

Emerging Issues Forum

Managing the Challenge

Funding Schedule Extension (2011)

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Funding Schedule Extension

- July, 2009 –PERAC Actuarial Advisory Committee:
 - Stephen Ricci, Ricci Consultants
 - Kathleen Riley, Segal Company
 - Daniel Sherman, Buck Consultants
 - Lawrence Stone, Stone Consultingmakes its recommendations.



Funding Schedule Extension

- Proposed long-term funding solution for Massachusetts systems
- 2008 investment returns were the impetus
- Discussions on extending 2028 began over 5 years ago
- Provide relief responsibly



Extend Schedule to 2040 (Under 22F)

- Increasing annual amortization 4.0% maximum
- Appropriation in any fiscal year at least as great as prior year (until fully funded)
- If appropriation would increase more than 8%, it may be adjusted



Funding Strategies

- Maintain the Budget!
- 2009 valuations (42)
- 2010 valuations (79)
- 2011 valuations (50 scheduled)

Stay Within 2030 Rules

- Preferred by many systems
- Is it feasible? 30% - 50% increases using same schedule
- Many systems must extend beyond 2030
- Originally expected 60-75% of locals to extend

Extend Beyond 2030

- Can't extend to 2040 unless necessary
- Alternatives
 - Shorten schedule
 - Lower annual amortization increase

Short-term Implications

- 2008 investment losses not fully recognized (actuarial value)
- 1/1/11 valuations- 2 more years to recognize
- “Things will get worse before they get better.”
 - Generally 15%- 20% returns required (short-term) to maintain position
 - 1/1/13 valuation may need to extend further to maintain appropriation

2009 Valuations

- Extension to 2030 – very little help
- Significant increases using same schedule (30% - 50% +)
- Without 2040 option many systems looking at 20% + increases



2010 Valuations

- Situation slightly improved
 - Investment gains
 - Liability gains (usually)
- 2030 schedules possible (for about **60%** of plans)
- 2040 schedules work for most



2011 Valuations

- Situation improved
 - Investment gains
 - Liability gains (usually)
- Already beginning to reflect 2008 losses (2009 Valuation)

2011 PERAC Local Valuations

Results to date: 9 systems

Reduce investment return assumption	3
Add mortality improvement assumption	9
Increase COLA base	3
Recognize another 40% of 2008 loss	9
No further extension of schedule necessary	9

2011 Valuations

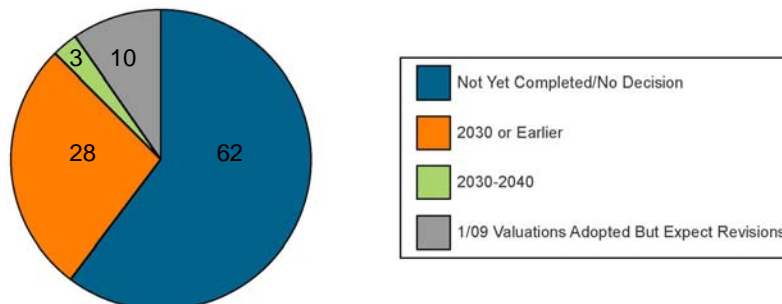
- Generally, no further extension is necessary
- Why?
 - Actuarial liability gains
(Primarily salary gains)
 - Decrease in active members
 - Actuarial value of assets corridor

2011 Valuations

- Extremely positive (and surprising?) results
 - Expected 5-10 years to deal with loss
 - Things **can** get worse before they get better
 - Mindset for 1/13 valuations: Expect schedule will need to be extended

Funding Schedules Adopted

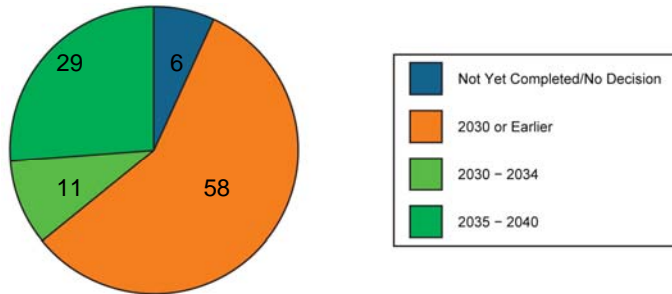
2009 and 2010 Valuations
As of September 2010



Funding Schedules Adopted

2009 and Later Valuations

As of September 2011



When 2040 Doesn't Work

■ Example:

- FY13 under current schedule \$1,000

- FY13 based on 1/1/11 valuation \$1,200

Phase-in Schedule

- To get systems back on track
- Schedule ramps up over 3-5 years
- Used for a number of systems under 2028 rules
- 8% annual increases serve as a phase-in

Alternative Approach

- Set increase in **total** appropriation
 - For example, 5% per year increases
 - More aggressive funding

Valuation Funding Schedules

- Regular: 4.0% annual increasing **amortization** to 2036
- Alternative: 5.0% annual increasing **appropriation** to 2032

FOR ILLUSTRATION PURPOSES ONLY!!!!

Investment Return Assumption

- Should it be reduced?
- PERAC “Standard”: 8.0% since 1997
- Pressure to **increase** in late 1990s
- Pressure to **decrease** over past few years

Investment Return and Salary Increase Assumption Example

Investment Return	8.0%
Actives	2,800
Retirees	<u>3,200</u>
Total Actuarial Liability	6,000
Assets	4,000
Unfunded Liability	2,000
Funded Ratio	66.7%

Investment Return and Salary Increase Assumption Examples

Investment Return	8.0%	7.5%
Actives	2,800	3,000
Retirees	<u>3,200</u>	<u>3,300</u>
Total Actuarial Liability	6,000	6,300
Assets	4,000	4,000
Unfunded Liability	2,000	2,300
Funded Ratio	66.7%	63.5%

Investment Return and Salary Increase Assumptions

- Long-term
- Inflation components
- Should generally move together

Investment Return and Salary Increase Assumption Examples

Investment Return	8.0%	7.5%	7.5%
Salary Scale	Current	Current	*
Actives	2,800	3,000	2,900
Retirees	<u>3,200</u>	<u>3,300</u>	<u>3,300</u>
Total Actuarial Liability	6,000	6,300	6,200
Assets	4,000	4,000	4,000
Unfunded Liability	2,000	2,300	2,200
Funded Ratio	66.7%	63.5%	64.5%

*current reduced by 1% at all ages

Investment Return and Salary Increase Assumption Examples

Investment Return Salary Scale	8.0% Current	7.5% Current	7.5 % *	7.75% *
Actives	2,800	3,000	2,900	2,790
Retirees	<u>3,200</u>	<u>3,300</u>	<u>3,300</u>	<u>3,250</u>
Total Actuarial Liability	6,000	6,300	6,200	6,040
Assets	4,000	4,000	4,000	4,000
Unfunded Liability	2,000	2,300	2,200	2,040
Funded Ratio	66.7%	63.5%	64.5%	66.2%

*current reduced by 1% at all ages

Final Observations

- Investment return assumption has the most impact
- Salary scale has the second most impact
- Reduction in investment return assumption should be mitigated
- Measured approach:
 - No need to reduce to 7.5% immediately
 - Over time – maybe?
 - Monitor all assumptions each year