Decision Brief

for the
State Administration and Veterans' Affairs
Interim Committee

Adopting a Long-term Plan

Prepared by Sheri Scurr, Staff Research Analyst

August 8, 2012 ***(REVISED 8/30/12)***

A Step-by-Step Approach

This brief is offered to provide a step-by-step overview for how the State Administration and Veterans' Affairs Interim Committee (SAVA) may approach the challenge of setting as sustainable pension policy, analyzing alternatives, and adopting a long-term funding plan for paying off the unfunded liabilities of the public employee pension plans.[1]

Proposed Steps, Tasks, and Time

Step 1	Establish target funding and amortization schedule	Aug. 8-9
Step 2	Determine what plan benefit changes you want to be considered when conducting the analysis under Step 3	Aug. 8-9
Step 3	Actuarially determine the ARC shortfall and amount needed to meet target funding and amortization schedule and analyze effect on funded ratio	October
Step 4	Convert ARC shortfall to dollar amounts required by each employer in the plan	October
Step 5	Analyze potential impact on employers	October
Step 6	Determine potential funding sources and decide how much of the ARC shortfall should be paid from which funding sources	November
Step 7	Request a bill to implement the plan	November

☞ *If the analysis shows that the amortization schedule is not aggressive enough (i.e., the funded ratio of the plan remains too low or worsens) or is too aggressive (i.e., the funding curve is too steep for employers), revise the target amortization schedule accordingly and repeat steps 2 through 5.*

[1] Analysis of alternatives is essential to considering non-contract impairing options prior to consideration of options that may impair contract. (See legal analysis previously provided.) A long-term funding policy is an essential part of establishing a sustainable policy. See Gabriel Roeder Smith & Company, "Developing a Pension Funding Policy for State and Local Governments", Research Report, January 25, 2012; Government Finance Officers Association Best Practices papers, including "Sustainable Funding Practices of Defined Benefit Pension Plans (2009)", "Responsible Management and Design Practices for Defined Benefit Pension Plans (2010); and "Developing a Policy for Retirement Plan Design Options (2007).

STEP 1: ESTABLISH TARGET FUNDING AND AMORTIZATION SCHEDULE

At its June 12, 2012, meeting, SAVA requested actuarial analysis to fill in the blanks in Tables B1 through B7 in the staff report entitled "Examining Pension Challenges". By doing this, SAVA essentially adopted the target amortization and funded ratio schedule shown in those tables for each of the pension plans. The schedule was for each plan to be 115% funded by 2040. This would require a 26-year amortization schedule starting July 1, 2013. When staff prepared these tables, they were a rough draft starting point for discussion purposes and may need further refinement. However, the essential decision point remains the same.

Decision Point #1: *Is 115% funding by the end of fiscal year 2040 the target funding goal and date that SAVA would like to set, or does SAVA want to modify the target funding goal to 110%[2] or something else and extend the target date to 30 years or something else from July 1, 2013?*

> **SAVA Action 8/9/12:** Adopted target of 100% funding and requested calculation of ARC shortfall amount to be funded in both a 40-year scenario and a 30-year scenario.

STEP 2: DETERMINE WHAT PLAN BENEFIT CHANGES YOU WANT TO BE CONSIDERED WHEN CONDUCTING THE ANALYSIS UNDER STEP 3

Any changes to benefits or plan design will affect the normal cost of benefits as they accrue in the future. If plan changes lower benefit costs, more of the employer contribution is available to fund the unfunded liabilities. Thus, if SAVA wants benefit changes to be factored into the cost estimates going forward, it must decide on those changes at this Step 2, prior to the actuarial analysis in Step 3.

Decision Point #2: *What benefit or plan design changes does SAVA wish to have considered, if any, in the actuarial analysis under Step. 3*

> **SAVA Action 8/9/12:** No motion was made to consider benefit or plan design changes as part of the analysis. Discussion was that the committee wanted to see the full costs with no benefit changes first and that as a matter of policy, the committee was reluctant to consider further "tiers" creating a new class of employees.

STEP 3: ACTUARIALLY DETERMINE THE ARC SHORTFALL AND THE AMOUNT REQUIRED TO MEET TARGET FUNDING AND AMORTIZATION SCHEDULE AND ANALYZE EFFECT ON FUNDED RATIO

At the June 12, 2012, SAVA meeting, SAVA asked the retirement boards to determine the cost for conducting the requested actuarial analysis. The cost estimates were $8,500 from the TRS actuarial

[2] The Teachers' Retirement Board (TRS) has adopted a long-term policy goal of 110% funding.

firm and $7,000 to $10,000 from the MPERA actuarial firm. The Legislative Fiscal Division is working on a model program that may assist in "back of the envelope" cost determinations. Additionally, the PEW Center on States has offered to provide free technical assistance, including actuarial estimates based on information already available in actuarial valuations, that my also provide "back of the envelope" cost estimates. However, uncertainties remain about whether the LFD model or the PEW Center's capabilities will meet SAVA's needs at this time. For SAVA to pay for the board actuaries to do the analysis, SAVA would need to request an additional allocation of funding from the Legislative Council.

Decision Point #3: *How would SAVA like to approach the actuarial analysis required to determine the ARC shortfall and the target funded ratio for the amortization schedule adopted under Decision Point #1?*

SAVA Action 8/9/12: Because target amortization schedules adopted by SAVA for a 40 year and 30 year schedule do not involve a complicated phased-in approach as previously contemplated, it was determined that the retirement board actuaries will provide these calculations as part of their actuarial valuation work for the boards at no additional cost to SAVA.

STEP 4: CONVERT ARC SHORTFALL AMOUNTS TO DOLLAR AMOUNTS REQUIRED FOR EACH EMPLOYER IN THE PLAN

Once we know the ARC shortfall (as a percentage of payroll) that is required to meet SAVA's target amortization schedule and funded ratio, we will need to convert the ARC shortfall to dollar amounts so that SAVA can see how much money will be required (by employer) to meet the obligations. Staff proposes to work with the retirement boards and PEW center staff to build the necessary spreadsheets. Unless SAVA objects to this approach, there is no decision point for the committee at this step in the process.

Staff update as of Aug. 30, 2012: The SAVA and LFD staff has been informed that PEW center staff will not be available to help build the necessary spreadsheets. However, LFD staff had done a some work on this already as part of the joint report "Examination of Pension Challenges" dated June 12, 2012. SAVA's staff was instructed to provide that work to SAVA rather than create the spreadsheet contemplated by SAVA's staff. If SAVA wishes to pursue the spreadsheets initially contemplated by SAVA's staff so that fiscal alternatives can be evaluated in conjunction with SAVA's policy decisions, SAVA will have to work with the Legislative Council and the Legislative Finance Committee to get authorization for contracted work or dedication of LFD resources to develop the spreadsheets.

SAVA staff's proposed spreadsheet concept is attached. NOTE: Most numbers are placeholders for illustration purposes only.

STEP 5: ANALYZE POTENTIAL IMPACT ON EMPLOYERS

When the dollar amounts required to actuarially fund each of the pension systems is known, then we can begin to look at the total impact to employers who have employees in multiple plans. SAVA committee staff would work with retirement board staff, LFD staff, and the PEW Center staff in developing the spreadsheets needed to calculate the impact on employers. Unless SAVA objects to this approach, there is no decision point for the committee at this step in the process.

> **Staff update as of Aug. 30, 2012:** This step cannot be accomplished without fulfilling Step 4. See note under Step 4.

STEP 6: DETERMINE POTENTIAL FUNDING SOURCES

At this point in the process, SAVA (or perhaps LFC or the two committees in concert) would identify which funding sources to consider. When the funding sources are identified, the committee or committees identify how much money should be provided from each identified source. The spreadsheets developed under steps 3 and 4 would allow the committee or committees to adjust the allocations and see how each adjustment would impact local government employers and taxpayers.

> **Staff update as of Aug. 16, 2012:** This step cannot be accomplished without fulfilling Steps 4 and 5. See note under Step 4.

STEP 7: REQUEST A COMMITTEE BILL TO IMPLEMENT YOUR PLAN

The final step in the process is to request a committee bill to implement the plan.

PENSION FUNDING ANALYSIS TEMPLATE		***Hypothetical Example***			
Pension System: TRS	Current Valuation **FY 2011**	**Starting July 1, 2013 Cost Based on Target Amortization Schedule Scenarios**			
Target Amortization Period	71 yrs	45 yrs	40 yrs	35 yrs	30 yrs
ARC shortfall - as a percentage of payroll	N/A	**3.00%** to be determined	**3.50%** to be determined	**4.00%** to be determined	**4.50%** to be determined
ARC shortfall - as a flat dollar amount	N/A	*$ 24,228,727*	*$ 39,573,587*	*$ 63,317,740*	*$ 99,725,440*
Funded Ratio	61.50%	to be determined	to be determined	to be determined	to be determined
Total covered payroll	*$ 746,694,000*				
Break out each employer's covered payroll as part of this spreadsheet in order to see total dollar amount by employer					
Potential funding sources to meet ARC shortfall					
Employer contributions	N/A	1.00%	1.50%	2.00%	2.50%
As $ amount	N/A	*$ 7,466,940*	*$ 11,200,410*	*$ 14,933,880*	*$ 18,667,350*
Other	N/A	1.00%	1.00%	1.00%	1.00%
As $ amount	N/A	*$ 7,466,940*	*$ 7,466,940*	*$ 7,466,940*	*$ 7,466,940*
Other	N/A	1.00%	1.00%	1.00%	1.00%
As $ amount	N/A	*$ 7,466,940*	*$ 7,466,940*	*$ 7,466,940*	*$ 7,466,940*
TOTAL PERCENTAGE	N/A	**3.00%**	**3.50%**	**4.00%**	**4.50%**
TOTAL DOLLAR AMOUNT	N/A	*$ 22,400,820*	*$ 26,134,290*	*$ 29,867,760*	*$ 33,601,230*