



Revised ASOP 4 and Applicability to Chapter 32 Systems

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EMERGING ISSUES FORUM

Effective Date

- Actuarial report issued on or after February 15, 2023
- Measurement date after February 15, 2023
- Therefore, in January 1, 2024 actuarial valuations
 - Disclose in 2023?

Applicability to Chapter 32 Systems

- Applicable to all pension plans
 - Public and private

NOTES:

Acronyms Used

- **ASOP:** Actuarial Standards of Practice
- **LDROM:** Low-Default-Risk Obligation Measure
- **ADC:** Actuarially Determined Contribution
- **RADC:** Reasonable Actuarially Determined Contribution
- **UAL:** Unfunded Actuarial Liability

Items to Be Discussed Today

- Actuarial Assumptions
- Gain/Loss
- LDROM
- Reasonable ADC

NOTES:

Actuarial Assumptions

- Should also refer to ASOP 27 and 35 (same as currently)
- Assess whether combined effect of assumptions is expected to have no significant bias
- Who sets assumptions?
 - Retirement Board on advice of the actuary

Gain/Loss Analysis

- Effect on the plan's fund status between two measurement dates
 - Difference between expected (based on assumptions) and actual experience
- Perform as part of each valuation
 - Separate total into investment and other (liability)

NOTES:

Gain/Loss Analysis *(Cont'd)*

- Limited impact on Chapter 32 plans
 - PERAC has always calculated
 - **May** require more detail than provided in past local valuation reports

Low-Default-Risk Obligation Measure (LDRM)

- New disclosure
 - Benefits earned to date or accrued liability
 - Use discount rate derived from low-default-risk fixed income securities with cash flows reasonably consistent with benefit payments to be paid
 - US Treasury Yields
 - Yields on corporate or tax-exempt general obligation municipal bonds

NOTES:

Low-Default-Risk Obligation Measure (LDROM) (Cont'd)

- Lower discount rate reflects higher liabilities
 - Ongoing long-term debate as to whether appropriate measure
 - Long term funding vs. short term discount rate
 - Confusion for readers of the report?

Low-Default-Risk Obligation Measure (LDROM) (Cont'd)

- The calculation and disclosure of this measure is not intended to suggest that this is the “right” liability measure for a pension plan
 - Provides a more complete assessment of a plan’s funded status and provides additional information regarding the security of benefits that members have earned as of the measurement date

NOTES:

Low-Default-Risk Obligation Measure (LDROM) (Cont'd)

Actuary should provide:

“commentary to help the intended user understand the significance of the LDROM with respect to the funded status of the plan, plan contributions, and the security of participant benefits”



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Reasonable Actuarially Determined Contribution (RADDC)

- Determine as part of actuarial valuation
 - Might not be the contribution determined under funding schedule
- Requires using reasonable actuarial assumptions
- Amortization method

EMERGING ISSUES FORUM 2022 | REVISED ASOP 4 | 13

NOTES:

RADC Amortization Method

- Each amortization base
 - Fully amortize in *a reasonable period*
OR
 - Reduce outstanding balance by *a reasonable amount* each year
- Total amortization bases
 - Fully amortize UAL in *a reasonable period*
OR
 - Reduce UAL by *a reasonable amount* in *a sufficiently short period*

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RADC Amortization Period

- Questions
 - What is a reasonable period?
 - What is a reasonable amount?
 - What is a sufficiently short period?



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NOTES:

RADC Amortization Period (Cont'd)

- Answers
 - We don't know.
 - But we will offer our opinion.



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RADC Amortization Period (Cont'd)

- All comments reflect PERAC's current opinion
- Subject to change as we learn more
- Our focus on **total** amortization bases
 - Most plans currently with one large base (UAL)
 - Other bases usually smaller (ERIs)

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NOTES:

RADC Amortization Period (Cont'd)

- Focus on each individual base instead of total base
- Layered Amortization Schedules (see 2019 EI)
 - Original UAL: 20 years
 - Plan Amendments changes: 10-15 years
 - Assumption changes: 15-25 years
 - Gain/(Loss): 15-20 years
 - ERIs: 5 years
- Would require a change in law!

EMERGING ISSUES FORUM 2022 | REVISED ASOP 4 | 18

RADC Amortization Period (Cont'd)

- Fully amortize UAL in *a reasonable period*
 - 15-20 years
 - 18 coincides with requirement of full funding by 2040
 - 10 seems too low
 - 20 seems at high end of reasonable period

EMERGING ISSUES FORUM 2022 | REVISED ASOP 4 | 19

NOTES:

RADC Amortization Period (Cont'd)

- Reduce UAL by *a reasonable amount* in a sufficiently short period
 - Sufficiently short period: 5-7 years
 - 10 seems too high if reasonable period is 15-20
 - Less than 5 seems too short
 - Reasonable amount
 - Probably the most nebulous
 - Need to look at funding schedule as how UAL amortized
 - ❖ 20-30% or more?? Not negligible, not most of the UAL

EMERGING ISSUES FORUM 2022 | REVISED ASOP 4 | 20

RADC Amortization Period (Cont'd)

- Schedules that have total payments which increase by certain percentage are not “traditional” amortization schedules
 - PERAC does not believe that these schedules satisfy the conditions for a RADC

EMERGING ISSUES FORUM 2022 | REVISED ASOP 4 | 21

NOTES:

RADC Impact on Funding Schedules

- Boards can still maintain current methodology
- However, must disclose RADC
- Move to developing schedules in accordance with RADC?

Chapter 32 Funding Schedules (as of 8/1/22)

- Traditional Amortization- pay off at set date
 - Max 4.5% annual increasing amortization to 2030 or earlier
 - Max 4.0% annual increasing amortization to 2030-2040
- Total Increasing Payments
 - Payments increase by a set percent each year until UAL paid off
- Phase-in Schedules
 - Total payments increase by a set percentage for a number of years, **then** traditional amortization
- At or near fully funded – normal cost or level dollar payments

NOTES:

Chapter 32 Funding Schedules (as of 8/1/22) (Continued)

11	Traditional
82	Total Increasing
6	Phase-In
5	At or Near Fully-Funded

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Chapter 32 Funding Schedules

- Prior to 2009, all schedules Traditional
- 2010 Municipal Relief Act
 - Established 4.0% increasing amortization to 2040 (from 2030)
 - Allowed Total Increasing of up to 8.0% **if** appropriation would have increased by over 8%
- Originally only those systems needing immediate relief adopted approach
 - Those completing amortization in 2028 (or 2030)

EMERGING ISSUES FORUM 2022 | REVISED ASOP 4 | 25

NOTES:

Chapter 32 Funding Schedules (Cont'd)

- Over time, well-funded systems also adopted this approach
 - Defined percentage increases for a set period
 - Allowed to fund more aggressively
- PERAC approved as long as funding was more aggressive than “minimum” schedule (4.0% increasing amortization to FY40)

Chapter 32 Funding Schedules and Impact on RADC Disclosure

- Total Increasing Schedules may pay down UAL more quickly
 - **BUT** it is not a traditional amortization method with payoff at a specific date
 - Therefore, likely will need to disclose using a traditional method
- If disclose a different schedule for RADC should we change methodology for determining funding schedule?
 - Then, no conflict between the two

NOTES:

Chapter 32 Funding Schedules and Impact on RADC Disclosure *(Cont'd)*

- Many with Total Increasing schedules could disclose RADC with the same or lower payments by extending length of schedule
 - Total Increasing 6.0% per year until FY27 final amortization payment FY28
 - RADC might be 4.0% increasing amortization until FY30

Chapter 32 Funding Schedules and Impact on RADC Disclosure *(Cont'd)*

- Would Board prefer:
 - Maintain the funding schedule and disclose a second schedule under RADC?

OR

 - Adopt a funding schedule which would also satisfy RADC?

NOTES:

Chapter 32 Funding Schedules and Impact on RADC Disclosure *(Cont'd)*

- Expect boards will feel differently
 - Some may want to continue funding more aggressively
 - Some may prefer to be consistent
- “Why do you have two different contributions based on two schedules?”

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Chapter 32 Funding Schedules and Impact on RADC Disclosure *(Cont'd)*

- Disclosed RADC might be same as current contribution
 - With same basis as the adopted funding schedule
- Disclosed RADC might be same as current contribution
 - With different basis from the adopted funding schedule
- Disclosed RADC might be different from current contribution
 - With different basis from the adopted funding schedule

EMERGING ISSUES FORUM 2022 | REVISED ASOP 4 | 31

NOTES:

Chapter 32 Funding Schedules and Impact on RADC Disclosure (Cont'd)

- Some boards will not be able to adopt a traditional schedule without a significant increase in appropriation
 - 8.0% Total Increasing to FY36 with a final amortization payment in FY37
 - 4.0% increasing annual amortization to FY40 (traditional)
 - Significant increase in first several years of schedule
- Expect these systems to maintain the Total Increasing schedule
 - Can't afford the increase in the Traditional schedule



NOTES:

Chapter 32 Funding Schedules and Impact on RADC Disclosure (Cont'd)

- 8.0% Total Increasing to FY36 with a final amortization payment in FY37 (In thousands)

FY	Normal Cost	Amortization of UAL	Total Cost
2023	2,400	3,000	5,400
2024	2,500	3,350	5,850
2025	2,600	3,700	6,300
2036	4,200	10,500	14,700
2037	4,400	600	5,000

EMERGING ISSUES FORUM 2022 | REVISED ASOP 4 | 34

Chapter 32 Funding Schedules and Impact on RADC Disclosure (Cont'd)

- 4.0% Increasing Annual Amortization of UAL to FY40 (in thousands)

FY	Normal Cost	Amortization of UAL	Total Cost
2023	2,400	3,400	5,800
2024	2,500	3,550	6,050
2025	2,600	3,700	6,300
2036	4,200	5,700	9,900
2037	4,400	5,900	10,300
2040	5,000	6,700	11,700

EMERGING ISSUES FORUM 2022 | REVISED ASOP 4 | 35

NOTES:

Chapter 32 Funding Schedules and Impact on RADC Disclosure *(Cont'd)*

- How many systems in this group?
 - Difficult to say
 - To determine accurately would take analysis for each system

Chapter 32 Funding Schedules – Breakdown of Total Increasing Schedules

- Includes several phase-in schedules deemed Total Increasing

Amortization Completed	Percent Increasing	Number of Schedules
Before 2030	4.0% or less	3
	4.1% to 6.0%	7
	6.1% to 7.9%	5
	8.0% or greater	11

NOTES:

Chapter 32 Funding Schedules – Breakdown of Total Increasing Schedules (Cont'd)

Amortization Completed	Percent Increasing	Number of Schedules
2031 - 2035	4.0% or less	3
	4.1% to 6.0%	20
	6.1% to 7.9%	4
	8.0% or greater	4

EMERGING ISSUES FORUM 2022 | REVISED ASOP 4 | 38

Chapter 32 Funding Schedules – Breakdown of Total Increasing Schedules (Cont'd)

Amortization Completed	Percent Increasing	Number of Schedules
After 2035	4.0% or less	1
	4.1% to 6.0%	7
	6.1% to 7.9%	4
	8.0% or greater	4

EMERGING ISSUES FORUM 2022 | REVISED ASOP 4 | 39

NOTES:

Conclusion

- Our focus has been on RADC
 - Applicability
 - Boards may be more involved
- Uncertainty regarding the LDROM disclosure
- This is a work in progress

NOTES:

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