THE **PUBLIC RETIREMENT** JOURNAL

Pension Reform, GASB 68 (Pension Statement) and Other Fun Stuff

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John E. Bartel

BARTEL ASSOCIATES, LLC

Agenda

Background

Background
CalPERS Contribution Rates

- Likely to continue to increase and remain high for 20-30 years
- Absent extended very high investment returns
  - 10-15% for several years
  - None predicted by independent investment advisors
- PEPRA will, for some agencies, provide some long-term relief

Background
Unfundeded Liability

- CalPERS Asset Smoothing Defers Recognition of Asset Losses
  - Modification of corridor extended deferral further
- Results in Continuation of Significant Difference Between Market and Actuarial Funded Status
- No Bright Line Test of What is Well or Poorly Funded Plan
  - Contribution Policy can have a big impact
  - What you are doing about contribution level is more important than current Funded Status

PEPRA

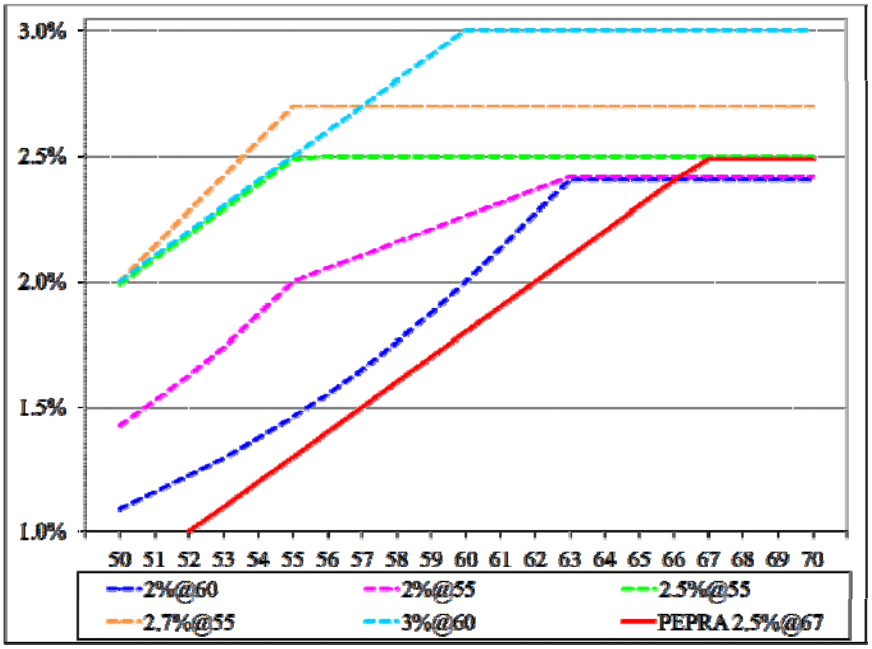
PEPRA
Defines New Members

- Employees Hired ≥ January 1, 2013 who
  - Did not participate in CalPERS or a Reciprocal System prior to January 1, 2013 or
  - Did participate in CalPERS or a Reciprocal System prior to January 1, 2013 but had a 6 month break in service before hire

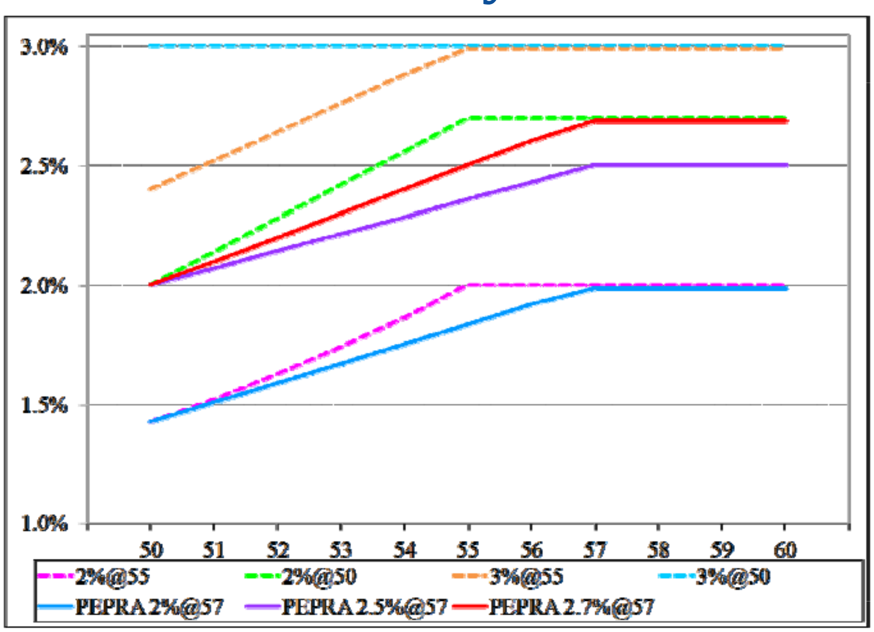
PEPRA
for New Members

- Significantly lower benefit formulas
- Generally increases Member Contribution to greater of:
  - 50% of Total Normal Cost and
  - What similarly situated employees pay
- Limits compensation used for calculating benefits
- Eliminates ability to provide supplemental DB plan

PEPRA
Miscellaneous



PEPRA
Safety



PEPRA
for New Members

- Compensation Limited to
  - 2013 Social Security Taxable Wage Base for those participating in Social Security
  - 120% of 2013 SSTWB for those **not** participating in Social Security
- Increased by CPI
- 2013 SSTWB
  - Announced in October
  - Likely ≈$113,000

PEPRA Normal Cost
for New Members

	Total	Employee
Miscellaneous 2.5% @ 67	11.9%	~~6.0%~~ 7%/8%
Safety 2.7% @ 57	21.0%	11.5%
Add for PRSA		
• Miscellaneous	≈0.6%	
• Safety	≈1.3%	

- Also add for COLAs > 2% & additional disability benefits

PEPRA
Comparing Total Normal Cost

- Increase PEPRA Total Normal Cost by
  - Post Retirement Survivor Allowance (PRSA)
  - Additional Disability Benefits and
  - COLA > 2%
- Calculate Current Member Total Normal Cost by adding:
  - Employer Normal Cost
    - If in a Risk Pool include any Class 1 Benefit surcharges
  - Member Contribution Rate

PEPRA
Comparing Employer Normal Cost

- PEPRA Employer Normal Cost
  - Total Normal Cost less
  - Employee Contribution Rate, greater of:
    - 50% of Total Normal Cost
    - Current Member contributions
- Current Member Employer Normal Cost by adding:
  - Employer Normal Cost
  - EPMC

Old Members
50% of Total Normal Cost

- 50% of sum of:
  - Employer Normal Cost
    - If in a Risk Pool include Class 1 Benefit surcharges
  - Member Contribution Rate
    - 7%/8% for Miscellaneous or
    - Generally 9% for Safety

For example	3% @ 50	2% @ 55
Er. Normal Cost	21%	9%
Member Rate	9%	7%
Total	30%	16%
50% of Total NC	15%	8%

PEPRA
for Old Members

- Does not require payment of 50% of Total Normal Cost
- Includes ability to impose cost sharing ≥ 1/1/18 with limits on total member rates:
  - 8% Miscellaneous
  - 12% Fire & Police Safety
  - 11% other Safety
- Freezes benefit formulas at December 31, 2012

PEPRA
Old Members Hired < 1/1/13

- Supplemental Plans in effect < 1/1/13, can
  - Continue and
  - Provide for increased benefits (future service only)

PEPRA
Old Members Hired ≥ 1/1/13

- Benefits based on pre PEPRA formula in place December 31, 2012
- Agencies may want to consider establishing a 2nd Tier before January 1, 2013:
  - Avoids higher formulas for laterals and
  - Likely December 31, 2012 formula can not be changed afterwards

PEPRA
All Members

- Requires Health Care Vesting be Equal for Represented and Unrepresented
  - Who does this apply to?
  - Does "Vesting" include level of benefit?
- Increases Safety IDR to greater of:
  - 50% of Pensionable Wages or
  - Actuarial Equivalent of Service Retirement Benefit

PEPRA
All Members

- Limits future benefit improvements to future service only
- Eliminates Air Time Service Purchase
- Eliminates Prior Service Benefit Improvements
  - COLAs specifically excluded
- Eliminates Contribution Holidays

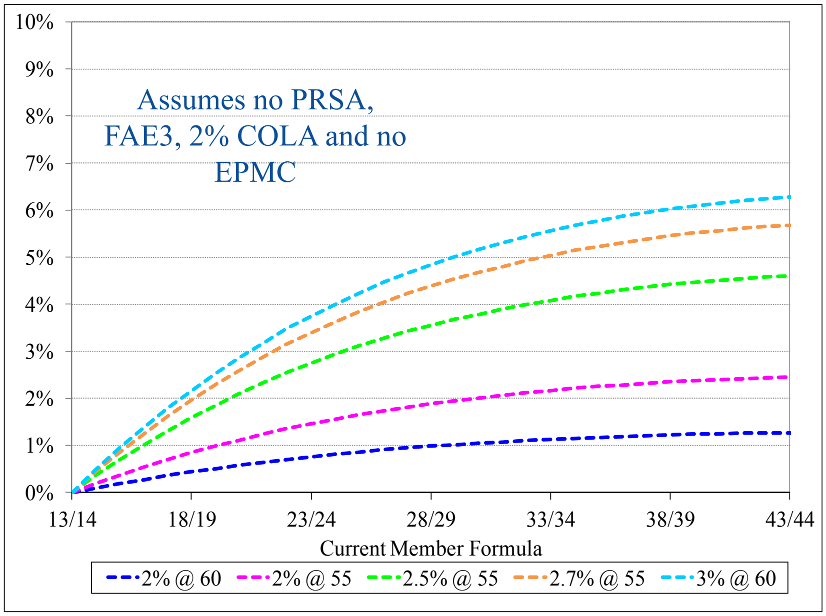
Cost Saving Projections

- Savings depend on:
  - Current formula(s)
  - Ancillary benefits (EPMC, Additional COLA and/or Enhanced IDR)
  - EPMC, including whether it is or is not pensionable

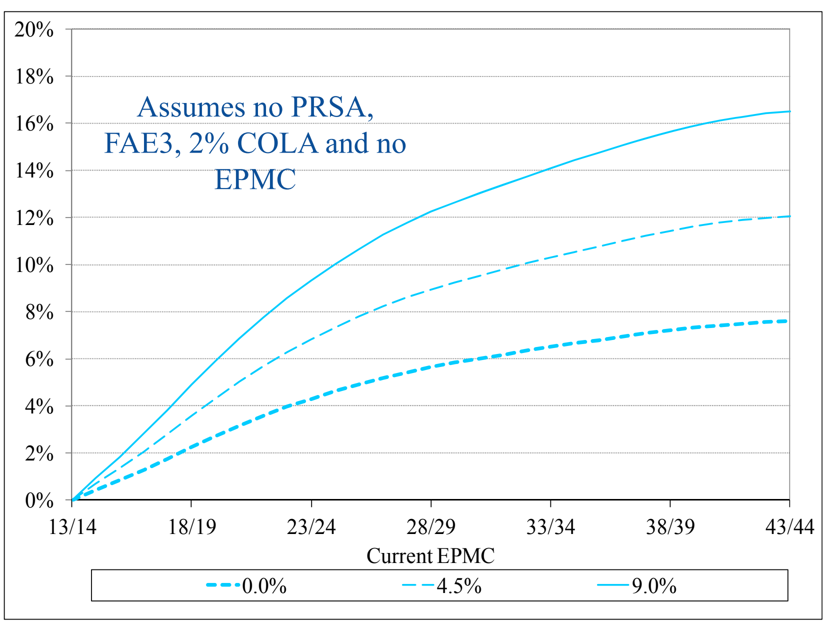
Cost Saving Projections

- E.g. 2.7% @ 55 with EPMC results in much higher savings than 2% @ 60 without
- Savings will occur gradually as New Members are hired

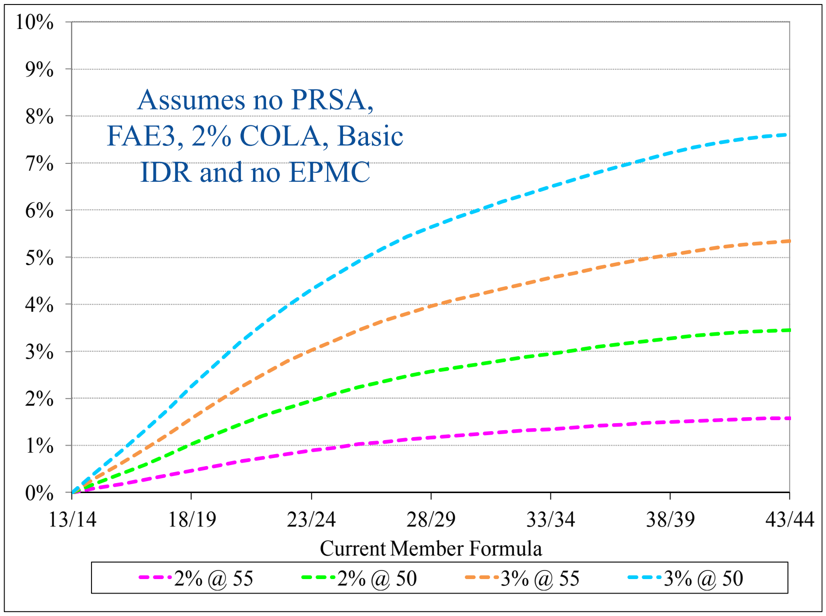
Miscellaneous Plan Projected Savings As Percentage of Total Payroll



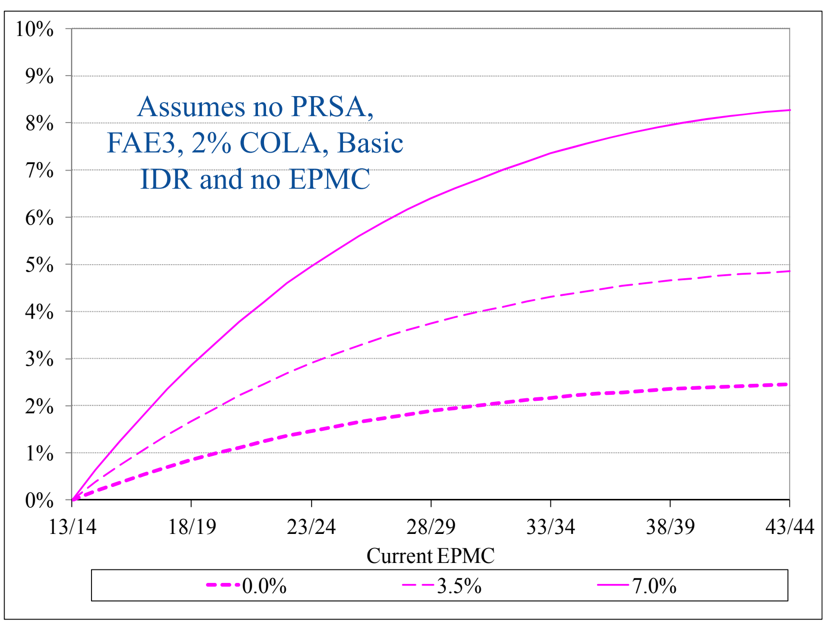
Savings for Miscellaneous 2% @ 50 with EPMC at Various Levels



Safety Plan Projected Savings As Percentage of Total Payroll



Savings for Safety 3% @ 50 with EPMC at Various Levels



Cost Saving Projections

- Savings can be significant in the long run, provided no changes in law
- Savings will occur gradually as New Members are hired

Pension and OPEB Discount Rates

CERBT Alternative Investment Mixes

- Additional CERBT asset allocations
  - Agency selects one option on or after July 1, 2011
- Target asset allocations

Asset Classifications	Option 1	Option 2	Option 3
Global Equity	66.0%	50.1%	31.6%
US Nominal Bonds	18.0%	23.9%	42.4%
REIT's	8.0%	8.0%	8.0%
U.S. Inflation Linked Bonds	5.0%	15.0%	15.0%
Commodities	3.0%	3.0%	3.0%
Total	100.0%	100.0%	100.0%

CERBT Alternative Investment Mixes

- CalPERS expected returns (20 year period):

	Option 1	Option 2	Option 3
75% Confidence Limit[1]	5.80%	5.60%	5.25%
50% Confidence Limit	**7.61%**	**7.06%**	**6.39%**
25% Confidence Limit	9.43%	8.52%	7.47%
Standard Deviation	11.73%	9.46%	7.27%

- Agency selects discount rate, not CalPERS
- Requirement that discount rate cannot be greater than 50% confidence limit rate

CERBT Discount Rate Development

- 1st 10 years expected returns – based on asset advisors 10 year projections
- Significantly higher returns assumed > 10 years
  - based on long term historical returns
  - implies investment losses in 1st 10 years
  - achievable?

CERBT Discount Rate Development

- Bartel Associates Recommendation:
  Select rate at 55% or 60% confidence limit

	Option 1	Option 2	Option 3
	55% Confidence Limit		
Discount Rate	**7.25%**	**6.75%**	**6.25%**
Maximum Discount Rate	7.61%	7.06%	6.39%
Margin for Adverse Deviation	(0.36%)	(0.31%)	(0.14%)
	60% Confidence Limit		
Discount Rate	**7.00%**	**6.50%**	**6.00%**
Maximum Discount Rate	7.61%	7.06%	6.39%
Margin for Adverse Deviation	(0.61%)	(0.56%)	(0.39%)

Pension & OPEB Discount Rates

- Discount rates are function of:
  - Real rates of return &
  - Inflation
- Outside (independent) investment advisors:
  - Significantly lower real rates of return
  - Bond returns in particular
- Do not be surprised if "***What is an appropriate discount rate?***" continues to be a major topic of discussion

GASB 68

New Pension Standard

GASB 68
What Is It?

- Changes GASB 27 – Employer accounting
- Final Standard Approved June 25th 2012
- Accounting only, contributions not affected

Who Does It Apply To?

- Employers with DB &/or DC pension plans administered through trusts in which:
  - Contributions are irrevocable
  - Assets are dedicated and used only to provide pensions to plan members
  - Assets protected from creditors
- Agencies participating in CalPERS & other California retirement systems/plans

Effective Dates?

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

GASB 68

- Types of plans
- Total pension liability
- Fiduciary net position

Types of Plans

- Three categories of pension plans
- Single Employer pension plan
  - Benefits only employees of one employer

Types of Plans (continued)

- Agent multiple-employer pension plan
  - Assets pooled for investment purposes but separate "accounts" maintained so that each employer's share legally available to pay pensions of only its employees.
- Cost-sharing multiple-employer pension plan
  - Both assets and the obligations to provide pension benefits are shared (pooled) by all employers—plan assets can be used to pay pensions of employees of any employer in the plan.

Total Pension Liability

- Measure of benefits deemed earned to date ("past service")
- Formerly known as Actuarial Accrued Liability
- "Entry Age Normal" level percent of pay cost method
- Based on:
  - Benefit terms plus 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
        - Employer contributions based on statute, written policy or last 5 years
      - 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

- Measurement Date:
  - Within 12 months of employer fiscal year end
  - OK to roll forward from a prior date within 30 months of employer fiscal year end
  - For example:

Employer Fiscal Year End	Earliest Measurement Date	Earliest Valuation Date
12/31/14	12/31/13	6/30/12
6/30/14	6/30/13	12/31/11

  - Preference is for Measurement Date = FYE

Fiduciary Net Position - Assets

- At measurement date
- Dedicated to provide pension benefits
- Fair market value, no smoothing

GASB 27
What Was It?

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

GASB 68
What Is It?

- Accounting, NOT Contributions
- Everyone will recognize pension unfunded liability (asset) regardless of contributions
- Net Pension Liability drives Pension Expense
- Systems and plan sponsors will need to look elsewhere for out of bounds markers
  - Actuaries?
  - Legislature?
  - Common sense?

GASB 68

- New: A pension plan's net liability is recognized in the employer's financial statements
- New calculation of pension expense
- Additional note disclosures and RSI
- Similar to recent FASB and international accounting

Single and Agent Employers Recognize

- Net Pension Liability (Asset):
  - Recognized in financial statement
  - Equal to:
    - Total Pension Liability

      net of
    - Fiduciary Net Position

Pension Expense

- Change in Total Pension Liability (AAL)

  minus
- Change in Fiduciary Net Position (MVA)

  less
- Deferred Outflows and Inflows for the period

  plus
- Portion of deferrals recognized in current period

Deferred Outflows and Inflows

- Deferred outflows and inflows of resources related to pensions
- Cumulative changes in Net Pension Liability which have not yet been recognized in pension expense
  - Unamortized portions of gains and losses and assumption changes.
- Contributions made after the Measurement Date

Change in Total Pension Liability

- Deferred recognition for active & inactive gains/losses and assumption changes.
  - Recognized over closed period based on average of active and inactive remaining future service
  - May be level \$ or level % of pay
  - Likely ≈5-8 years
    - Shorter for plans with high ratio of retirees and
    - Longer for plans with high ratio of actives

Change in Total Pension Liability

- Immediate recognition for:
  - Service Cost based on same method and assumptions as noted above
  - Interest using blended single discount rate
  - Benefit changes
  - Data adjustments ?
  - Plan administration costs if paid from plan assets, etc.

Change in Fiduciary Net Position

- Immediate recognition for
  - Expected investment earnings
  - Contributions, benefit payments
- Deferred recognition for
  - Investment gains/losses on MVA
    - Five year closed period
    - More rapid than typical current practice.

Cost Sharing Multiple-Employer Pensions

- For example, CalPERS Risk Pools
- Plan or Risk Pool's net pension liability calculated same as for single and agent employers
- Agency reports & recognizes proportionate share of Plan's or Risk Pool's net pension liability
  - Any reasonable method to determine proportion
  - Should be consistent with the contribution determination
  - Likely but not required to be determined by Plan

Cost Sharing Multiple-Employer Pensions

- Deferred recognition over closed period based on average remaining future service of the Plan's active & inactive employees for:
  - Gains/losses & assumption changes
  - Effect of change in employer's proportion
  - Effect of differences between actual recognized contribution and expected proportionate share of total employer-related contributions

GASB 68 - Other Issues

- Special funding situations
  - Special provisions apply to entities other than the employer that are legally required to contribute to the employer's plan
- Employers with pension plans not funded through qualified trusts:
  - Will be addressed later and
  - Should continue to apply Statement Nos. 27/50

GASB 68 - Other Issues

- Defined Contribution Pensions, Recognize:
  - Expense for contributions for period as defined by plan's terms
  - Cash expenditures for amounts contributed
  - Liability for difference
- Employers with OPEB:
  - Will be addressed later and
  - Continue to apply Statement No. 45

What Can You Do About Increasing Pension Costs?

What Can You Do About Increasing Pension Costs?

- Short Term
  - Employer Paid Member Contributions (EMPC)
  - Employees Pay Portion of Employer Rate
  - Early Retirement Window
  - CalPERS Pooled Plan – Side Fund
- Long Term
  - 2nd Tier
  - CalPERS non-Pooled Plans
  - More Pension Reform
  - Understand the Issues

Early Retirement Window §20903 - 2 Yrs Additional Svc Credit

- Specified job classification, department, etc.
- 90-180 day window
- Disclose under GC §7507
- Generally does not save money if positions are filled

Early Retirement Window
§20903 - 2 Yrs Additional Svc Credit

- Additional "Cost":
  - Estimated by agency not CalPERS
  - Factored into future rates (2 years later) based on actual election

Early Retirement Window

- Establish own incentive:
  - For example
    - Enhanced retiree medical benefit
    - Supplemental plan
  - Generally does not save money if positions are filled

CalPERS Pooled Plan Side Fund

- Created when Risk Pools created in June 30, 2003 Valuation
- Pool treats side fund as contribution receivable
- Fixed 7½ % interest rate
- Can likely borrow at much lower rate
  - Unless amortization period is long
- Can be significant & immediate savings

CalPERS Pooled Plan Side Fund

- 2nd Tier with long amortization can significantly mitigate savings
- PEPRA essentially creates 2nd Tier for every agency
- CalPERS will need to re-address how side fund payments will be made

Message

- 2nd Tier likely saves very little in the short run
- Real savings comes from having employees pay more

Appendices

- PEPRA:
  - Bartel Associates September 20, 2012 PEPRA Summary
    - www.Bartel-Associates.com
  - September 14, 2012 PERS PAC Alert
- Anthony T. Oliveira, *The Local Challenges of Pension Reform*
  - http://www.tonytoliveira.com/Research.html