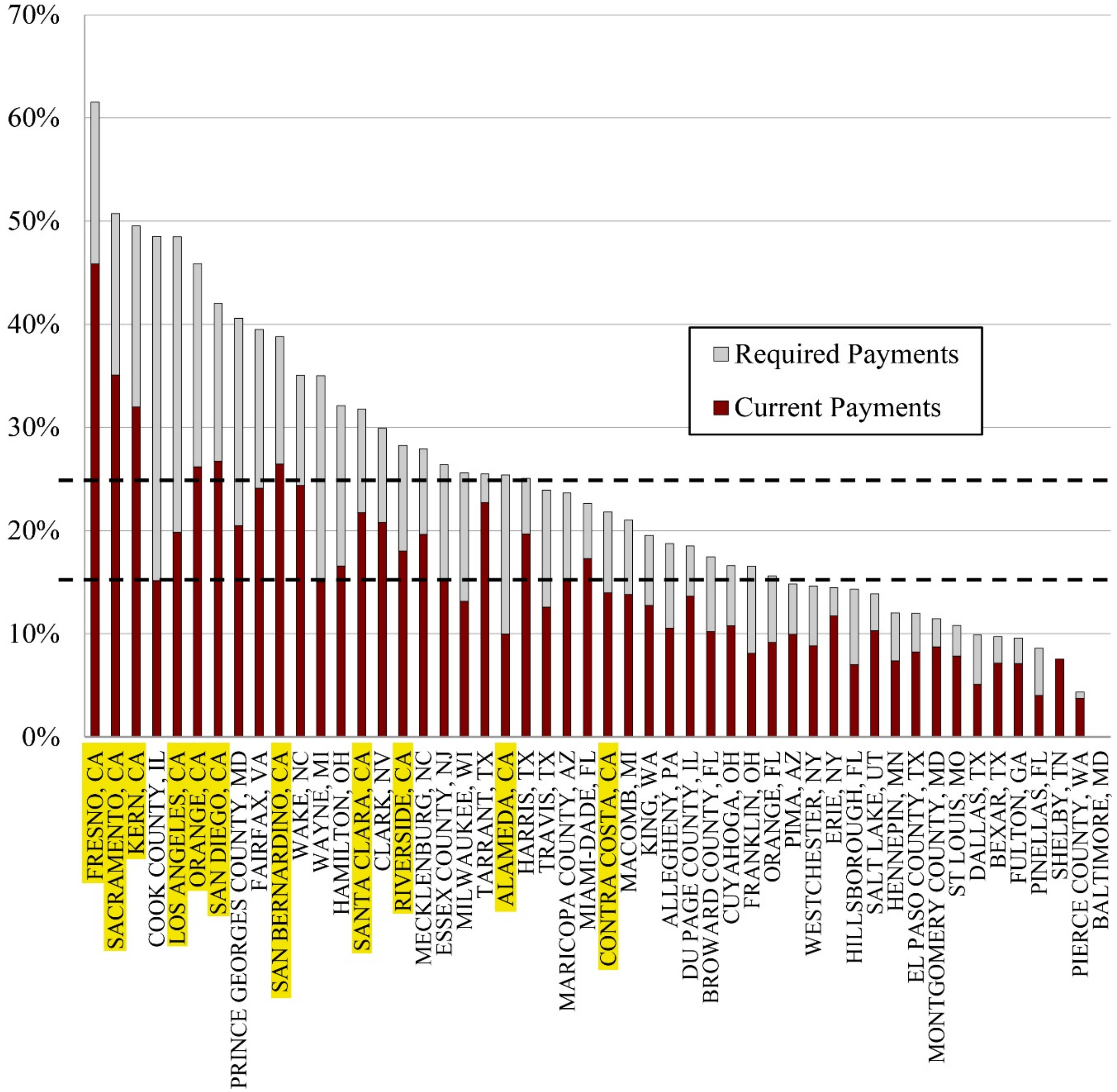
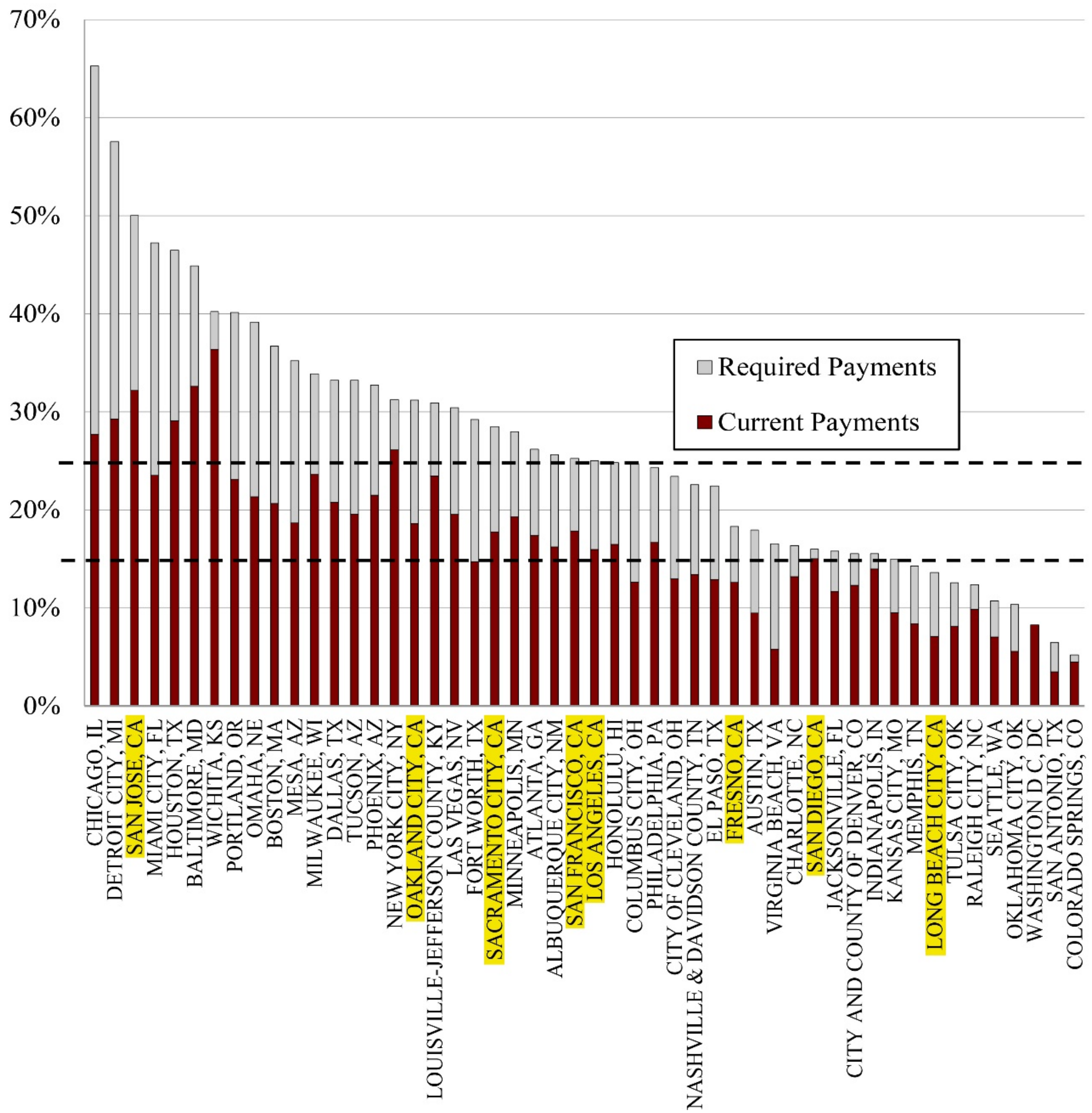
"An Overview of the Pension/OPEB Landscape," Alicia H. Munnell & Jean-Pierre Aubry. July 2016. Data based on various FY 2014 plan and government financial reports and actuarial valuations; U.S. Census Bureau (2014).

Large Counties: Current and Required Pension; OPEB and Interest Payments as a Percentage of Own-Source Revenue, 2014



“An Overview of the Pension/OPEB Landscape,” Alicia H. Munnell & Jean-Pierre Aubry. July 2016. Data based on various FY 2014 plan and government financial reports and actuarial valuations; U.S. Census Bureau (2014).

Large Cities: Current and Required Pension; OPEB and Interest Payments as a Percentage of Own-Source Revenue, 2014



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Learn more at:

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