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Current Issues for Public Pensions

Topics

1. GASB Changes
2. Funding Policy
3. Actuarial Assumptions
4. Moody's Adjustments
5. Pension Obligation Bonds

Welcome to

Bizarro World

Topic 1:
GASB Changes

GASB Changes

- New Statements Issued in 2012, effective 2014-15 – Major Changes
- GASB 67 – for the Plan itself (replaces 25)
- GASB 68 – for the Employer (replaces 27)
- No more ARC, no more NPO
- Funding numbers no longer based on GASB accounting
  - Separation of funding and accounting
- Many additional disclosures required

GASB Changes

- New terminology
  - Plan Net Position = asset value (market basis)
  - Total Pension Liability = actuarial liability
  - Net Pension Liability = unfunded liability
  - Service Cost = normal cost
  - Deferred inflows/outflows
- Accounting cost will be volatile (and could even conceivably be negative) due to quick recognition of favorable/unfavorable experience
- Entry Age cost method required
- Discount rate will NOT be a major issue

Topic 2: Funding Policy

Funding Policy

- With GASB changes, a written funding policy is needed
- Need to work with actuary to align policy with board, plan sponsor objectives
- Old GASB (25/27) basis could be a starting point for funding policy
  - Contribution = Normal Cost + Amortization of Unfunded
- Many plans already have a policy, and many are starting the discussion now
- Good idea to review policy itself when assumptions are reviewed

Funding Policy

- Policy components
  - ✓ Funding progress objectives
  - ✓ Cost volatility
  - ✓ Minimum contributions
  - ✓ Actuarial assumptions/methods, and periodic review of such
  - ✓ How to handle extreme events (like 2008)
- This list is NOT all-inclusive
- Need to consider short and long term objectives
- Must be reasonable and enforceable

Topic 3: Actuarial Assumptions

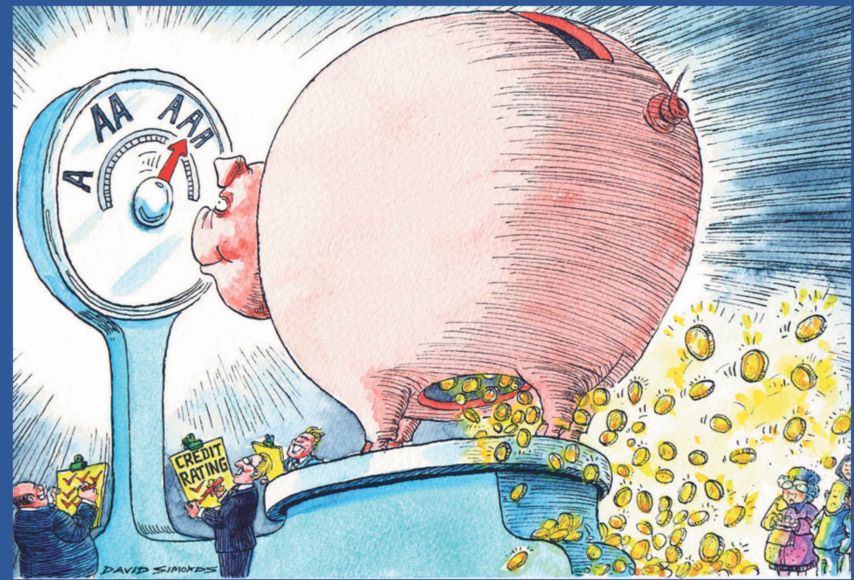
Of all the actuaries at the firm, none could match the zeal of Earnest T. Cromwell.

Actuarial Assumptions

- Investment Return and Inflation
  - Trending downward for many years
  - A clear movement from 8.0% with 3.5% inflation to something closer to 7.5% with 3.0% inflation
  - Many plans decreasing in 25 basis point increments
    - Current analysis re: impact of 7.25% or 7.00% rate
  - GASB now asking for justification and asset class info
- Mortality assumptions
  - Actuarial Standards of Practice put more focus on this in 2012
  - Actuary needs to consider mortality improvement
    - Not required to project improvement though
    - Society of Actuaries also published a new scale (BB)

Actuarial Assumptions

- Changes in assumptions
- Experience studies/assumption reviews becoming more common
  - All assumptions need a sound basis
  - Study/review should be done every 4 or 5 years
- Must keep in mind purpose of assumptions: To Align Expectations More Closely With Actual Experience
  - This gives the plan the best chance for stable contributions



Topic 4: Moody's Adjustments

Moody's Adjustments

- Announced "final" version in April, 2013
- To be used in determining bond/credit ratings
- No additional information is required
  - They will make the adjustments on their own
- Ostensibly for "transparency and consistency"
- Moody's will compute their own unfunded liability and amortization of such, by:
  1. Adjusting reported liability using a bond index rate (Citigroup Pension Liability Index, now about 4%)
  2. Compute Unfunded with market value of assets
  3. Compute amortization using 20 year period
  4. *Also, allocate costs to ERs for multiple-employer plans*

MOODY'S ADJUSTMENTS

- Example (single employer)
  - Plan Assets (MVA) = $100 million
  - Smoothed (AVA) value = $105 million
  - Actuarial Accrued Liability = $105 million (AVA/AAL = 100%)
  - Plan Discount Rate = 7.05%
  - Measurement Date = 12/31/2012
- Step 1: conversion factor = 1.13^3 = 1.443
  (based on 4.05% index rate, 7.05 - 4.05=3)
- Step 2: adjusted liability = $105 million x 1.443 = $152 million
- Step 3: adjusted unfunded = $152 - $100 = $52 million
  (funding = 66%)
- Step 4: amortization = $52 ÷ 14.08 = $3.7 million
  (actual amortization = $0)

POB

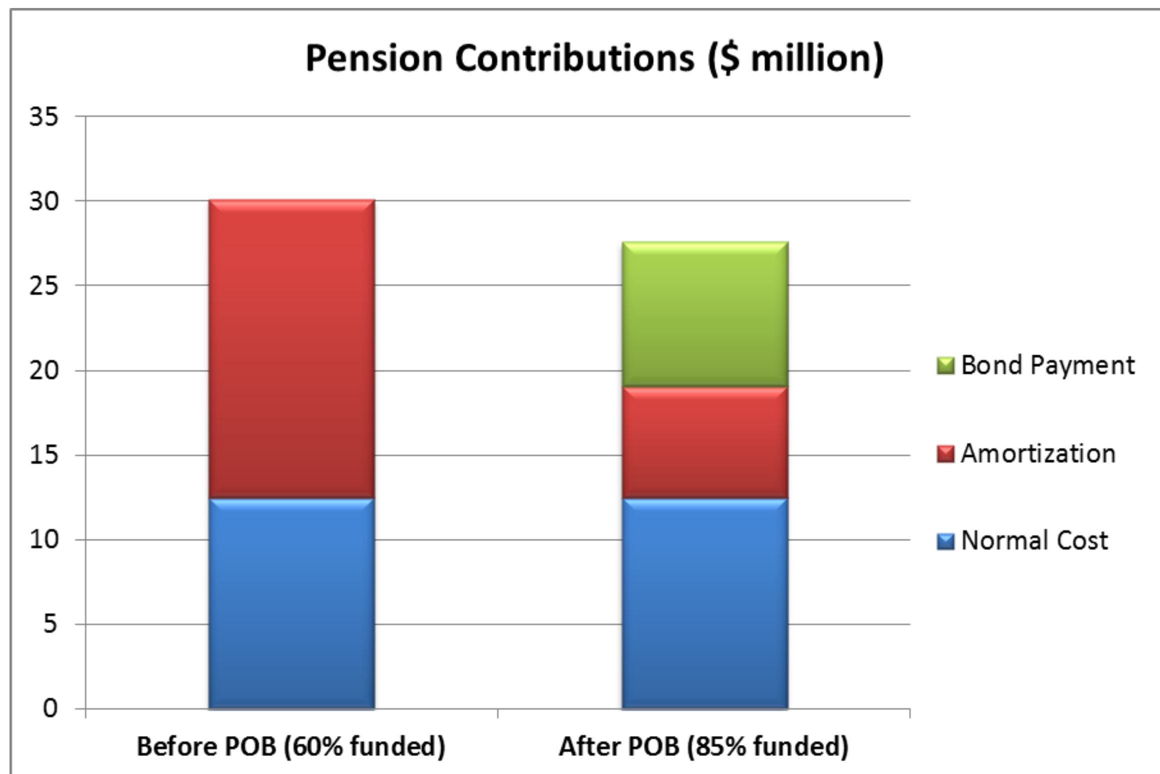
TOPIC 5: PENSION OBLIGATION BONDS

PENSION OBLIGATION BONDS

- Governments have been issuing POBs since 1985
- Some have worked well, some have failed miserably
  - Not legal to issue in some states
- Replaces variable pension payment with fixed debt service payments
  - Viewed as very risky by some
  - Can also be viewed as <u>reducing</u> volatility
- POB discussions popular again in 2013 – Why?
  - Pension costs high since 2008
  - Historically low borrowing rates (some near 3%)
  - Spread between a conservative return assumption and bond rate is attractive; annual savings potential
  - Hard debt is easier to budget

PENSION OBLIGATION BONDS

- How it is supposed to work



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THANK YOU!

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