Oregon PERS Update

OMFOA Fall Conference

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PERS Oregon Public Employees Retirement System

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Today’s Topics

- PERS funded status and contribution rates
- Introduction to GASB 67 and GASB 68
- Implementation of GASB 68 for PERS Employers
- Demystifying GASB 45 retiree medical/OPEB reporting, time permitting

PERS Funded Status & Contribution Rates

"It's tough to make predictions, especially about the future"

-Yogi Berra

Valuation Process and Timeline

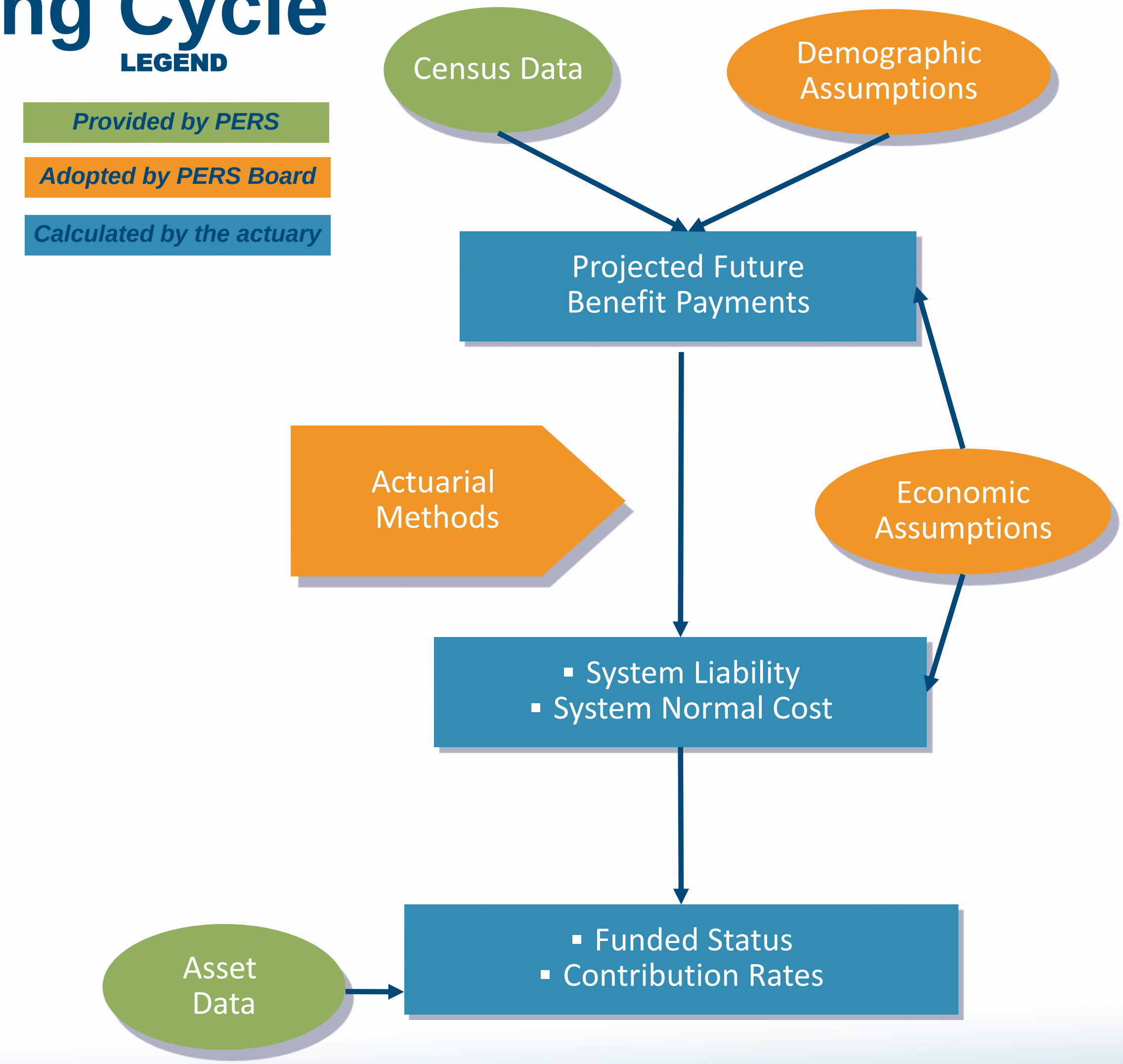
All slides in this section are from the July 2014 presentation by Milliman to the PERS Board

- Actuarial valuations are conducted annually
  – Alternate between “rate-setting” and “advisory” valuations
  – The 12/31/2013 valuation was rate-setting
- The PERS Board adopts employer contribution rates developed in rate-setting valuations
  – Those rates go into effect 18 months subsequent to the valuation date

Valuation Date	Employer Contribution Rates
12/31/2011 →	July 2013 – June 2015
12/31/2013 →	July 2015 – June 2017

Two-Year Rate-Setting Cycle

- July 2013: Assumptions & methods endorsed by Board in consultation with the actuary
- September 2013: System-wide 12/31/12 “advisory” actuarial valuation results
- November 2013: Advisory 2015-2017 employer-specific contribution rates
- July 2014: System-wide 12/31/13 “rate-setting” actuarial valuation results
- September 2014: Disclosure & adoption of employer-specific 2015-2017 contribution rates



Guiding Principles for Setting Rates

- In setting rates, the PERS Board has identified the following guiding principles:
  - Transparent
  - Predictable and stable rates
  - Protect funded status
  - Equitable across generations
  - Actuarially sound
  - GASB compliant
- Tension exists between some of the goals (e.g. stability of rates and protecting funded status)
  - Balancing the competing priorities is important to the policy decisions surrounding the rate-setting cycle

Guiding Principles for Setting Rates

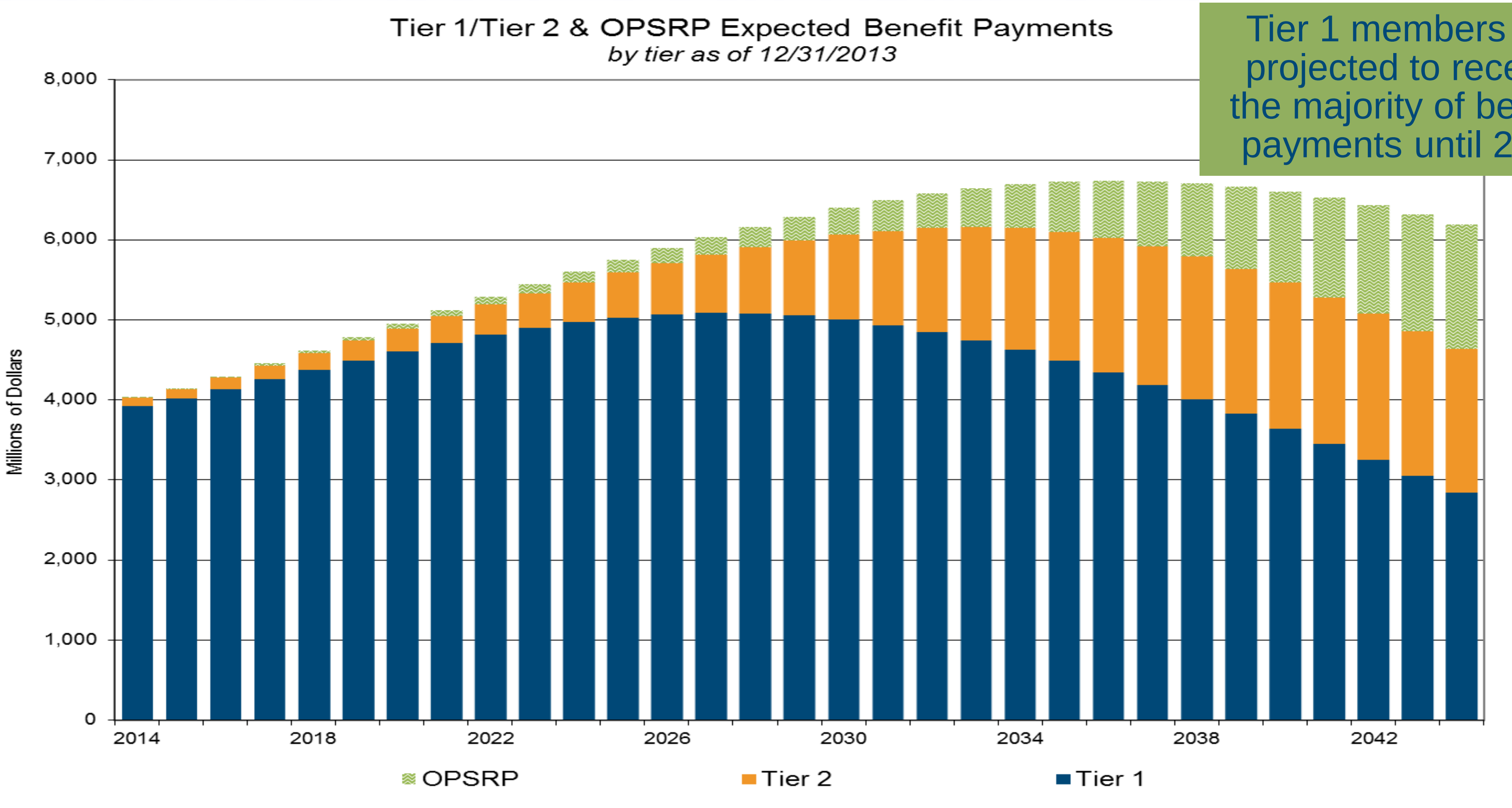
- Recently, several notable organizations have published principles and policy objectives for public plan sponsors to consider
  - GFOA and “Big 7”, American Academy of Actuaries, Conference of Consulting Actuaries, Society of Actuaries
  - Many similarities to the PERS framework shown on prior slide
- For example, GFOA recommends that sponsoring employers:
  - Base contributions on an actuarially determined rate
  - Fully fund the actuarial rate in each period
  - Develop the actuarial rate to balance goals of:
    - Keeping contributions stable, and
    - Equitably allocating costs over periods of service
  - Demonstrate accountability and transparency

Changes Since Last Rate-Setting Valuation

- 12/31/2011 valuation developed initial 2013-2015 contribution rates
- 2013 legislative changes (SB 822 & 861) lowered projected benefits
  - Reflected in final 2013-2015 rates per legislative direction
- PERS Board adopted new assumptions and methods from the 2012 Experience Study, including:
  - Lowering investment return assumption to 7.75%
  - Changing to the GASB 68-friendly Entry Age actuarial cost allocation method
  - Re-amortizing all existing Tier 1/Tier 2 Unfunded Accrued Liability (UAL) as of 12/31/2013 over a twenty-year period
- 2012 and 2013 asset returns were greater than assumed
  - Generated approximately $6.4 billion actuarial gain over the biennium

Development of Liabilities

Liabilities are calculated from projected benefit payments



Tier 1 members are projected to receive the majority of benefit payments until 2042

System-Wide Pension Valuation Results

Tier 1/Tier 2 & OPSRP (Excluding Retiree Health Care)

Reflects:	12/31/2011	12/31/2012	12/31/2013
SB 822 & SB 861 Benefit Changes?	***No***	***Yes***	***Yes***
2012 Experience Study Assumptions?	***No***	***Yes***	***Yes***
Accrued Liability	\$61.2	\$60.4	\$62.6
Assets (excluding side accounts)	\$44.9	\$49.3	\$54.1
Unfunded Accrued Liability (UAL)	\$16.3	\$11.1	\$8.5
Funded Status (excluding side accounts)	**73%**	**82%**	**86%**
Assets (including side accounts)	\$50.2	\$54.8	\$60.0
UAL (including side accounts)	\$11.0	\$5.6	\$2.6
Funded Status (including side accounts)	**82%**	**91%**	**96%**

(amounts in billions)

Collared System Average Base & Net Rates

Excludes Retiree Health Care & IAP Contributions

	12/31/2011[1] 2013 - 2015 Rates			12/31/2013[1] 2015 - 2017 Rates		
	Tier 1 / Tier 2	OPSRP	System-Wide	Tier 1 / Tier 2	OPSRP	System-Wide
Collared Base Rate	**17.34%**	**14.90%**	**16.50%**	**19.70%**	**14.31%**	**17.46%**
Side Account (Offset)	(5.26%)	(5.26%)	(5.26%)	(6.38%)	(6.38%)	(6.38%)
SLGRP Net (Offset)	(0.44%)	(0.44%)	(0.44%)	(0.47%)	(0.47%)	(0.47%)
Collared Net Rate	**11.64%**	**9.20%**	**10.80%**	**12.85%**	**7.46%**	**10.61%**
Change from 2013-2015				**1.21%**	**(1.74%)**	**(0.19%)**

Rates vary substantially by employer and by pool, and not all employers have side account offsets

Changes in side account offsets are not restricted by the "rate collar", and thus net rates are more volatile than base rates

[1] *For this exhibit, adjustments are assumed not to be limited due to an individual employer reaching a 0.00% contribution rate.*

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Comments on System Average Rates

- No single employer pays the system average rate
  - School district base rates are above the average
  - Most SLGRP employers' base rates are below the average
- Rates shown do not include the effects of:
  - Individual Account Plan (IAP) contributions
  - Rates for the RHIA & RHIPA retiree healthcare programs
  - Debt service payments on pension obligation bonds

Pool Average Employer Contribution Rates

- A listing of contribution rates for each employer was presented at the September Board meeting
- Employer rates are developed by payroll category
  - Tier 1/Tier 2
  - OPSRP General Service
  - OPSRP Police & Fire
- An employer's rates in each category depend on:
  - Tier 1/Tier 2 pooling arrangement (SLGRP, school district, independent)
  - Employer-specific items like side accounts or pre-SLGRP liabilities
- Following slides show <u>pool average</u> "base" and "net" rates for employers in the two large Tier 1/Tier 2 rate pools

SLGRP Average Contribution Rates

(Includes Retiree Health Care, Excludes IAP)

	Pool Average Base Rate			Pool Average Net Rate		
	2013-15	2015-17	Change	2013-15	2015-17	Change
Tier 1/Tier 2 GS/PF Payroll	16.05%	19.58%	3.53%	11.03%	13.79%	2.76%
OPSRP GS Payroll	13.04%	13.13%	0.09%	8.02%	7.34%	(0.68%)
OPSRP PF Payroll	15.77%	17.24%	1.47%	10.75%	11.45%	0.70%
Weighted Average	**15.11%**	**17.06%**	**1.95%**	**10.09%**	**11.27%**	**1.18%**

- Between the 2011 and 2013 rate-setting valuations the SLGRP's Tier 1/Tier 2 UAL decreased from $7.9 billion to $3.9 billion
  - SLGRP payroll is approximately $5.1 billion
- Individual employer rates will vary from average due to:
  - Member payroll split between tiers and job classifications
  - Employer-specific pre-SLGRP liabilities or surpluses and transition liabilities or surpluses
  - Employer side accounts

School District Average Contribution Rates

(Includes Retiree Health Care, Excludes IAP)

	Pool Average Base Rate			Pool Average Net Rate		
	2013-15	2015-17	Change	2013-15	2015-17	Change
Tier 1/Tier 2 Payroll	22.29%	22.33%	0.04%	13.94%	11.71%	(2.23%)
OPSRP GS Payroll	20.29%	17.64%	(2.65%)	11.94%	7.02%	(4.92%)
Weighted Average	**21.64%**	**20.50%**	**(1.14%)**	**13.29%**	**9.88%**	**(3.41%)**

- Between the 2011 and 2013 rate-setting valuations school districts' Tier 1/Tier 2 UAL decreased from $7.0 billion to $3.4 billion
  - School district payroll is approximately $2.7 billion
  - The UAL decrease is similar to the SLGRP's but school district payroll is barely half of SLGRP payroll, making school district base rates more sensitive to investment outperformance than SLGRP base rates
- Side accounts further leveraged net rate changes
- Individual district rates will vary from average due to side accounts

Introduction to GASB 67 & 68

Public Pension Accounting Making Headlines

Headline One:

New GASB Pension Statements Bring About Major Improvements in Financial Reporting

"Improves the decision-usefulness of reported pension information and increases the transparency, consistency, and comparability of pension information across governments."

"GASB pronouncements continue to be of high quality."

- GASB press release June 2012

Public Pension Accounting Making Headlines

Headline Two:

Pension Accounting for Dummies

"Since the Board (GASB) is run mainly by former public officials, its standards are often low."

"it's impossible to get governments to come clean about their pension debts…"

– *Wall Street Journal Editorial dated July 10, 2012*

Public Pension Accounting Making Headlines

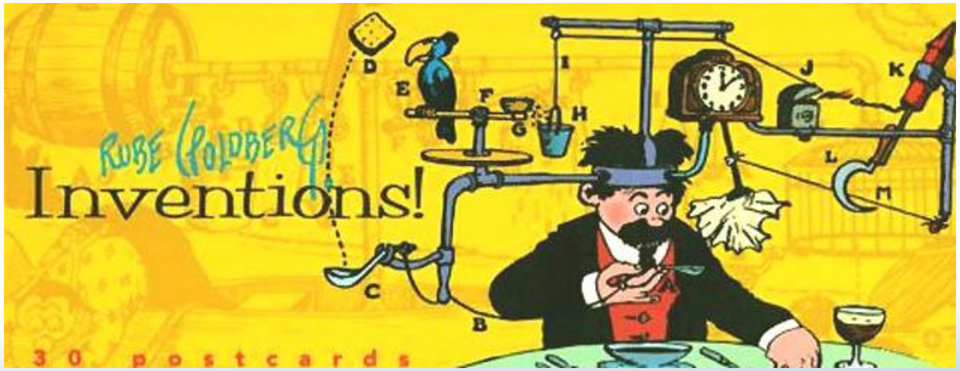
Headline Three:

Little-known Board Stokes Pension Debate

"A perfectly nuanced solution to a difficult question."
– Paul Angelo, the Segal Company

"GASB has built a Rube Goldberg machine filled with complexity."
– Jeremy Gold

- Reuters, July 10, 2012



Funding & Accounting – Outgoing Standards

- Under the outgoing standards, the funding contribution and income statement expense (ARC or CRC) typically coexist in peaceful bliss
- Outgoing standards' structure encourages this
  - Significant flexibility in calculating the ARC
    - Includes option of permanent negative amortization
    - You can pay a lot…or quite a bit less…and either way you have "contributed the actuarial number" under the outgoing standards
  - Incentives to align funding and accounting policies
    - Regularly contributing the ARC or CRC allow sponsors to avoid any balance sheet liability under the outgoing standards

Accounting - New GASB 67 & 68 Standards

- With 67 / 68, GASB has formally separated financial reporting and funding policies
- GASB retains financial reporting ownership
- The new financial reporting standards will:
  – Bring shortfall, based on fair market asset values and a standardized liability calculation approach, onto employer balance sheets
  – Significantly expand financial disclosures
  – Make income statement accounting entries volatile
  – Change the discount rate used in liability calculations for systems with actuarially unsound funding policies

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Funding – New GASB 67 & 68 Standards

- GASB recommends that systems develop formal, documented funding policies
- If the funding policy is not actuarially sound, the actuary will estimate a "crossover" date
  - Crossover is a sterilized term for insolvency
  - Post-crossover payments are discounted using yields of tax-exempt, long-term municipal bonds
- Liabilities and balance sheet shortfalls will be <u>much</u> higher for systems and employers that are severely underfunded or lack formal, sound funding policies

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Plan Expense – New GASB 67 & 68 Standards

- The harmoniously paired contribution and income statement expense were the centerpiece of the outgoing standards
- The balance sheet entry is the new standards' centerpiece
  - Income statement expense gets you from one balance sheet to the next
- Balance sheet entries can swing wildly in just a single year
- A material portion of a given year's balance sheet swing is first recognized in the GASB 68 income statement expense in the year in which the swing occurs
  - The remainder is held as a "deferred inflow or outflow of resources" and amortized via income statement recognition in subsequent years
    - Five year amortization for investment return variance
    - Projected future service life recognition for demographic variance

Where Can I Learn More?

- A variety of entities have published guidance to help understand the new standards
- Milliman has published a series of short educational articles on various GASB 67 & 68 topics, which can be accessed via the web at: ***www.milliman.com/gasb6768/***
- As items become finalized, OPERS will post explanatory information on its website to assist PERS employers and their external auditors in complying with the new standards

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GASB 68 Implementation for PERS Employers

Balance Sheet Changes Bring Added Scrutiny

- Currently, most PERS employers are considered to be in a GASB 27 cost-sharing arrangement for their pension reporting
  - Under that statement, CAFR entries are generally footnotes
- Starting with June 30, 2015 CAFRs, GASB 68 becomes the new employer pension reporting standard
- Portions of the PERS unfunded accrued liability (UAL) will move onto the balance sheets of employers
  - Additional scrutiny will come with this

When Is Balance Sheet Liability Calculated?

- In a cost-sharing plan like PERS, the UAL under the new standards is calculated once a year on the **Measurement Date**, with the calculation being done at a system-wide level
  - That calculation <u>must</u> use audited system fair market assets, so the annual Measurement Date for PERS is June 30
  - In GASB 67 & 68, the UAL is called the **Net Pension Liability (NPL)**
- The NPL is being calculated as of June 30, 2014
  - The calculated NPL will be divided up proportionately for placement on employers' balance sheets beginning with June 30, 2015 CAFRs
  - The difference in the years noted above is <u>not</u> a typo
    - GASB 68 allows employers to use a NPL that is calculated up to 12 months prior to the employer's fiscal year end

When Is Income Statement Expense Calculated?

- Paralleling the NPL calculation, income statement expense under the new standards is calculated once a year, with the calculation being done at a system-wide level
  - The expense is the change in NPL from one Measurement Date to the next, minus any portions of the change marked as “deferred inflows or outflows” that are recognized in later years’ expense via amortization
- The first income statement expense will reflect NPL changes between June 30, 2013 and June 30, 2014
  - The calculated expense will be divided up proportionately for inclusion in employers’ income statements beginning with June 30, 2015 CAFRs
    - First income statement entry will be for the 2014 – 2015 employer fiscal year for employers with July 1 fiscal years
  - The difference in the years noted above is <u>not</u> a typo, for the same reason as noted on the previous slide

How Will Results Be Audited?

- PERS' external auditor and internal audits staff will audit detailed census data for up to 10 employers per year
  - First round of audits is underway
  - Generally, the larger the employer the greater the likelihood of audit
- In addition, PERS' external auditor will audit PERS' GASB 67 CAFR data and employer-specific GASB 68 data provided by Milliman each year prior to distribution to employers
  - After audit certification, PERS will distribute GASB 68 information to employers for use in employer CAFR preparation

What is the Road Map in the Long-term?

Actuarial Valuation Date:	12/31/2012	12/31/2013		12/31/2014	
GASB 67 NPL Measurement Date (MD)	6/30/14	6/30/15	6/30/15	6/30/16	6/30/16
GASB 68 Employer Reporting Date (RD)	**6/30/15**	**12/31/15**	**6/30/16**	**12/31/16**	**6/30/17**

Using a Measurement Date twelve months prior to the Reporting Date for July 1 fiscal employers will allow those employers to have the PERS-supplied portion of their GASB 68 reporting information, including supporting certifications, in as timely a manner as is possible under the new standards

How Are Proportionate Shares Determined?

- Paragraph 48 of GASB 68, with emphasis added by today's presenters, states that:
  - *"The basis for the employer's proportion should be consistent with the manner in which contributions to the pension plan…are determined. The use of the <u>employer's projected long-term contribution effort</u> to the pension plan…as compared to the <u>total projected long-term contribution effort</u> of all employers…is encouraged."*
- Projected long-term contribution effort has two components:
  - Normal Cost Rate: Economic value of benefits for projected future service
  - UAL Rate: Projected cost to amortize shortfalls between benefits allocated to service already provided and assets accumulated for those benefits over a specified period of time, if future experience follows assumptions

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How Are Proportionate Shares Determined?

- Employer-specific factors such as side accounts further complicate the proportionate share determination
  - Side account assistance is temporary, rather than long-term, in nature
- Because of the complicated structure of PERS, an actuarial approach is appropriate for the proportionate share calculation
  - The calculation will contemplate the factors noted above and be audited by PERS’ external auditor to allow employer reliance
  - PERS and Milliman will make available to employers and their auditors information regarding both the theoretical rationale and the technical methodology behind the proportionate share calculation
- Consistent with the new GASB statements, the proportionate share calculation will be updated annually to reflect the updated demographics of each PERS employer

How Do We Pay for the GASB 68 Work?

- HB 4155, enacted this year, allows PERS to recover costs of implementing GASB changes from employers
- Costs of all additional actuarial, auditing, and PERS staff time to implement GASB 68
  - Development of actuarial schedules
  - Audit of actuarial schedules and PERS CAFR
  - Employer communication and education
- Costs to be deducted from annual earnings credited to the Employer Reserve
  - Estimated GASB 68 implementation costs would have reduced earnings crediting by one basis point (0.01%) in three of the last ten years, with no effect in the other seven years
  - Employer side account and member account crediting will be unaffected

How Soon Can We Look at Sample Disclosures?

- PERS and Milliman will be conducting a GASB 68 “dry run” to give PERS employers a feel for what to expect in June
- The dry run will use sample actuarial schedules, including suggested note disclosure language
- Since it is a dry run, and we’d like to get the sample schedules to employers as early as possible, unaudited information will be used
- Anticipated timing for dry run completion is December 2014
- Prior to the dry run, Milliman and PERS will be composing a template employer schedule sans numbers, that will be available for employer review prior to the November PERS Board meeting

Demystifying GASB 45 OPEB/ Retiree Medical Reporting

"It is a riddle, wrapped in a mystery, inside an enigma"

- Winston Churchill

GASB 43 & 45 - Confusion Reigns Supreme

- More confusion over GASB 43 & 45 retiree medical/OPEB reporting than any other subject
  - Sponsors are confused
  - Auditors are confused
  - Perhaps even some of the actuaries are confused
- Retiree medical/OPEB & pension valuations have similarities
  - Inputs of data, assumptions, methods and provisions
  - Actuarial accrued liabilities and normal costs for outputs
- However, there are some “minor” differences that layer in additional complexity & confusion
  - Example: what is the “employer contribution” to a retiree medical/OPEB program in a given year under the GASB 43 & 45 standards?

Oh, To Understand What We Report…

- How to best begin to unwind the confusion and understand the reporting?
  - With sincere apologies, it's best to start from the actuary's perspective
- Until the conclusion of this discussion, you are all declared to be deputy GASB 43 & 45 healthcare actuaries
- Our assignment: set per capita premium levels for three sponsoring entities each of which, for our convenience, report under GASB 43 & 45
  - Fortunately, each sponsor filled out a questionnaire to assist us…and they even provided us with photos of organizational leadership

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Our Board of Directors

Employer 1 – Hamish's Hipster Hut

- Employee demographics: Hipsters!
- Retiree demographics: Come again?
- What's an appropriate monthly per capita health insurance premium for Hamish's Hipster Hut? Is it high, medium or low given Hamish's current demographics?


Cal – Our President

Employer 2 – Cal’s Convertible Cars

- Employees: Mix of middle-aged and younger staff
- Retirees: Not yet, but yes in the future after we age gracefully
- What’s an appropriate monthly per capita health insurance premium for Cal’s Convertible Cars? Is it high, medium or low, given Cal’s current demographics? How does it compare to Hamish’s premium?

Actives

Annie – Our Founder

Employer 3 – Annie’s Analog Appliances

- Employees: Mix of middle-aged and young (identical to Cal’s)
- Retirees: Sizeable group of current retirees
- What’s an appropriate monthly per capita health insurance premium for Annie’s if actives and retirees are charged the same premium? How does that compare to Cal’s and Hamish’s?

Actives *Retirees*

Premium Comparison Between Entities

- As deputy actuaries, so far we have reached the not so impressive “insight” that demographics cause premiums to differ
  - Cal’s > Hamish’s because of current active demographics
  - Bear in mind that the only reasons that Annie’s active employee premiums differ from Cal’s are:
    - Annie’s currently has retirees, while Cal’s does not, combined with
    - Annie’s policy of charging identical premiums for both actives & retirees

Now for the GASB Financial Reporting Part

- If Annie's pays the active & retiree premiums, what is this year's GASB 45 retiree medical/OPEB employer contribution?

A common sense answer

- The amount in red seems correct
  - If I ask Annie's, this will be their answer
- This answer is not the GASB 45 employer contribution for the year!

Now for the GASB Financial Reporting Part

True, full retiree cost - the correct answer under GASB 45

- Annie's active premiums are higher due to retiree coverage
- The true, full cost of this year's retiree benefits is shown in red
  - The right hand column is the direct subsidy retiree medical contribution, which the sponsoring entity can calculate
  - The red in the left hand column is the indirect subsidy retiree medical contribution, which the actuary needs to calculate

Now for the GASB Financial Reporting Part

The correct answer under GASB 45

- GASB 45 estimates this true, full retiree cost for all future years and accrues it during an employee’s working career
  - It accrues via build-up of the <u>Net OPEB Obligation</u>, which is linked to the Actuarial Accrued Liability
- The financial reporting liability accrued during the working career is unwound via pay-as-you-go benefits in retirement
  - These benefits include direct and indirect subsidies
  - Even if the employer has retirees pay 100% of their blended active/retiree premium, there is still an indirect subsidy and an OPEB GASB 45 cost

GASB 45 – Annoying, Insightful or Both?

- To be kind, GASB 45 is painfully complex
- Is it annoying, insightful or both?
  - Once understood, it can be a helpful looking glass into the future for today's policy makers and financial reporting professionals
- Demographic changes can exert a significant future burden, sometimes even for employers that merely provide retiree-paid "same premium as the actives" medical plan access to retirees
- Speaking generationally, today's Hamish's Hipster Hut <u>will</u> be tomorrow's Cal's Convertible Car, and Cal's <u>will</u> be tomorrow's Annie's
  - GASB 45, for all its warts, tries to quantify this demographic burden in present value terms and accrue it in financial reporting during the working career via increases in the Net OPEB Obligation

Thanks for Your Time Today

Questions???

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