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Public Pension Funding Analysis Following GASB Changes: What Do the Actuaries Say?

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The New Standards

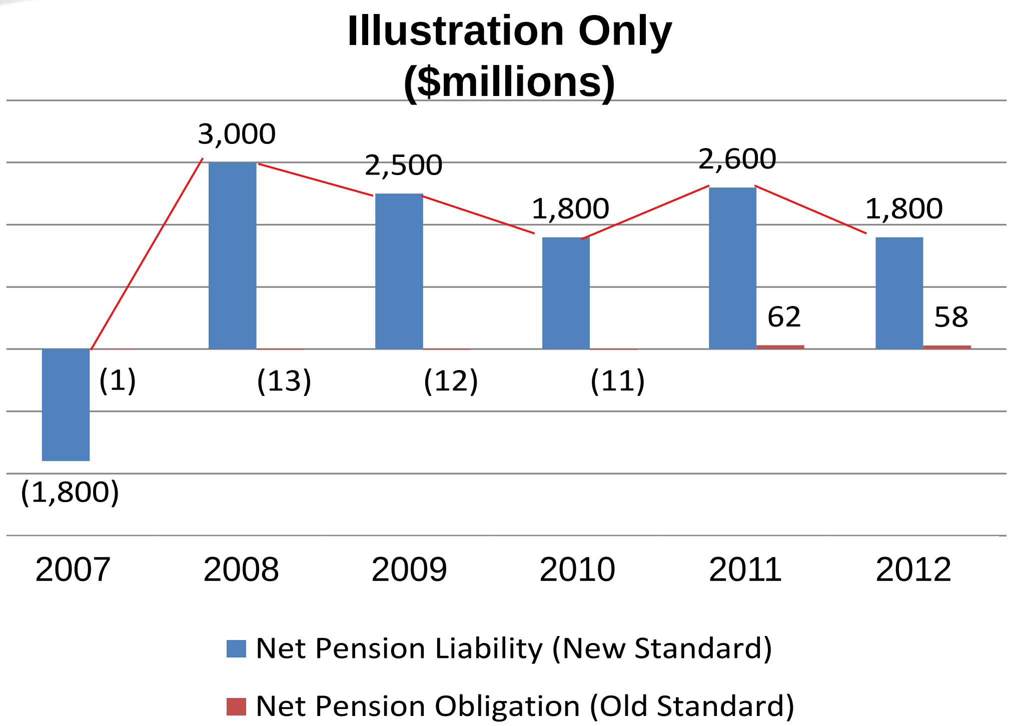
- The accounting standards applicable to public-sector retirement systems are changing
  - GASB 67, Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25, takes effect for fiscal years beginning after June 15, 2013
  - GASB 68, Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27, takes effect for fiscal years beginning after June 15, 2014
  - Earlier application is encouraged!

Highlights of the New Standards

- Improved comparability through more uniform measurement and reporting
- Pension balance sheet liability now based on unfunded actuarial liability. Previous standard focused on degree to which actual funding tracked with an actuarially sound funding benchmark
- Balance sheet = Actuarial Liability minus Market Value of Assets
  - Single uniform actuarial liability measurement approach (Entry Age Normal)
  - Actuarial liability measurement takes into account extent to which benefits are forecasted to be paid from trust assets versus general sponsor assets. Generally, benefit liabilities are valued using a discount rate based on the assumed portfolio return, however, any benefit liabilities not projected to be paid for by trust assets are valued using a discount rate based on a high quality municipal bond rate
- Long term solvency testing used to determine liability measurement basis
- New expense calculation
  - More comparable to private sector
  - Distinct from funding calculation

Balance Sheet Impact – General Observations

- Net Pension Obligation (old standard) may be dramatically different than Net Pension Liability (new standard)
- Balance sheet volatility increase:
  - portfolio volatility
  - liability will generally exhibit low year-over-year volatility unless solvency test requires liability measurement using blend of expected portfolio return and high quality municipal bond rate



	2007	2008	2009	2010	2011	2012
Market Value of Assets	17,600	13,700	15,100	16,200	16,000	17,300
Actuarial Accrued Liability	15,800	16,700	17,600	18,000	18,600	19,100
Net Pension Liability /(Asset) - New GASB	(1,800)	3,000	2,500	1,800	2,600	1,800
Net Pension Obligation - Old GASB	(1)	(13)	(12)	(11)	62	58

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Balance Sheet Reporting Illustration

Standardized measures:

- Market value of assets
- Entry Age Normal actuarial liability

NPL = Actuarial liability minus assets

Non-standardized measures:

- Smoothed actuarial value of assets
- Retirement system specific measure of actuarial liability

Illustration Only

Estimated NPL (GASB 67/68) vs. NPO (GASB 25/27)

GASB 67/68

Valuation Date	**12/31/2011**	**12/31/2010**	**12/31/2009**
Market Value of Assets	$ 17,908,429,907	$ 17,758,651,398	$ 16,137,374,092
Entry Age Accrued Liability	19,899,555,149	$ 19,042,111,838	$ 18,335,809,427
Unfunded Actuarial Accrued Liability	$ 1,991,125,242	$ 1,283,460,440	$ 2,198,435,335
Funded Ratio	90.0%	93.3%	88.0%
Run Out Date	None	None	None
Discount Rate	7.25%	7.25%	7.25%
Measurement Date	12/31/2011	12/31/2010	12/31/2009
Reporting Date (fiscal year ending)	**6/30/2012**	**6/30/2011**	**6/30/2010**
Net Pension Liability (NPL)* (balance sheet liability)	$ 1,991,125,242	$ 1,283,460,440	$ 2,198,435,335

GASB 25/27

Valuation Date	**12/31/2011**	**12/31/2010**	**12/31/2009**
Actuarial Value of Assets	$ 19,326,359,293	$ 18,570,513,903	$ 17,723,253,496
Frozen Entry Age Accrued Liability	$ 19,373,799,717	$ 18,646,430,030	$ 17,804,791,750
Unfunded Actuarial Accrued Liability	$ 47,440,424	$ 75,916,127	$ 81,538,254
Funded Ratio	99.8%	99.6%	99.5%
Run Out Date	N/A	N/A	N/A
Discount Rate	7.25%	7.25%	7.25%
Reporting Date (Fiscal Year Ending)	**6/30/2012**	**6/30/2011**	**6/30/2010**
Net Pension Obligation (NPO)** (balance sheet liability)	N/A	N/A	N/A

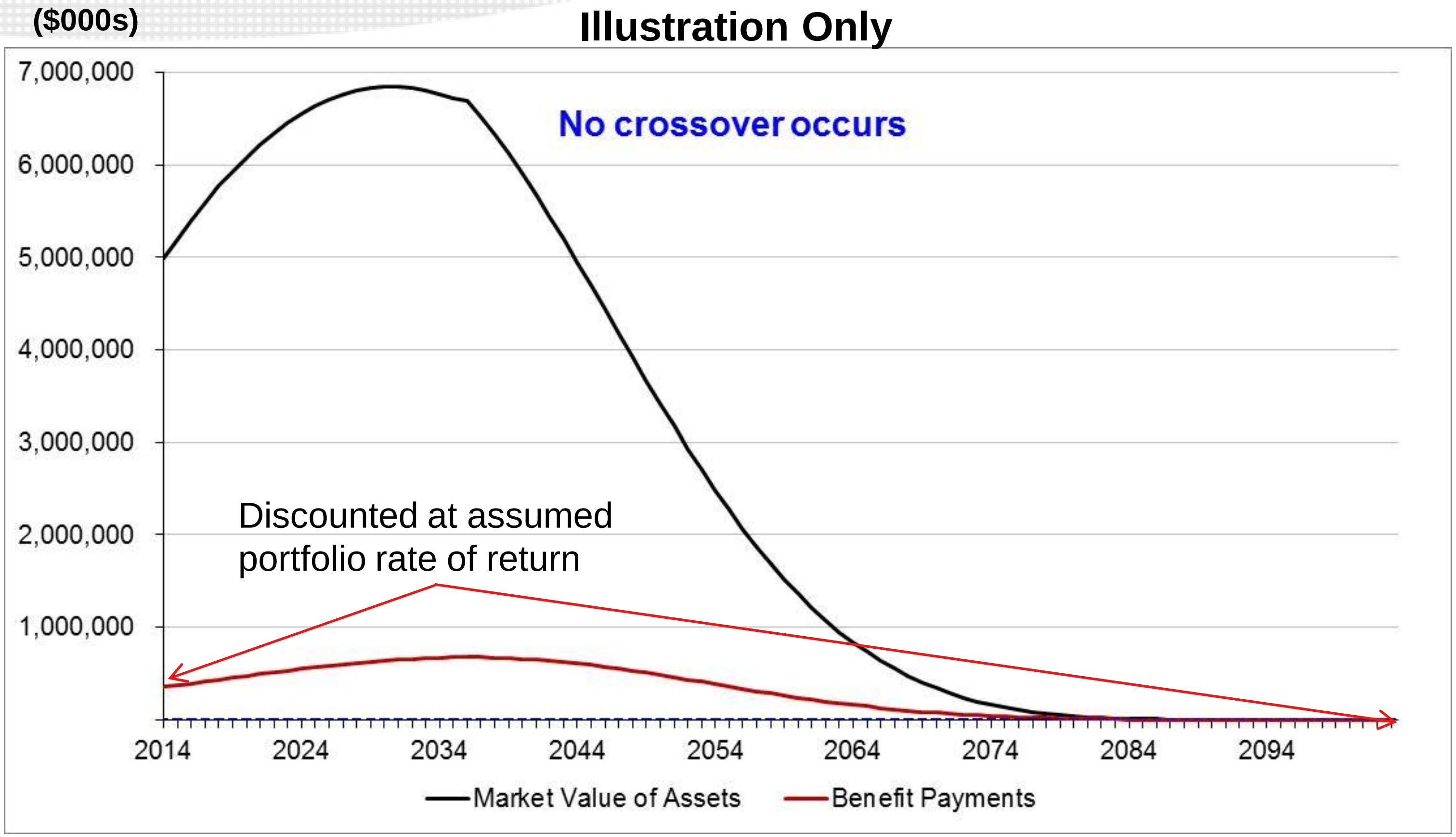
* Each participating employer will need to disclose their proportionate share of the Net Pension Liability

** Each participating employer reports their Net Pension Obligation

Expense

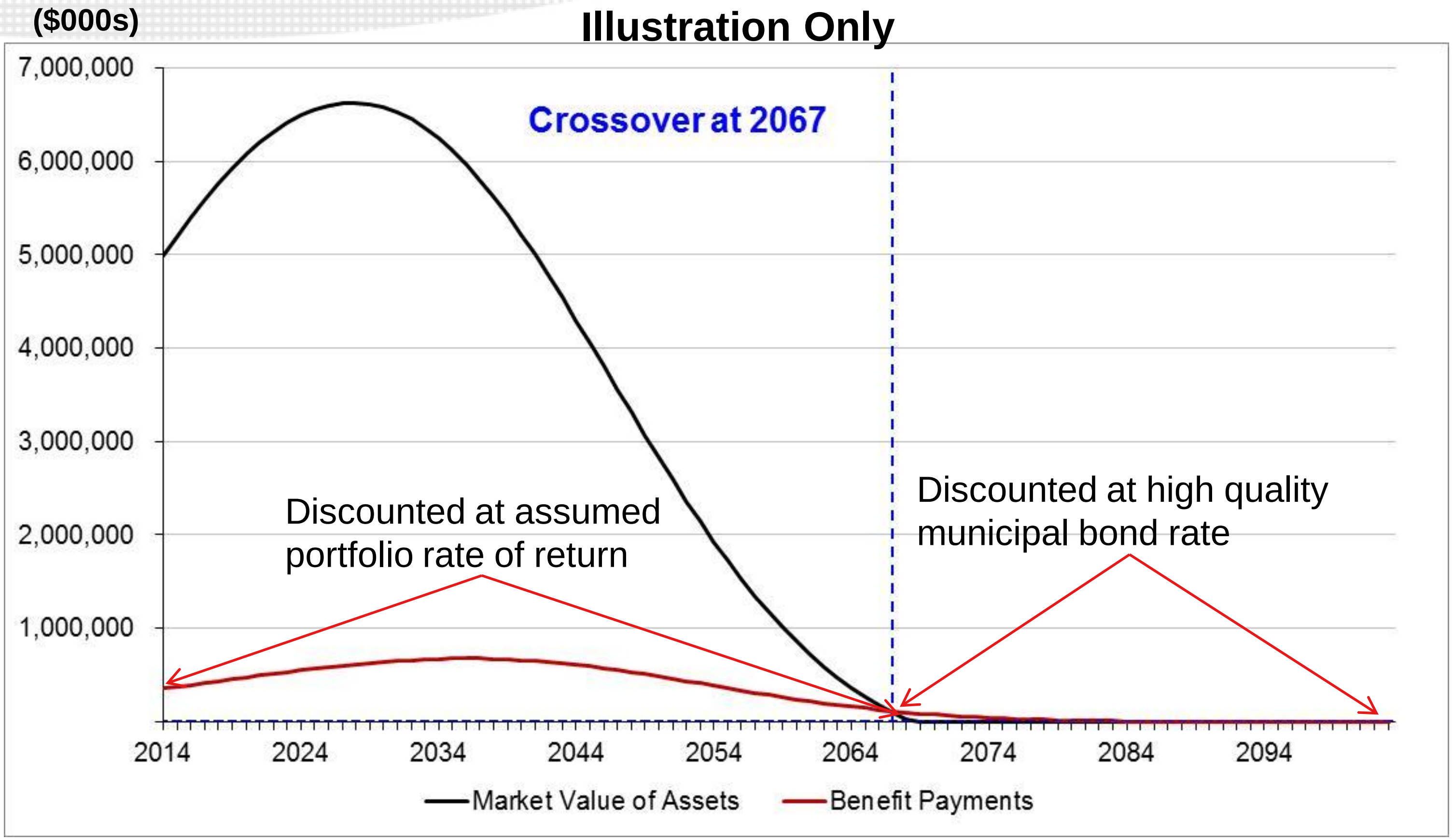
- Benefits earned during the reporting period (service cost)
- Interest on the total pension liability
- Projected portfolio earnings for the reporting period
- Recognition of changes in benefits that affect the total pension liability, as follows:
  – Assumption changes / non-investment gains and losses: over average expected remaining service lifetime (for actives and inactives)
  – Amendments: full and immediate
- Recognition of asset gains and losses over a five-year period

GASB Solvency Testing



- Under recent funding practices (generally past 5 years), plan assets are projected to fund all benefit payments for current plan members
- The actuarial liability for GASB purposes is calculated using a discount rate equal to the assumed rate of portfolio return

GASB Solvency Testing



- Under recent funding practices (generally past 5 years), plan assets are projected to fund all benefit payments for current plan members only until 2067
- the actuarial liability for GASB purposes is calculated using a discount rate that produces the same result as discounting pre-2067 forecasted benefit payments at the assumed rate of portfolio return and post-2066 forecasted benefit payments at a high quality municipal bond rate

Implications for Funding

- Clear funding strategy and discipline are necessary to ensure improvement in funding status and to accumulate the funds to pay retirement benefits
- Governments and their pension boards/committees may be compelled to reevaluate funding strategies. Some are explicit in statute (although an opportunity to review exists), others are not
- Funding strategies can vary in their likelihood of success across a wide range of economic and capital market conditions