Contribution Stabilization Policies - Case Study

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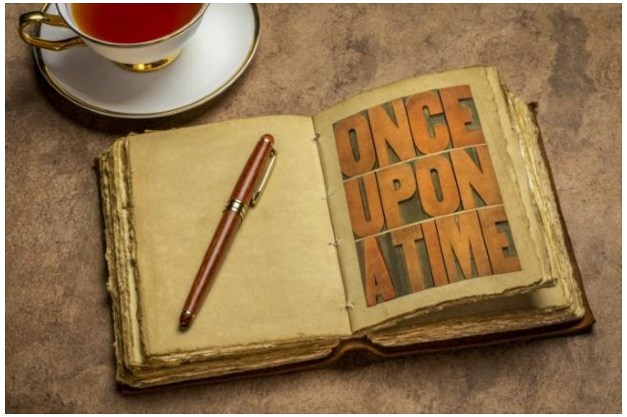


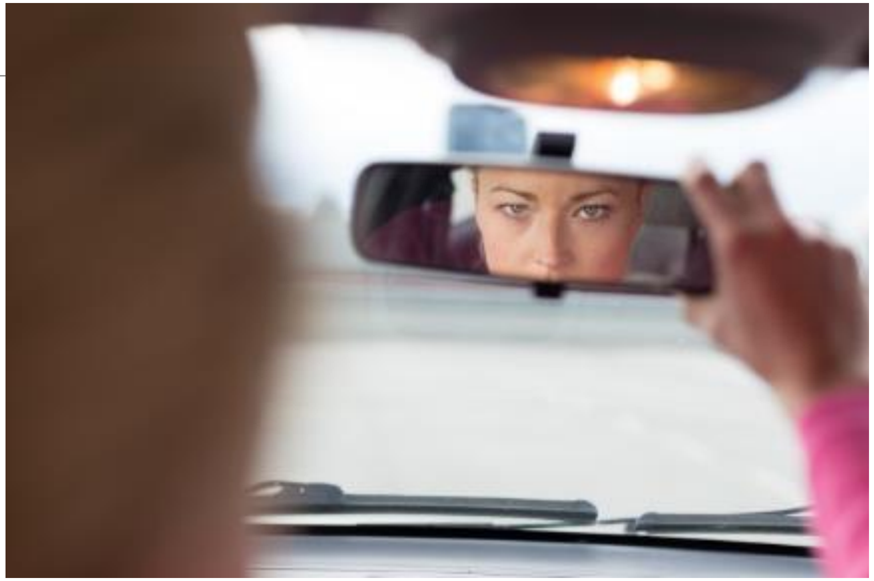
Once Upon A Time

Let’s First Look Back at the Late 1990s

Most pension plans were 100% funded (or more) and contributions were low and fairly stable.

A few events since then have had significant impacts on the volatility of employer contributions.

What can we learn from the past, as a guide, to reduce the volatility of future employer contributions?



Chapter 99-1

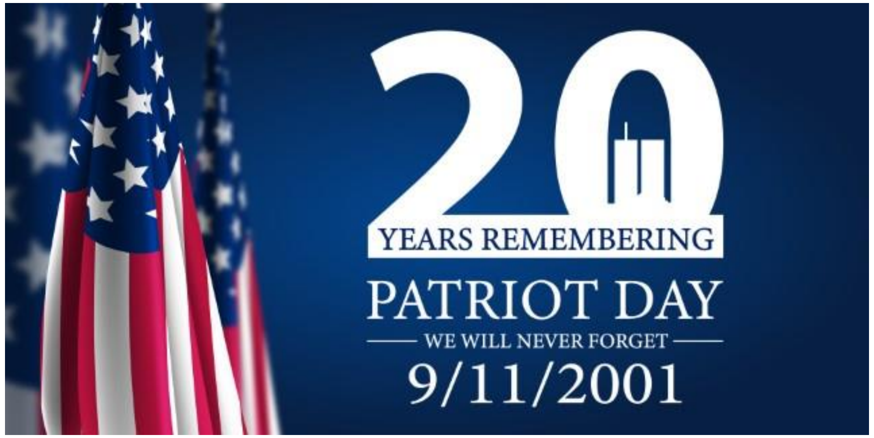
- This 1999 law significantly changed Chapters 175 (Firefighters) and 185 (Police Officers).
- Cities were required to comply with specific minimum and extra benefit standards to be eligible for premium tax revenues.
  - Resulted in benefit increases for many Public Safety pension plans.

September 11, 2001

Led to Public Safety benefit increases in many pension plans beyond Chapter 99-1 minimums.

Some cities also increased pension benefits for General Employees.

At the same time, most pension plans had significant investment losses during FY 2001 and FY 2002.

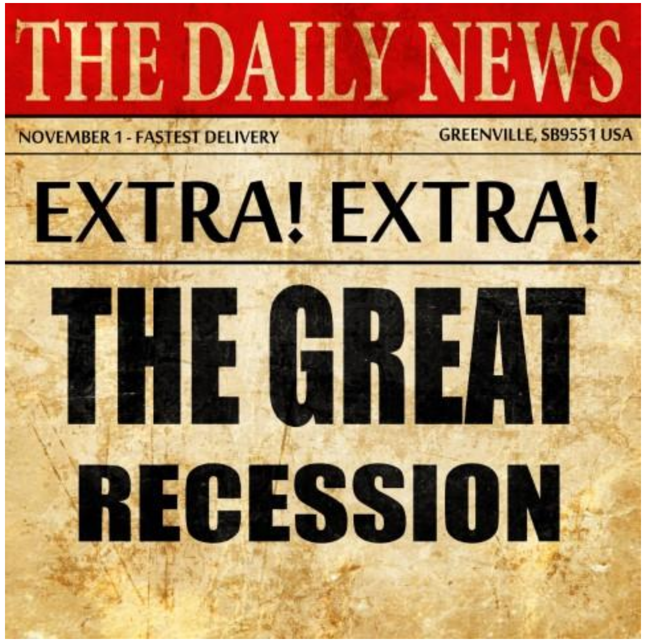


Great Recession (2008-2009)

Most pension plans experienced significant investment losses.

Cities faced challenging combination of declining revenues and increasing costs.

Significant decreases in funded ratios and increases in unfunded liability and employer contributions.

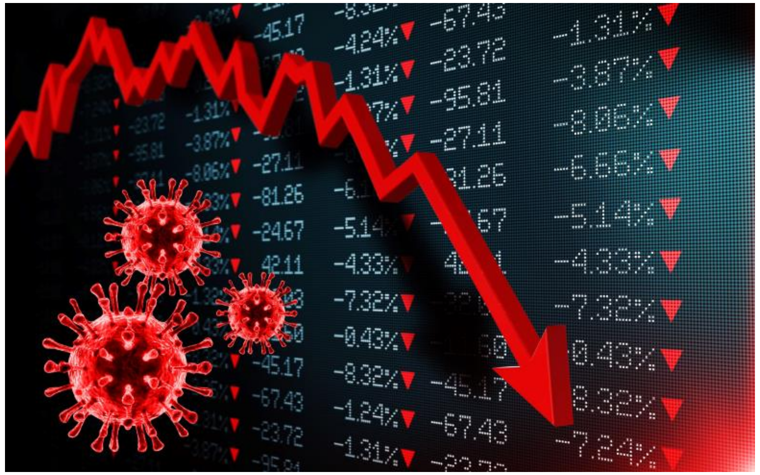


The Pandemic (2020-2022)

Stock market fell by more than 30% in March 2020.

However, actual rate of return for most pension plans during FY 2020 ended up near or above the assumed rate of return.

Volatility followed, which will likely affect pension plans in some respects for the next few years.



How are Pension Plans Doing Now?

- Most pension plans are doing pretty well.
- Investment Return Assumptions have been trending lower over the last decade.
- Returns on Assets for most pension plans are negative this year, after a runup last year.
- Funded Ratios increased last year, but many will see a pause in the 2022 valuation results.

The Roles of Actuarial and Funding Techniques

Actuarial Assumptions

True or False? The cost of a pension plan is determined by the assumptions used.

What are the implications of understating or overstating the plan’s liability?

Asset Valuation Methods

What smoothing period does your plan use?

What is the importance of asset smoothing methods as the plan reaches 100% funding?

Amortization Policies

When is your plan expected to reach 100% funding according to its amortization policy?

What considerations are required when the plan is 100% funded (or more)? What amortization pitfalls should be monitored?

Time Horizons

What time horizon(s) does your plan consider when evaluating investment decisions?

What metrics, other than funded status, should plans consider when setting investment and funding policy?

“Success Occurs When Opportunity Meets Preparation.” *Zig Ziglar*

Stabilizing Employer Contribution Rates

Is the idea of stabilizing Employer contribution rates a myth?

If benefits or liabilities increase faster than payroll, is the plan subject to more Employer contribution rate volatility?

Periods of Extraordinary Actuarial Experience

How did your plan handle periods like 2008/ 2009? How do you plan to handle 2022?

What options are available to most pension Boards to mitigate extreme actuarial losses?

Prepaid Employer Contribution Reserves

Are you familiar with Prepaid Employer Contribution Reserves/Credit Balances? Does your plan have one? Has it ever?

When is the best time to establish a Prepaid Employer Contribution Reserve?

Case Study

First Steps

- Approach the Board of Trustees about establishing a prepaid employer contribution reserve.
- Should include at least one upper management employee in decision.
- Request a study to determine next steps.

Next Steps

- Perform study and present to Board.
- Recommend establishing a prepaid contribution reserve using contributions in excess of minimum required amount.
- Gain approval from Board of Trustees and the Employer.

Alternate Approaches

- Ways to build prepaid contribution reserve:
  - Set a contribution floor – when minimum required exceeds it, add excess to reserve.
  - Set a lower expectation of State $, then if actual State $ is higher, add excess to reserve.
  - City contributes earlier in year – then use interest savings to increase reserve.

Amend Funding Policy Statement

- Assumes Board has a Funding Policy Statement.
- Recognize initial value of prepaid employer contribution reserve, if any, and how to build it.
- Set boundary conditions on maximum annual usage of prepaid reserve and give examples.
- Have Board of Trustees adopt the amended Funding Policy Statement.