

Funding Policy Review

Brian B. Murphy, F.S.A.

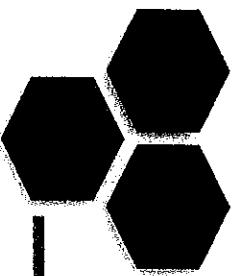
Brad L. Armstrong, A.S.A.

Amy Williams, A.S.A.

May 23, 2011

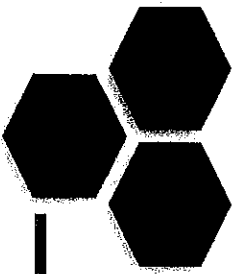
GRS

Gabriel Roeder Smith & Company
Consultants & Actuaries
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Objective

- ◆ Show projections under the enacted pension reforms (with reinvested savings up to \$300 million annually.)
 - ▶ Using current funding policy.
 - ▶ Using the Board of Trustees' proposed funding policy intended to improve contribution rate stability.



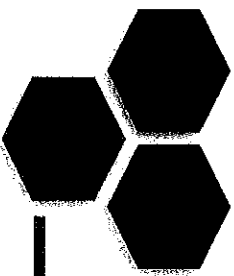
Funding Policy Components

- ◆ Actuarial Cost Method
- ◆ Amortization Method
- ◆ Asset Valuation Method
- ◆ Funding Target
- ◆ Gains and Losses
- ◆ Risk Sharing
- ◆ Implementation
- ◆ Overfunding
- ◆ Benefit Changes
- ◆ Assumption Changes



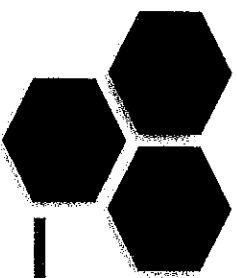
Current Assumptions

- ◆ Based on 2002-2006 experience study
- ◆ Key assumptions:
 - ▶ 7.75% investment return
 - ▶ 3.50% wage inflation
 - ▶ 3.00% price inflation



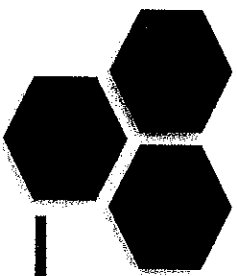
Main Topics Under Review

- ◆ Amortization Policy
- ◆ Corridor Funding Methodology
- ◆ Asset Valuation Method



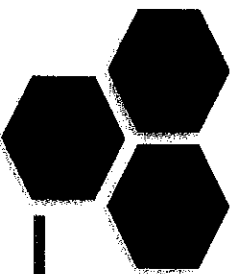
Amortization Policy

- ◆ Level \$ vs. Level % of pay
 - ▶ Level \$ front loads the funding
 - ▶ Level % can produce “negative amortization”
- ◆ Closed vs. Open period
 - ▶ Open period never actually pays off UAL



Amortization Policy

- ◆ Current Amortization Policy:
 - ▶ Gains/(Losses) over 25 years
 - ▶ Year 2000 initial amount over 20 years
 - Credit for Employees and State Police
 - Charge for Teachers, LEOPs, and Judges
- ◆ Issues:
 - ▶ Rate can change dramatically in a single year when various bases are fully amortized
 - ▶ Corridor funding can exacerbate existing problems



BOT Funding Policy

Recommendations — Amortization

- ◆ 20 year open level percent of pay
 - ▶ Projected to result in relatively smooth contribution rates.
 - ▶ Funded ratio is not projected to reach 100% under open amortization policy.



Corridor Funding Methodology

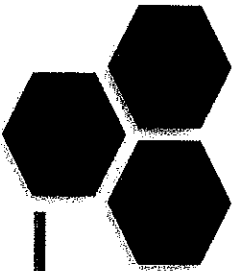
- ◆ When funded ratio is less than 90% or greater than 110%, rate is 80% of prior rate plus 20% of actuarial rate for TCS and ECS.
 - ▶ Rate does not change if within the corridor.
- ◆ Rate will remain less than actuarial rate under present conditions.
- ◆ Rate under corridor may be higher under some potential future conditions.



BOT Recommendation

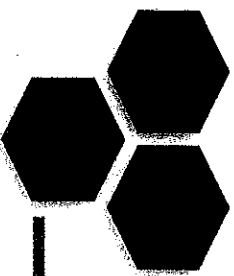
- ◆ New funding methodology with phase out of corridor method at the rate of 10% per year.

<u>Fiscal Year</u>	<u>% of Prior Rate</u>	<u>% of Actuarial Rate</u>
2013	80%	20%
2014	70%	30%
2015	60%	40%
2016	50%	50%
2017	40%	60%
2018	30%	70%
2019	20%	80%
2020	10%	90%
2021	0%	100%



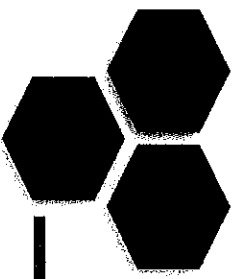
Asset Valuation Method

- ◆ Current method
 - ▶ Assumed return (7.75%) recognized each year
 - ▶ Differences between actual and assumed return are phased-in over 5-years
- ◆ Not particularly influential for TCS or ECS due to the operation of the corridor method.
- ◆ No changes are recommended.



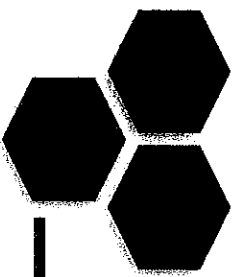
Issues with Present Funding Policy

- ◆ The combination of the corridor funding methodology with the asset valuation method and 25 year amortizations results in significantly delayed responses to funding circumstances.
- ◆ Any one year's losses or gains are not fully felt for as much as 15 years
 - ▶ Double smoothing due to corridor and asset smoothing



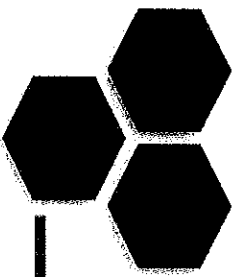
Issues with Present Funding Policy

- ◆ Contribution rates developed in accordance with the corridor policy cannot generally be used for accounting and financial reporting in connection with GASB 25 and 27.
 - ▶ Results in a Net Pension Obligation in the state's annual report (CAFR).



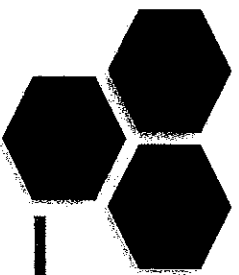
Issues with Present Funding Policy

- ◆ The policy does produce relatively stable rates for the corridor plans.
 - ▶ For other plans, there is inherent instability due to asset volatility that produces a sudden increase or decrease in the rates.
 - ▶ For some plans, the policy itself produces instability.



Recommendations of the Board of Trustees

- ◆ Phase out corridor funding at 10% per year “10-year phase out”.
- ◆ 20-year open period amortization instead of separate 25-year closed amortization bases.



Results of Board of Trustees' Recommendations

- ◆ Proposed policy would result in contribution rates that meet GASB definition of ARC.
- ◆ BOT recommendations focus on
 - ▶ Contribution stability and sound funding practices.
 - ▶ To a lesser extent, on how funding ratios would improve over time.



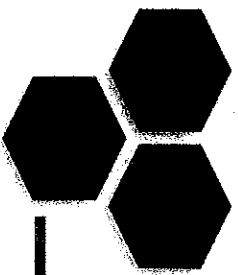
Updated Projections

- ◆ Updated projections reflect the provisions under the enacted pension reforms passed by the General Assembly.
- ◆ Reforms include reinvestment of savings from reforms, up to \$300 million per year.



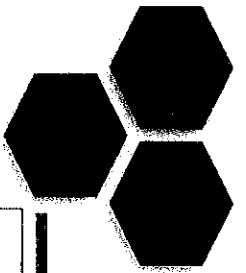
Year Projected to Reach 80% Funded

	Current Policy		Proposed Policy
	Prior Benefit Provisions	With G.A. Reforms	
Combined State	2026	2024	2026
Teachers'	2025	2023	2024
Employees'	2028	2025	2027
State Police	2028	2027	2032
LEOPS	2022	2021	2029
Judges	2021	2021	2024



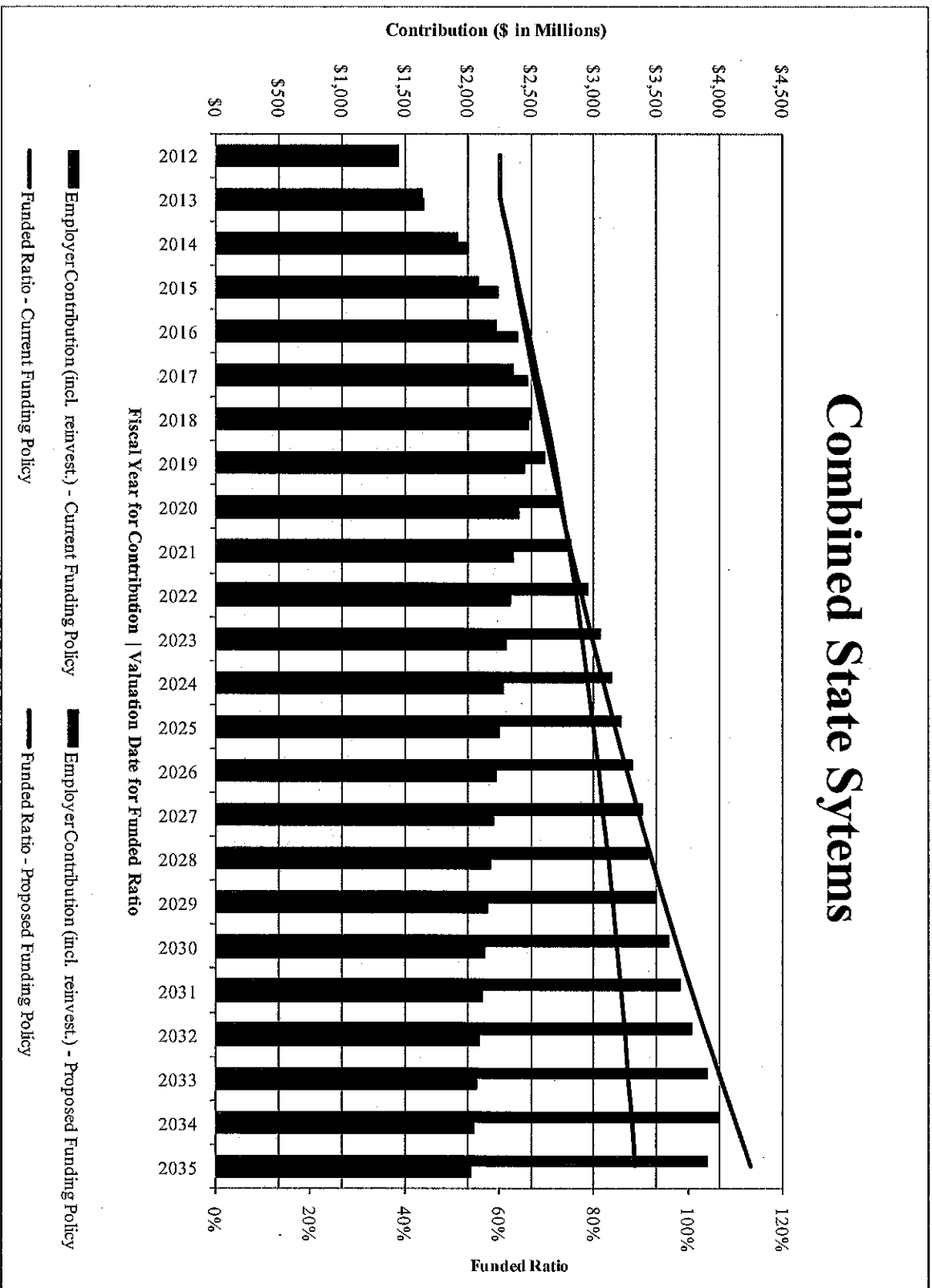
Year Projected to Reach 90% Funded

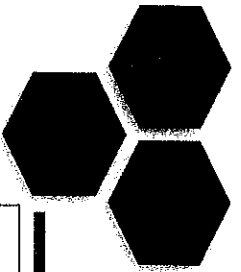
	Current Policy		Proposed Policy
	Prior Benefit Provisions	With G.A. Reforms	
Combined State	2030	2028	2038
Teachers'	2030	2027	2039
Employees'	2031	2028	2035
State Police	2030	2030	2048
LEOPS	2027	2026	2039
Judges	2027	2027	2036



Projected Results of Proposed Funding Policy Revisions Under G.A. Reforms

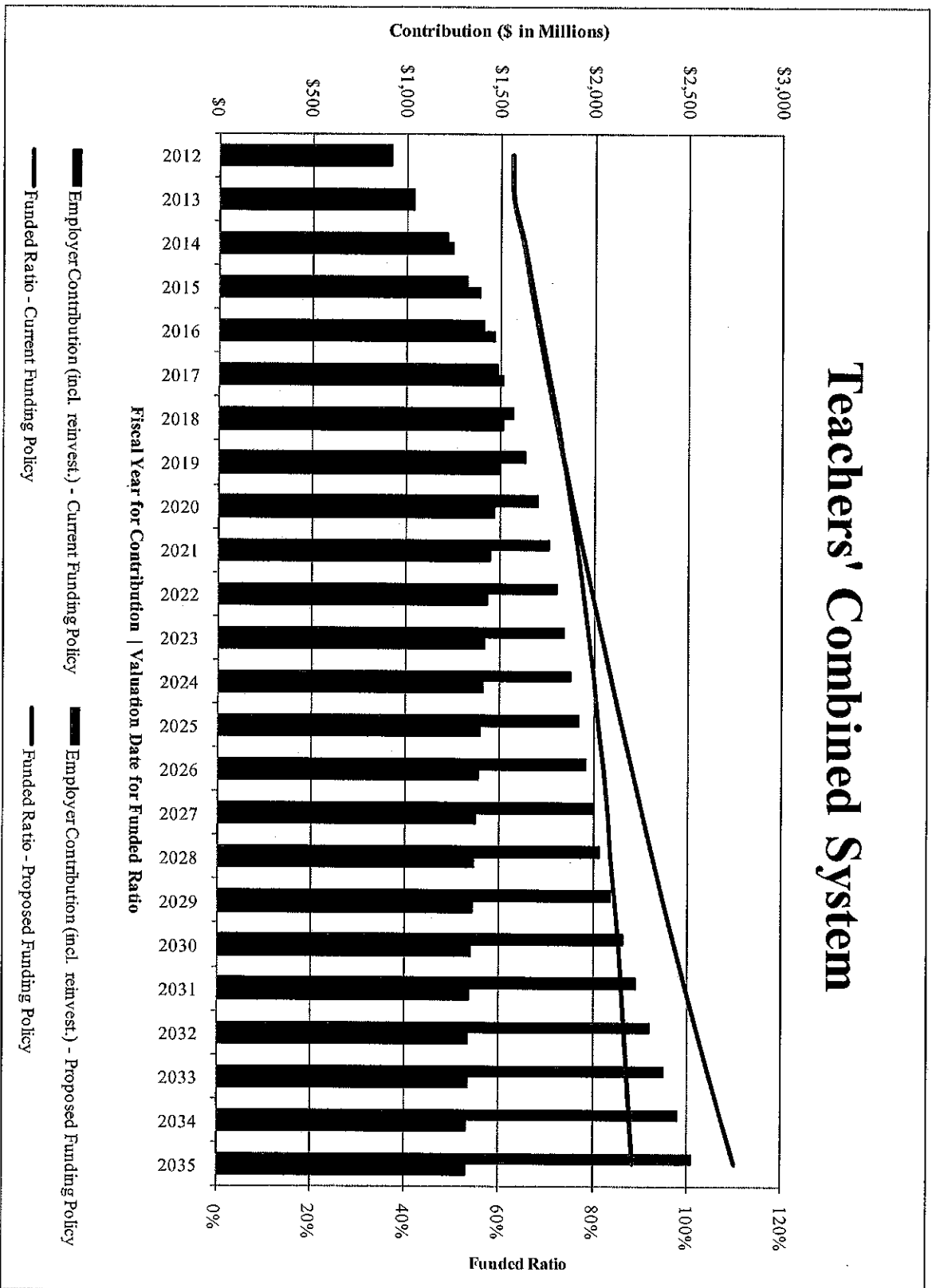
Combined State Systems

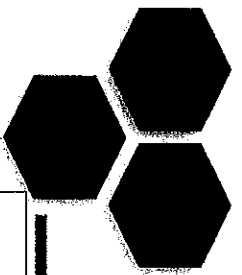




Projected Results of Proposed Funding Policy Revisions Under G.A. Reforms

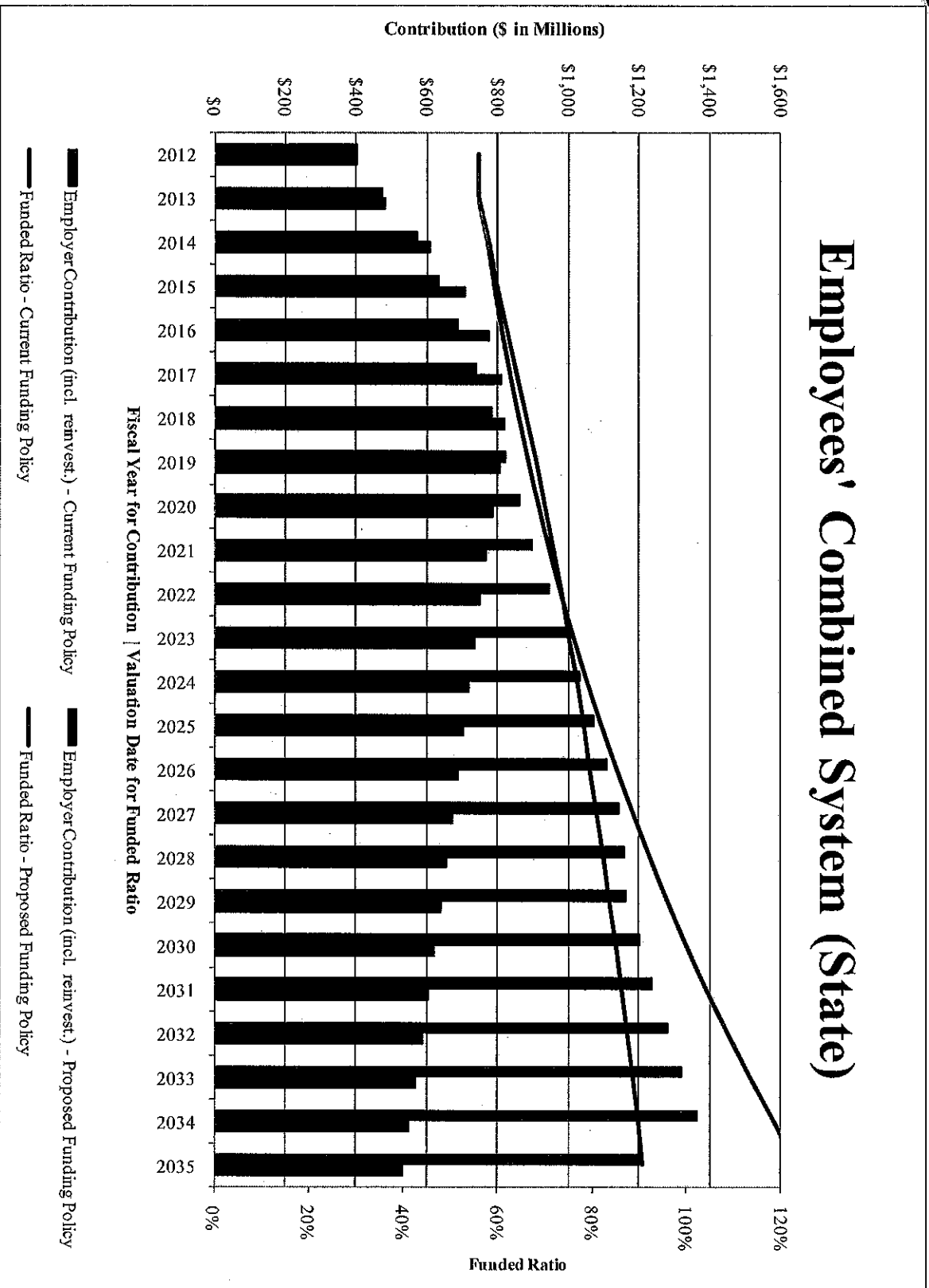
Teachers' Combined System

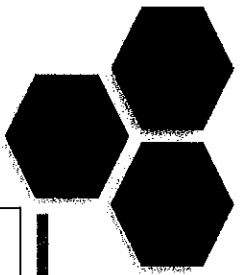




Projected Results of Proposed Funding Policy Revisions Under G.A. Reforms

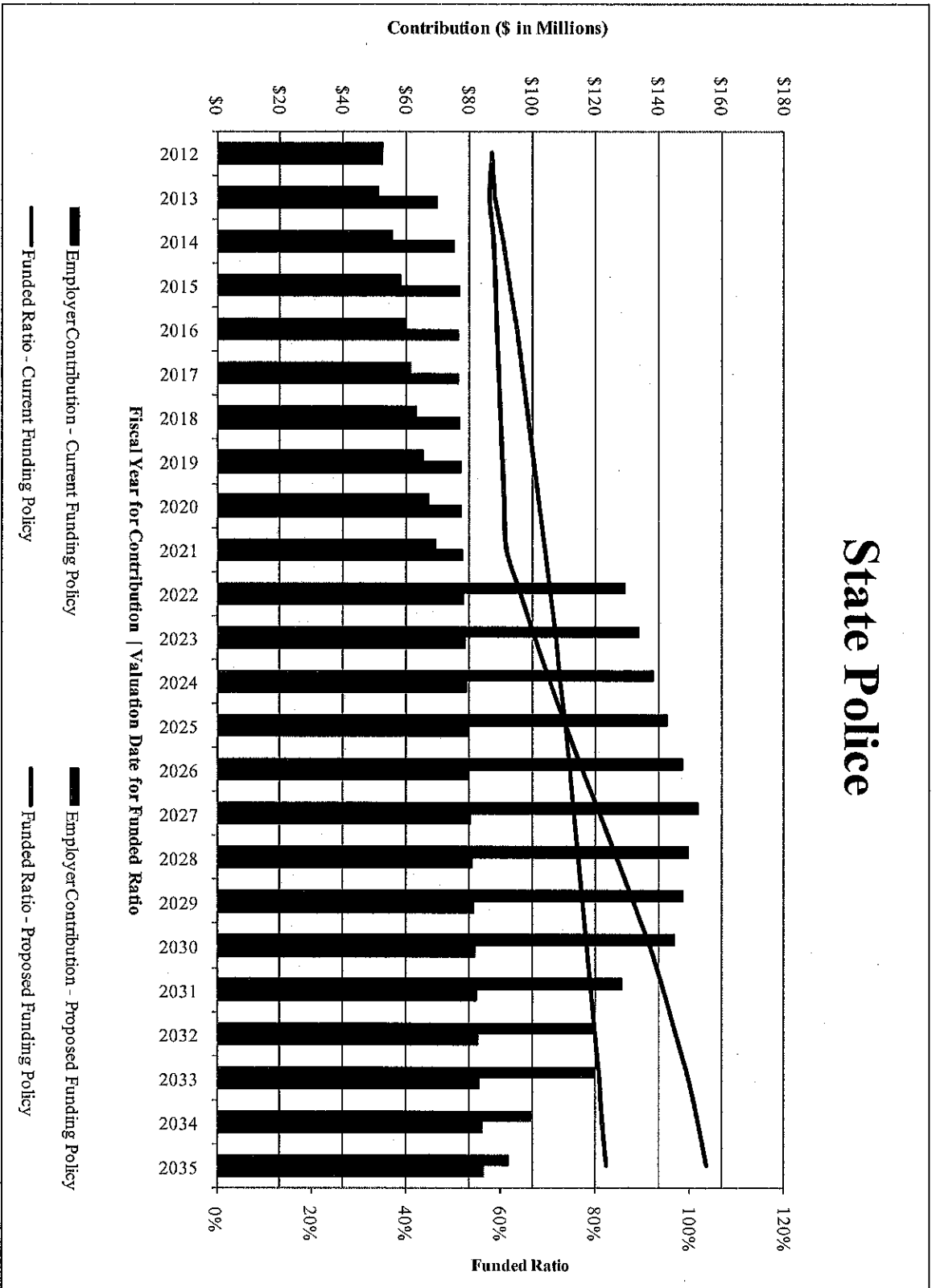
Employees' Combined System (State)

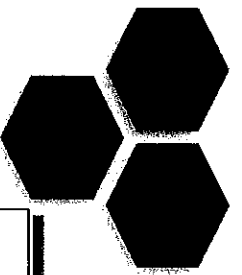




Projected Results of Proposed Funding Policy Revisions Under G.A. Reforms

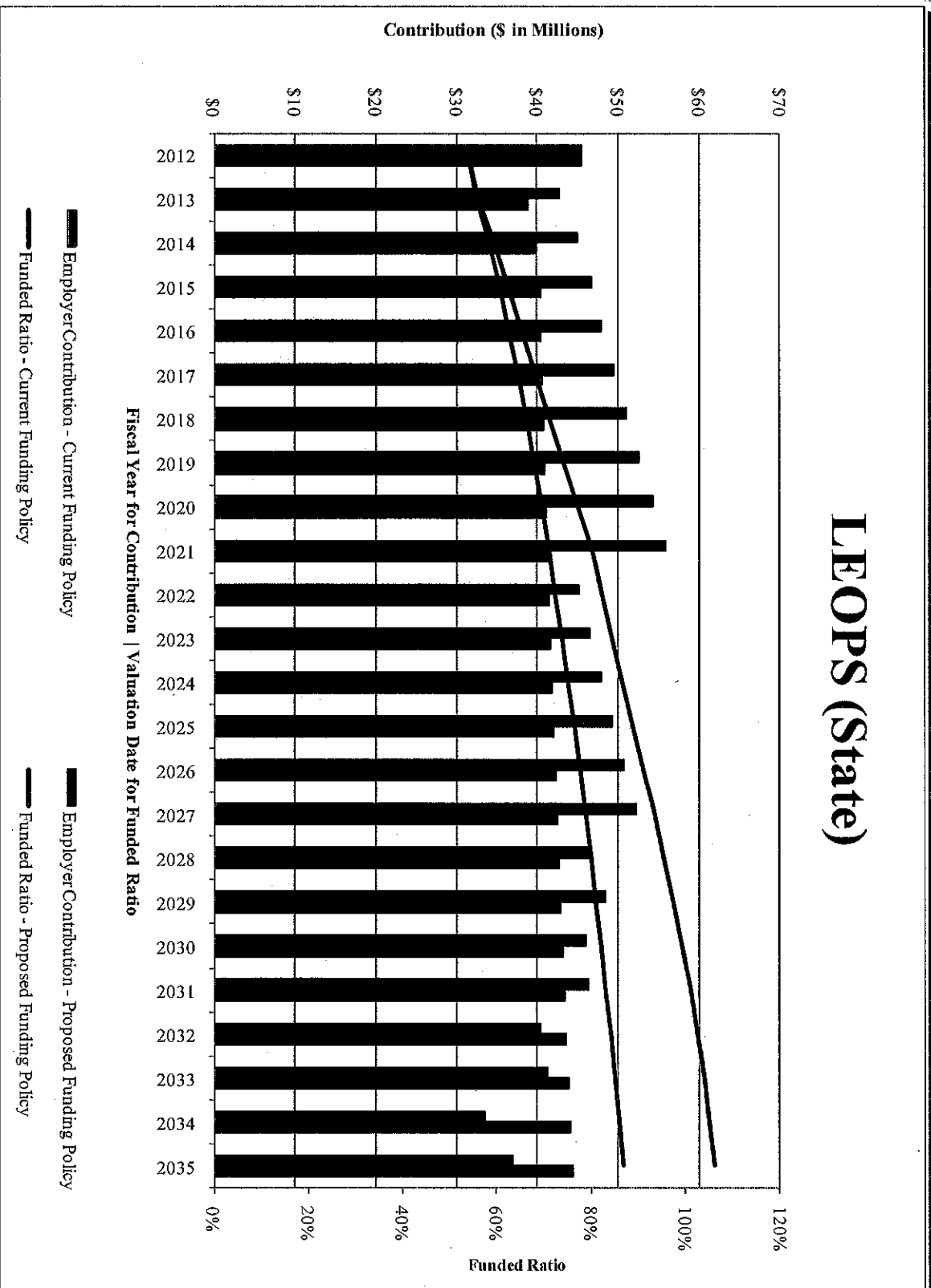
State Police

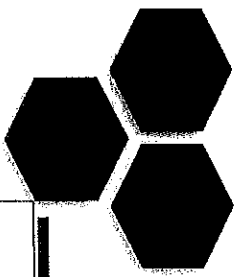




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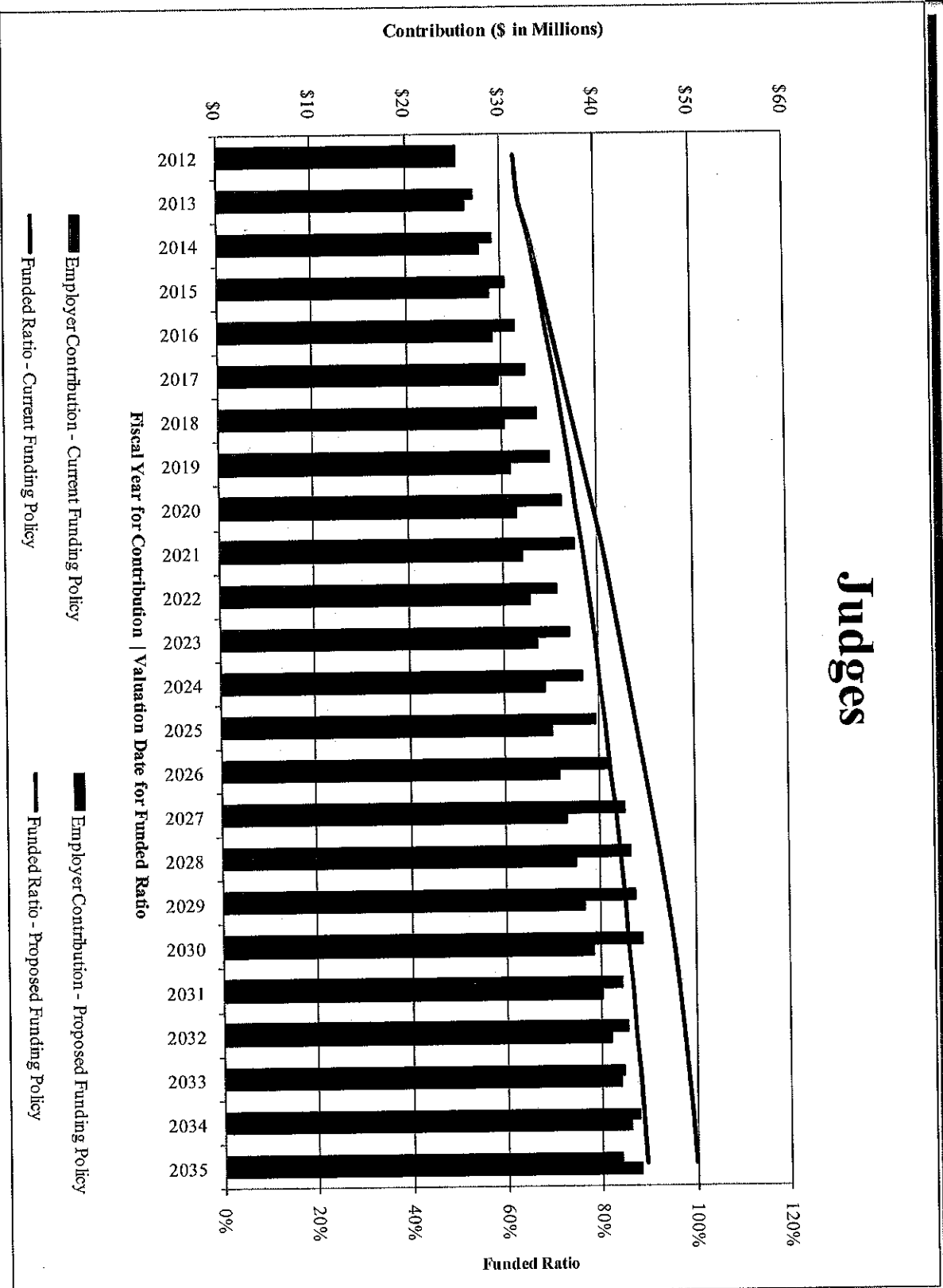
LEOPS (State)

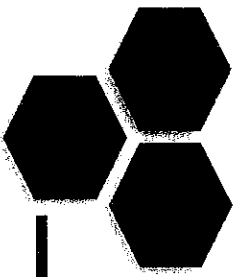




Projected Results of Proposed Funding Policy Revisions Under G.A. Reforms

Judges





This presentation shall not be construed to provide tax advice, legal advice or investment advice.