Minnesota Legislative Commission on Pensions and Retirement

July 1, 2014 Audit Review and Funding Discussion

October 13, 2015

Michael de Leon, FCA, ASA, EA, MAAA
Judy Stromback, FSA, FCA, EA, MAAA

Agenda

- Background
- Completed Projects
  - Statewide Pension Systems Review
  - Replication Valuation of MSRS General Plan
- Pension Fundamentals
- Funding Policy
- Discount Rate
- Pending Projects

Background

July 1, 2014 Funded Status and Contribution Rates

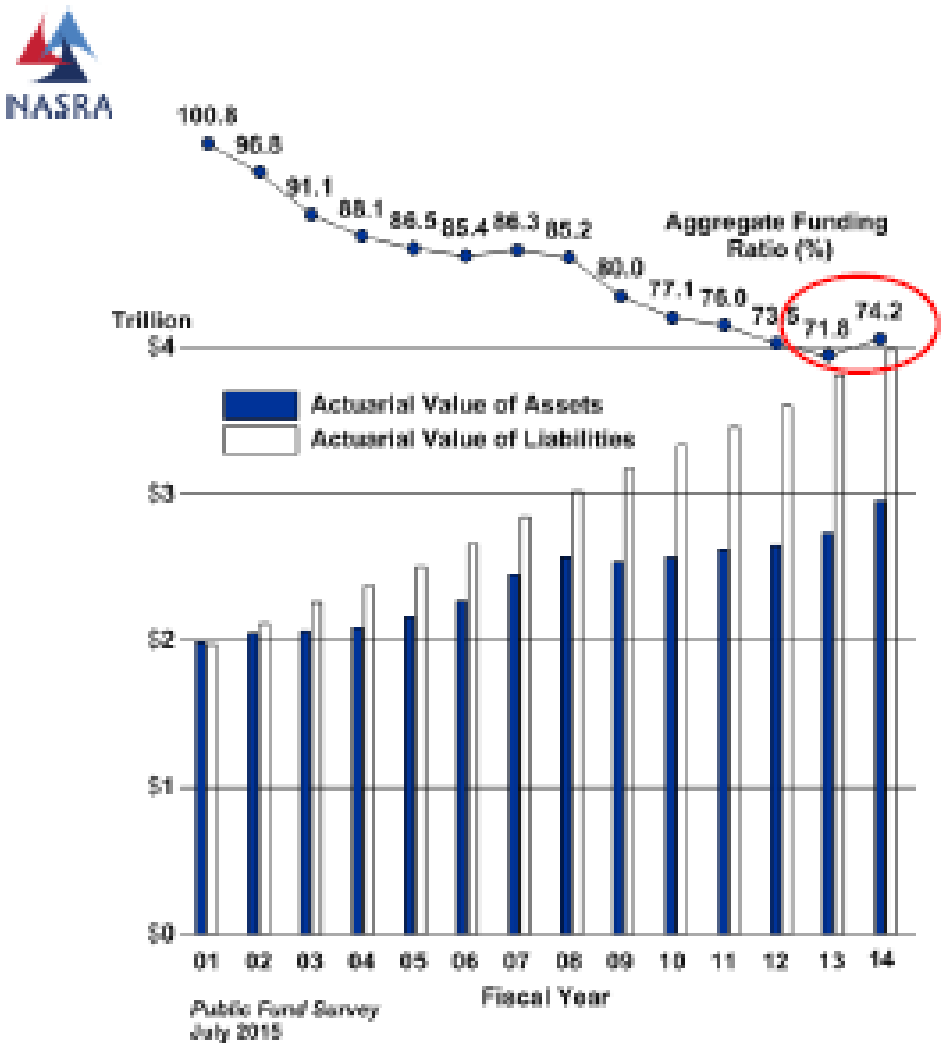
	MSRS General	PERA General	TRA	Nat'l Average ***
Funded Ratio (MVA)	92.4%	81.8%	82.7%	
Funded Ratio (AVA)	83.0%	73.5%	74.1%	74.2%
Statutory Contribution				
Employee	5.5%	6.4% *	7.5%	6.0%
Employer	5.5%	7.4% *	8.2% **	11.5%
Total	11.0%	13.8%	15.7%	17.5%
Required Contribution	12.8%	15.8%	19.2%	21.6%
Sufficiency/(Deficiency)	(1.8%)	(2.1%)	(3.5%)	(4.1%)

* PERA General Contribution rates are a blend of 2014 (6.25%/7.25% EE/ER) and 2015 (6.50%/7.50%) contribution rates.

** TRA contribution includes 0.48% in Supplemental contributions; TRA Employer-only contribution is 7.7%.

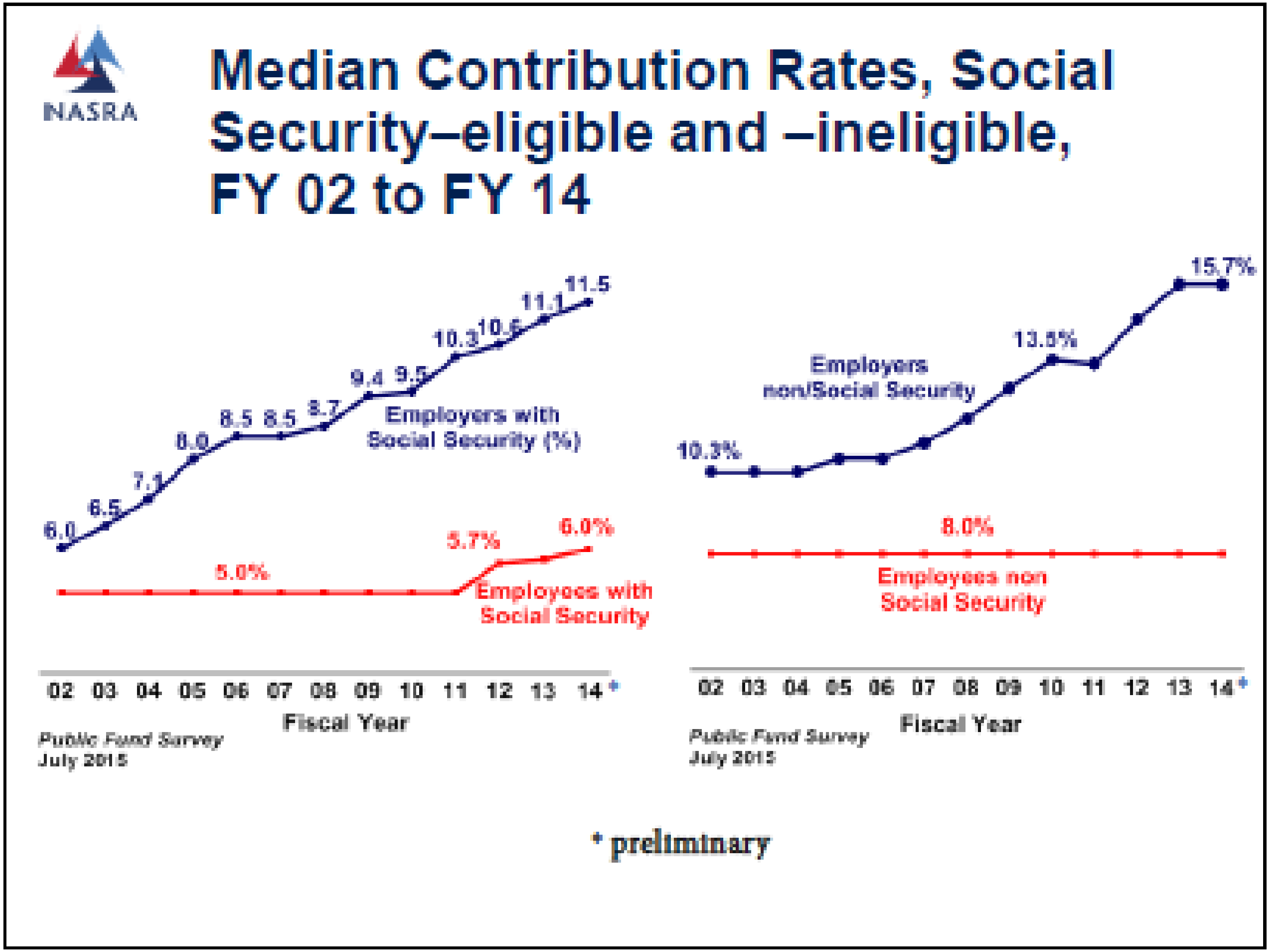
*** Source: Public Fund Survey – survey of 126 large public funds representing >85% of public retirement systems

National Public Sector Pension Plans – Funding Ratio



Aggregate Public Pension Funding Level, FY 01 to FY 14

National Public Sector Pension Plans – Contribution Rates



Completed Projects

Results of Retirement Systems Review

- **Scope**
  - Assess reasonableness and reliability of July 1, 2014 actuarial reports
  - Determine compliance with
    - Minnesota Statutes
    - Standards for Actuarial Work of the LCPR
    - Applicable actuarial standards of practice

- **Process**
  - Reviewed census data and asset information for accuracy
  - Reviewed detailed sample life output from each actuary's valuation software for 120 participants
  - Compared assumptions, plan provisions and valuation reports to applicable standards

Results of Retirement Systems Review (continued)

- **Results**
  - No errors or corrections that would significantly impact the calculation of liability or contribution amounts
- **Overall Recommendations**
  - Consideration that employees will not take ***most valuable*** benefit upon retirement
  - Update to the Combined Service Annuity assumption, which was last studied by all Systems in 2002
  - Consideration and discussion of best practices in funding methods between the Systems, their actuaries, and the Commission
- **System-specific Recommendations**
  - A handful of minor recommendations
  - Impacts on liability were limited to a fraction of a percentage point

Matching Valuation Results: MSRS General

- **Scope**
  - Determine compliance with Minnesota Statutes, the Standards for Actuarial Work of the LCPR and applicable actuarial standards of practice (similar to all other plans)
  - Perform replication of July 1, 2014 actuarial valuation

- **Process**
  - Program the data, assumptions and plan provisions into our valuation software
  - Compared our results to retained actuary's
  - Address differences in Present Value of Benefits (PVB) greater than 2%, or Actuarial Accrued Liability (AAL) greater than 5%

Matching Valuation Results: MSRS General (continued)

- **Results**
  - Again, no errors or corrections that would significantly impact the calculation of liability or contribution amounts

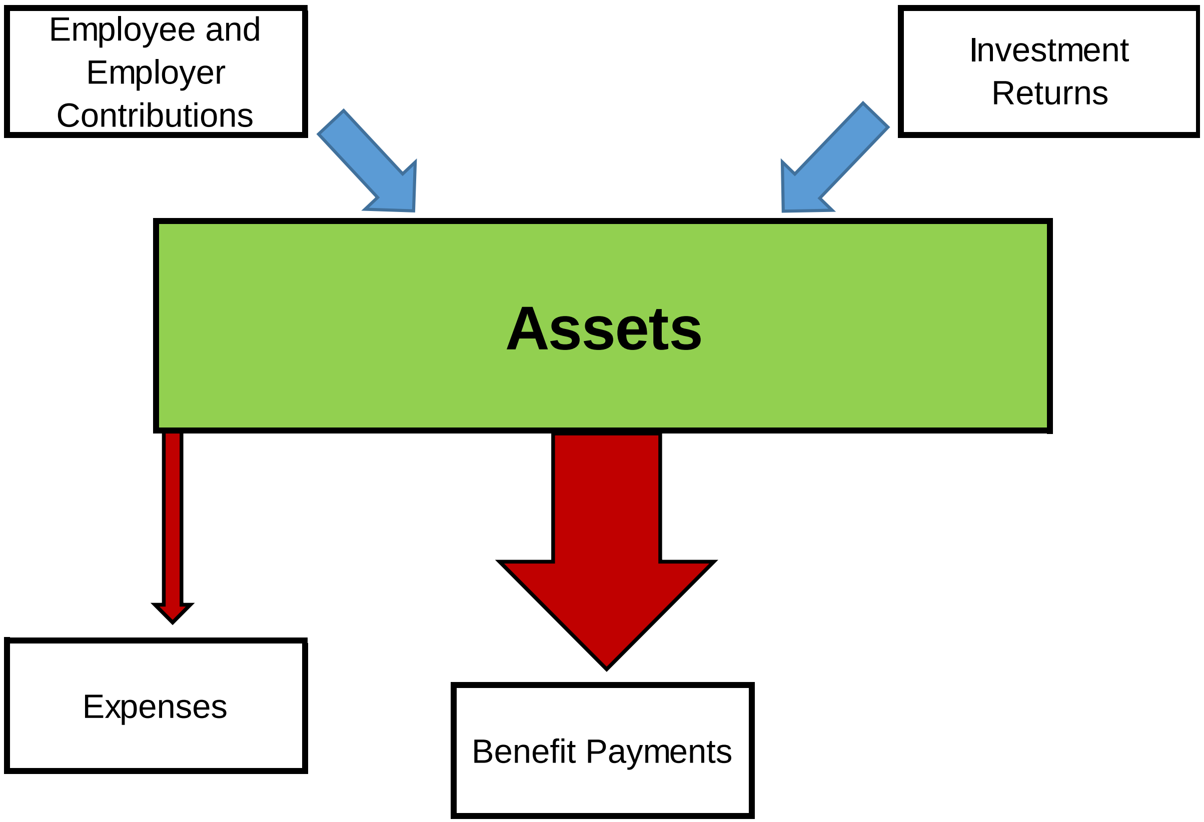
	GRS	Deloitte	Difference
Present Value of Benefits	$13,748,525	$13,785,603	0.27%
Actuarial Accrued Liability	$12,445,126	$12,416,479	-0.23%
Required Contribution	12.82%	12.36%	-0.46%

- **Recommendations**
  - Minor corrections that are immaterial
  - Same recommendations as noted for all other plans/systems covered in LCPR Review

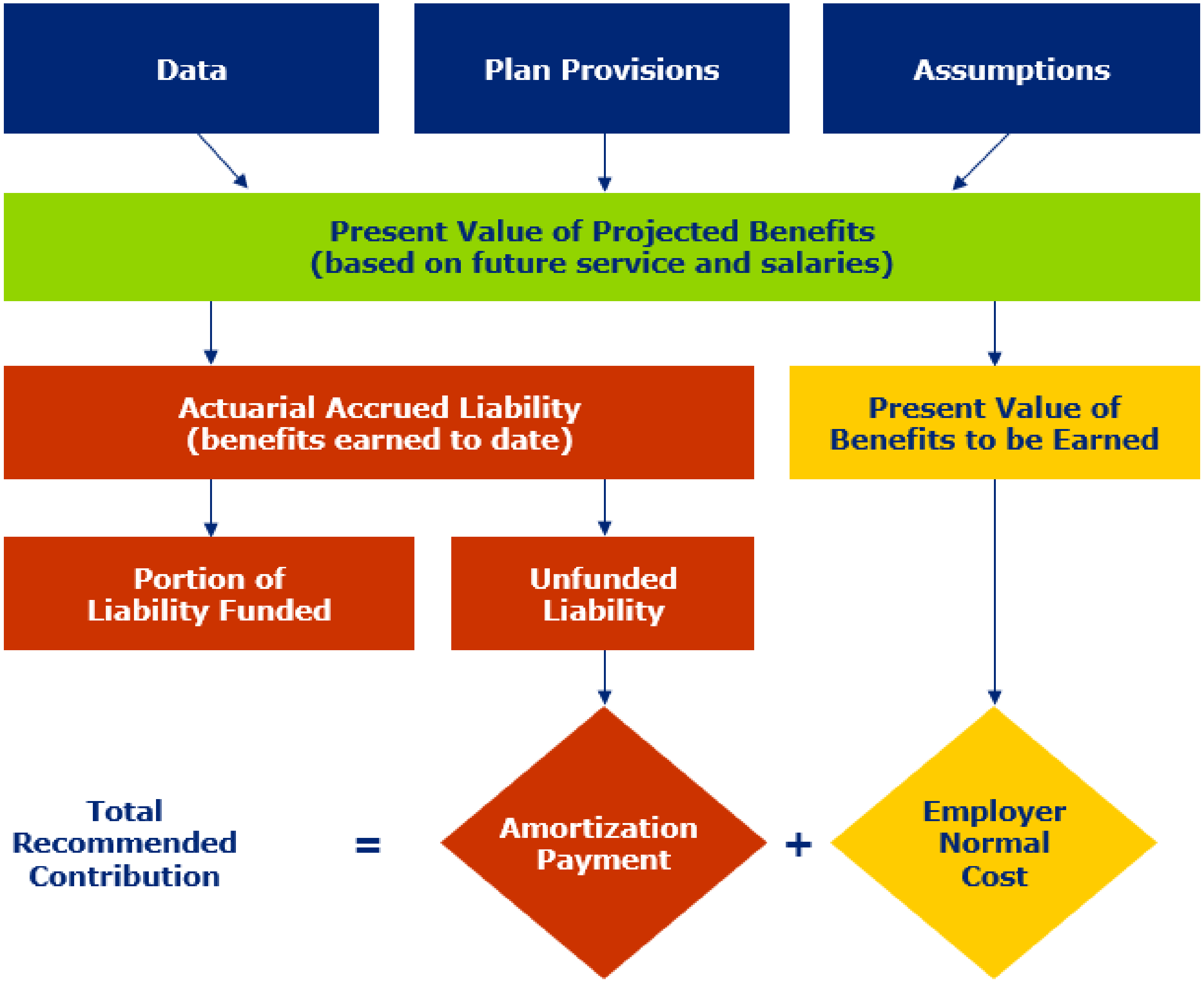
Pension Fundamentals

Pension Plan Axiom

Contributions + Investments = Benefit Payments + Expenses



Valuation Process – How the Contribution is Determined



Funding Policy

Emerging Trends in Public Sector Funding Policy

- **A number of entities have weighed in on best practices in Public Sector Funding Policy recently**
  - Society of Actuaries Blue Ribbon Panel
  - Government Finance Officers Association
  - "Big 7" State and Local government associations
    - National Governors Association
    - National Conference of State Legislatures
    - Council of State Governments
    - National Association of Counties
    - National League of Cities
    - The United States Conference of Mayors
    - International City / County Management Association
  - California Actuarial Advisory Panel
  - American Academy of Actuaries
- **These entities agree on some broad topics**
  - Benefit Security and Adequacy
  - Intergenerational Equity
  - Contribution Stability
  - Transparency

Current Funding Policy

Actuarially Determined Contribution (Funding Target) as of July 1, 2014:

- Single Closed Amortization Period
  - MSRS General: 27 years, PERA General: 19 years, TRA: 23 years
  - Target date adjusted for assumption and plan provision changes
  - Unfunded Liability amortized as percent of payroll
- Five-year Asset smoothing
  - Five-year smoothing of asset gains and losses
  - Basis for recommended contribution
- COLA Valuation
  - Project COLA increase date based on current contribution rates
    - MSRS: 2016, PERA: 2027, TRA: 2031
    - COLA increase to 2.5% after 90% funded ratio attained for two consecutive years (decreases to 1%/2% if <80% funded in one year or <85% in two consecutive years)

Contribution Rate Setting:

- Discretionary based on information available
- Determined by the Plans in consultation with their actuaries

Current Funding Policy – COLA's and the Funding Target

"Shared sacrifice": In 2010, the legislature adopted shared sacrifice recommendations, which reduced annual COLA increases for retirees from 2.5% to 1%/2% while gradually increasing contributions made by employees and employers.

The current funding target partially funds the retirees' portion of the shared sacrifice.

Assume COLA never increases

Estimate COLA increase date (current)

Assume COLA immediately increases

Only experience gains would fund 2.5% COLA

Contributions and experience gains fund 2.5% COLA

Proposed Funding Policy

- **Separate funding policy from reporting method**
  - Funding Target based on current COLA increases (1%/2%), not anticipating future (2.5%) COLA increases
  - If Employer/Employee contribution rates reach pre-2010 levels, COLA would automatically increase to 2.5%

- **Benefits of proposed policy**
  - Funding Target is no longer a “moving target” (90% of an AAL that increases as funding status improves)
  - Shared Sacrifice principle applies until experience gains can fund 2.5% COLA

Contribution Sufficiency/Deficiency Summary

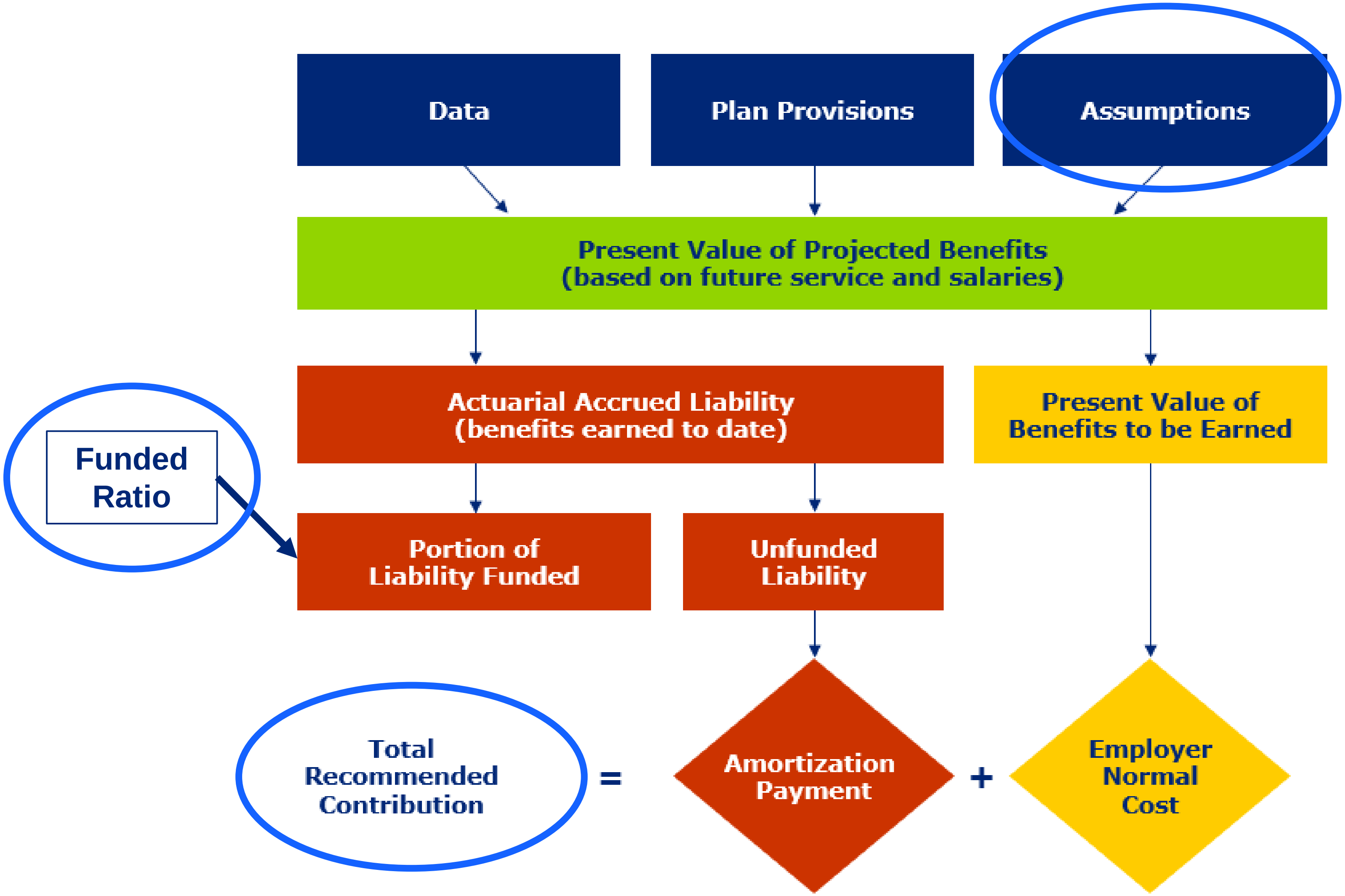
July 1, 2014 Rates	MSRS		PERA		TRA	
	Current	Proposed	Current	Proposed	Current	Proposed
Actuarially Determined Contribution	12.8%	11.3%	15.9%	14.0%	19.2%	18.6%
Actual Contribution	11.0%	11.0%	13.8%	13.8%	15.7%	15.7%
Sufficiency / (Deficiency)	(1.8%)	(0.3%)	(2.1%)	(0.2%)	(3.5%)	(2.9%)

- Actual contributions have not reached the funding target under the proposed method; therefore, this policy change does not impact any prior decisions

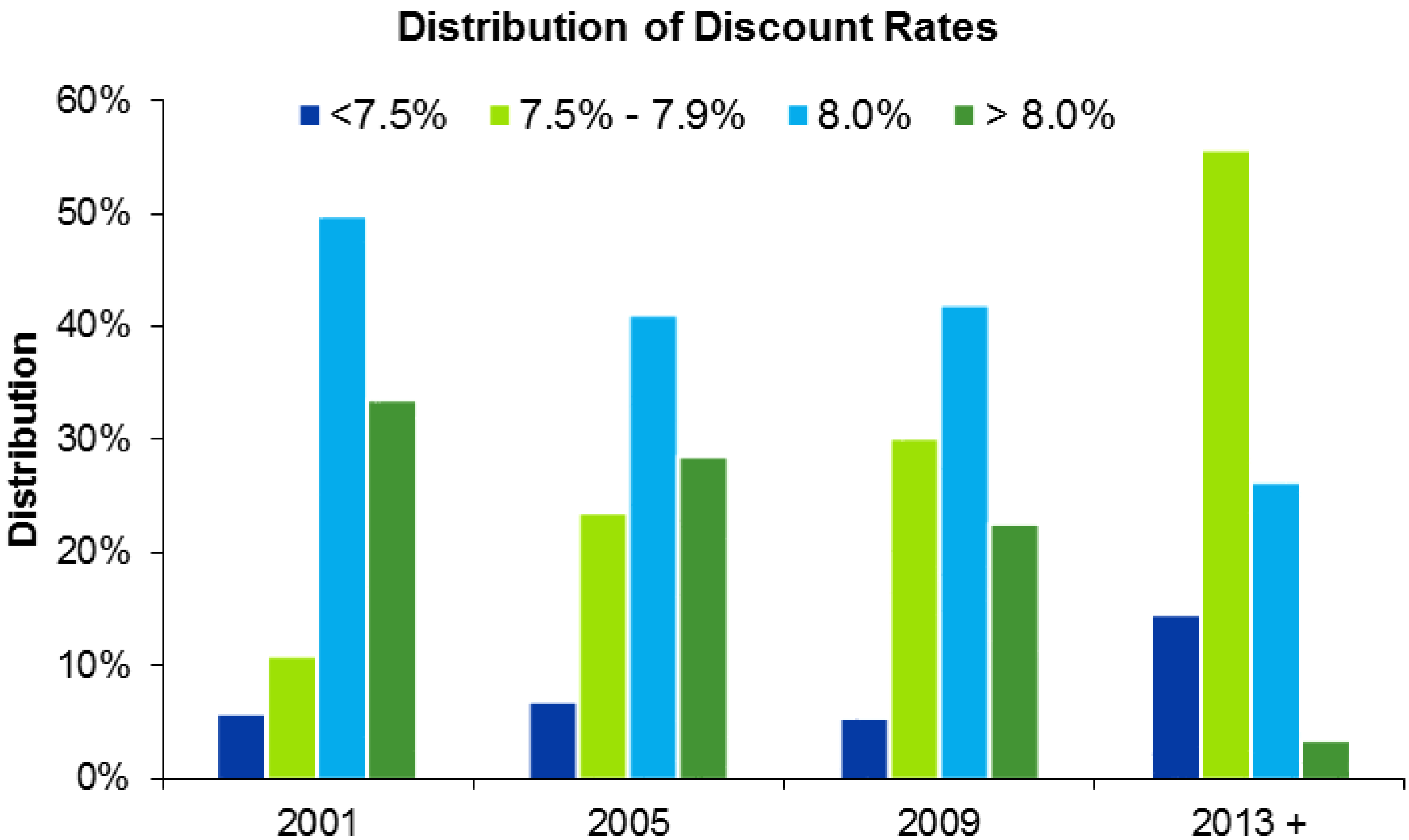
- The proposed funding policy has a smaller impact on TRA because the COLA differential is smaller (2.0% vs 2.5%) and in the valuation it was not projected to be paid until 2031

Discount Rate

Assumptions Drive Funded Ratio and Contributions



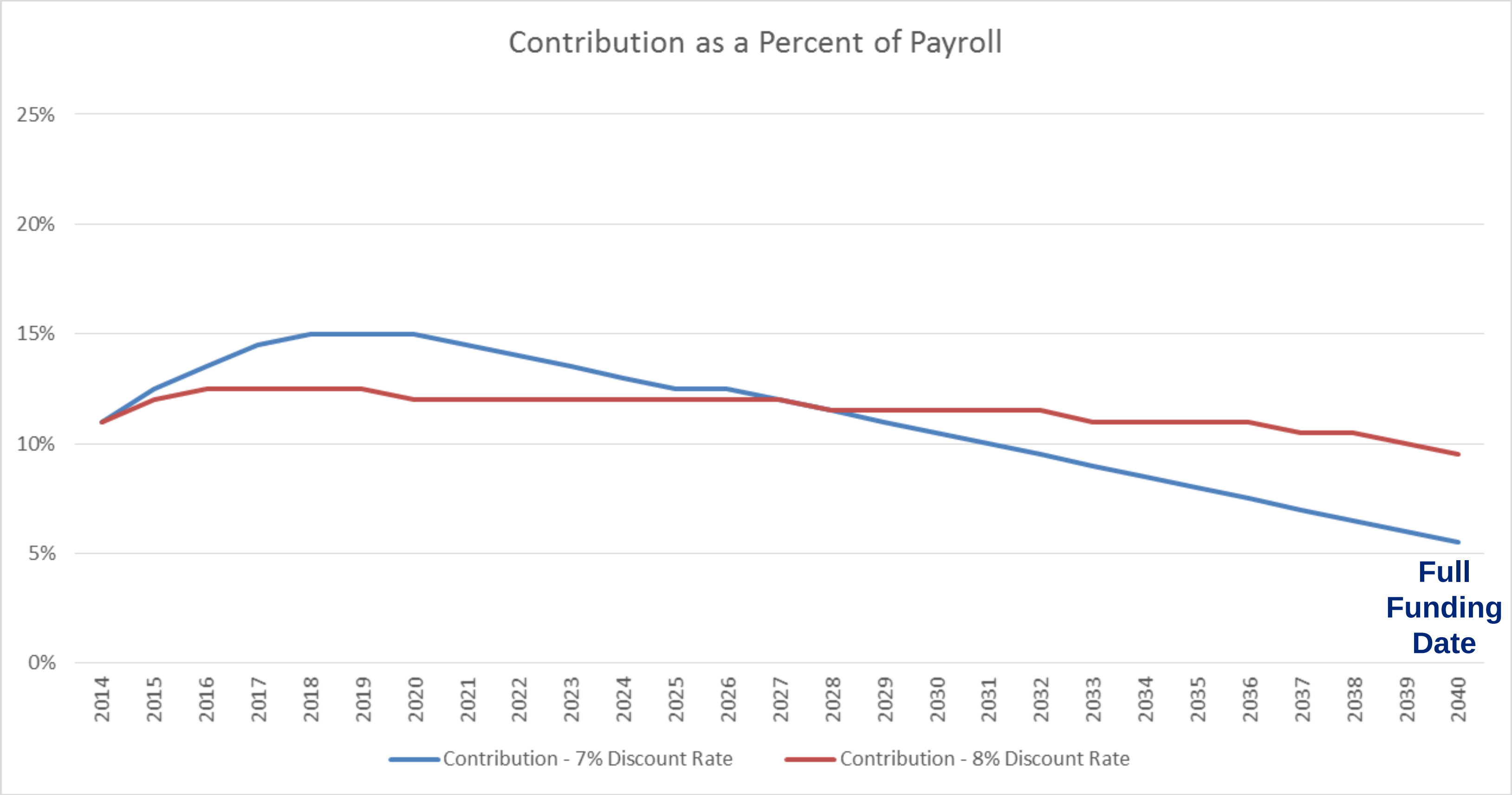
Change in Public Sector Discount Rates: 2001 – Current*



Average	8.1%	8.0%	7.9%	7.7%

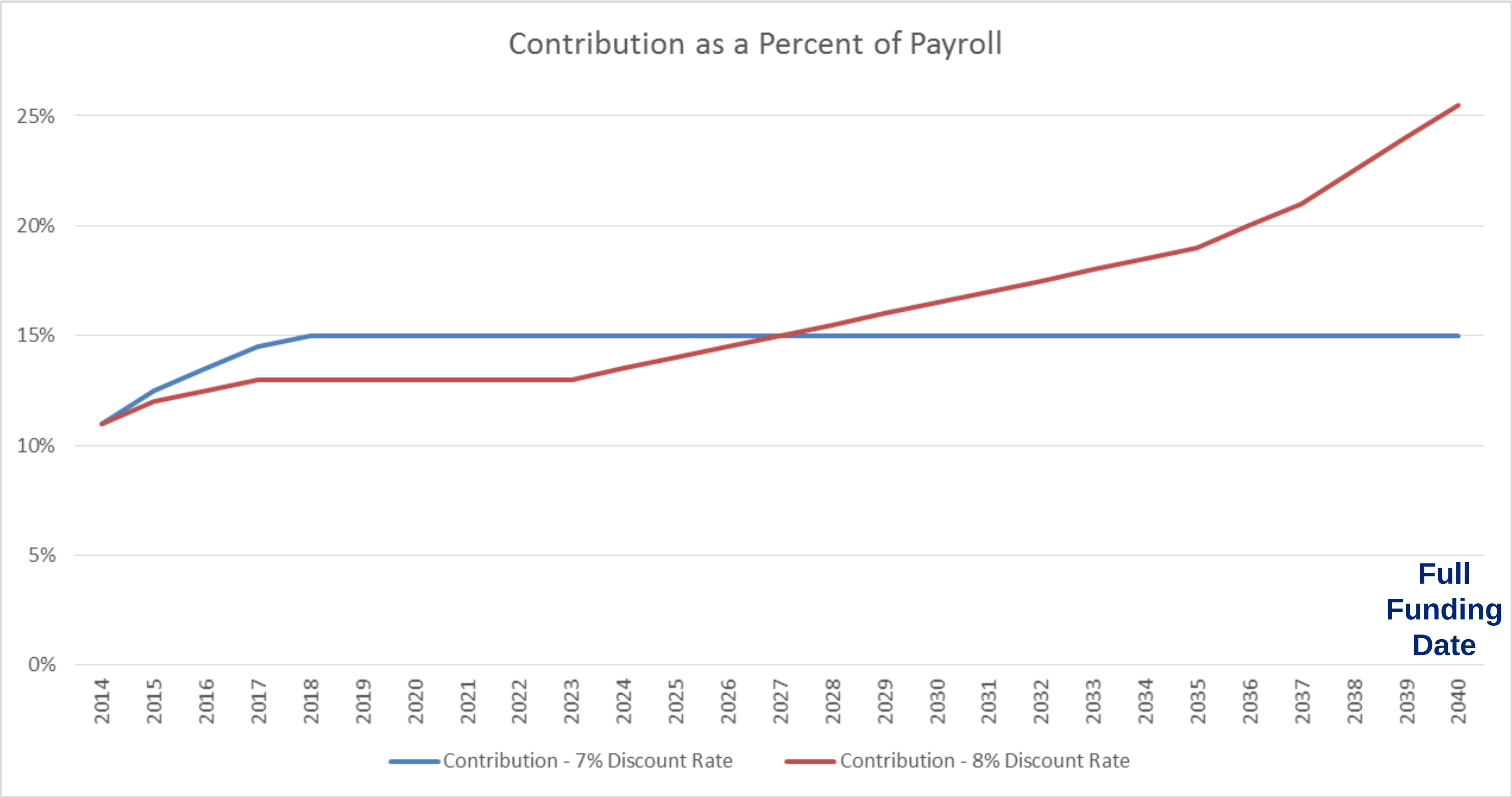
*** Source: Public Fund Survey**

MSRS Projected Contribution Rate – 8% Investment Return Environment



Note: Assumes actual funding policy mirrors that suggested by prior contribution stabilizers.

MSRS Projected Contribution Rate – 7% Investment Return Environment



Note: Assumes actual funding policy mirrors that suggested by prior contribution stabilizers.

Impact of Discount Rate Assumption

- **Reducing the discount rate has the impact of:**
  – Higher initial contribution rates
    - Reducing risk of increasing future contributions
    - Increasing the portion of contributions paid by the current generation of taxpayers/employees

  – Lower initial funded ratios
    - Reducing risk of declining future funded ratios

Pending Projects

Pending Projects

- **Projects in progress**
  - – Experience Study Review (November Commission Meeting)
  - – Review of Standards for Actuarial Work

- **Future Projects**
  - – July 1, 2015 Statewide Pension Systems Review
  - – Valuation replication for PERA – General Plan
  - – Other Commission Priorities

Deloitte.

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