# Managing Unfunded Accrued Liability

Presented by


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# Objectives for Today

- What is unfunded liability

- Examples of how unfunded liability developed

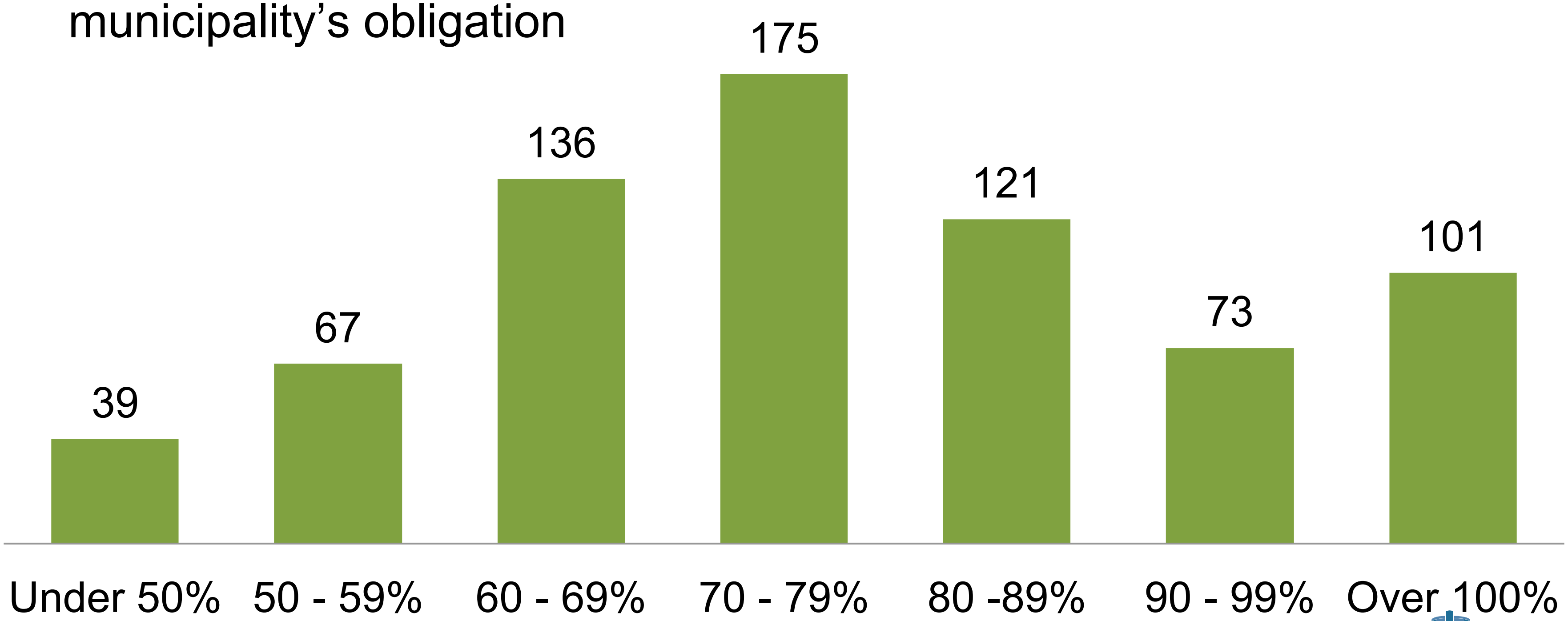
- Ways to reduce future liabilities

- Reducing current unfunded liabilities

# Distribution of Funded Percentage

Our Defined Benefit Plan is a multiple-employer plan

- Assets are pooled for investment purposes only
- Separate trusts are maintained for each individual employer
- We do not borrow from one municipality's account to cover another municipality's obligation



# Funding Concepts

- State statute requires that pension plans be pre-funded, meaning regular contributions for each worker are made into the retirement fund during the course of that worker's career
  - Set aside money now to pay for the benefit payments later
  - Investment income helps pay for the benefits
- Other Post Employment Benefits (OPEB) plans have historically not been pre-funded; however, some employers have set-up a trust such as MERS Retiree Health Funding Vehicle to help pre-fund the benefits

***Basic Funding Equation***

Contributions + Investment Income = Benefit Payments + Expenses

# Funding Concepts

The employer contribution rate is made of up two parts:

1. Employer Normal Cost – Present value of benefits allocated to the current plan year less any employee contribution
2. Amortization Payment of Unfunded Accrued Liability – Payment to reduce any shortfall between liability for past service and assets

# What is Unfunded Liability?

Unfunded liability is the difference between a plan's estimated pension benefits and assets that have been set aside to pay for them

- The dollar value of the benefits is actuarially determined each year for pension
- Assets are held in a trust and are professionally managed over the years
- Unfunded liability is paid off over a period of years

# OPEB Unfunded Liability

- Other Postemployment Benefits (or OPEB) are benefits provided to retired employees
  - These benefits typically include health care benefits, but also may include life insurance, disability, legal and other services
- Previous GASB 45 changes
- Currently, there is no requirement to ***fund*** OPEB, however, potential changes to GASB in the future

# Why Unfunded Liabilities Occur

- Actual experience different than assumed (liabilities and assets)
  - Market performance
  - Demographic experience
  - Rates of retirement
- Benefit enhancements adopted and not entirely funded
  - Early retirement windows
  - Increased benefit multiplier
  - COLA
- Higher than projected Final Average Compensation
- Granting prior service for benefits without funding

# Strategies to Reduce Liability

# Ways to Reduce Liability

## *Trends at MERS*

| Strategy | Description | Trend 2013 | Trend 2014 YTD | Trend '13 Q3 | Trend '14 Q3 | Impact |
|---|---|---|---|---|---|---|
| **Cost Sharing for Existing Employees** | Employees contribute to help fund the overall cost of the plan | 280 | 83 | 122 | 11 | • Reduces the employer cost, but does **not** affect total cost or the plan's unfunded liability |
| **Lower Benefit to New Hires** | New hires receive a lower tier of Defined Benefit provisions | 53 | 25 | 14 | 1 | • Existing employees are not affected<br>• Reduces the liability for new hires |
| **Bridged Benefits for Existing Employees** | Benefits are offered in parts to existing employees<br><br>Multiplier is then lowered on a going-forward basis | 19 | 19 | 4 | 1 | • Leaves earned benefits unchanged<br>• Reduces the liability for new hires and existing employees |
| **Hybrid for New Hires** | New hires receive a Hybrid Plan | 31 | 31 | 8 | 6 | • Existing employees are not affected<br>• Reduces liability for new hires |
| **Defined Contribution for New Hires** | New hires receive a Defined Contribution Plan | 45 | 15 | 15 | 6 | • Existing employees are not affected<br>• Eliminates liability for new hires |

# Plan Design Strategies to Reduce Liability

## Action

**Lower Tiered Benefits for New Hires**

- Lower multiplier
- Removed cost of living adjustments
- Removed early retirement options
- Increased vesting period
- Increased retirement age

## Impact

**Reduces the future liability accrual**

Future benefits will be lower, and therefore less expensive, than the previous benefits offered

# Lower Defined Benefit to New Hires

- New hires are covered by a lower tier of either Defined Benefit or Hybrid benefits
- Existing employees are not affected
- Reduces the liability for new hires

| Anyone hired **before** 8/1/2013 | Anyone hired **after** 8/1/2013 |
| --- | --- |
| **Tier I**<br>• 2.5% Benefit Multiplier<br>• FAC 3<br>• Vesting of 8 years<br>• Early Retirement Age 55 with 15 years of service<br>• COLA | **Tier II**<br>• 1.70% Benefit Multiplier<br>• FAC 5<br>• Vesting of 10 years<br>• Early Retirement Age 55 with 25 years of service<br>• No COLA |

# Plan Design Strategies to Reduce Liability

| Action | Impact |
|---|---|
| **Defined Contribution Plan for New Hires** | **Eliminates future accrual of liabilities for new hires** |

# Defined Contribution for New Hires

- New hires, rehires, and transfers are covered by the Defined Contribution Plan
  - Active employees may be given a one-time option to convert
- Funding level for municipality and division is considered when making this change
- Accelerated amortization is applied to the closed Defined Benefit Plan
- A projection study is required
  - Shows the long-term cost of the current benefit plan compared to the long-term cost of the proposed benefit plan
  - Shows how employer contributions would be affected 20 years into the future

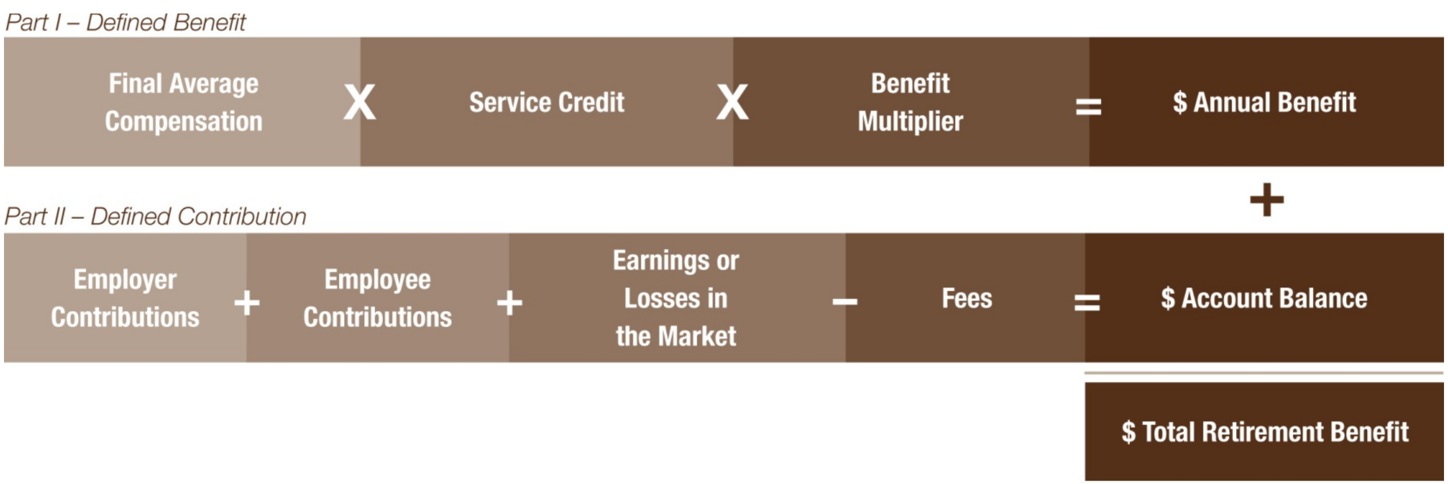
# Plan Design Strategies to Reduce Liability

**Action** | **Impact**

| Action | Impact |
|---|---|
| **Hybrid Plan for New Hires** | **Reduces future accrual of liabilities**<br><br>Future benefits will be lower and potentially less expensive, than the previous benefits |

# Hybrid Plan for New Hires

- New hires, rehires, and transfers are covered by the Hybrid Plan
  - Active employees may be given a one-time option to convert if municipality meets funding requirements
- Actuarial report is needed to calculate the contributions for the Defined Benefit portion of the Hybrid Plan



# Plan Design Strategies to Reduce Liability

| Action | Impact |
|---|---|
| **Bridged Benefit for Active Employees** | **Reduces future accrual of liabilities**<br><br>Active employees accrue liability at a lower rate and may reduce existing liability. New hires receive the reduced multiplier |

# Bridged Benefits

- Benefits are offered in parts to existing employees
- Multiplier is lowered on a going-forward basis
- Leaves earned benefits unchanged
- Reduces the liability for new hires and existing employees

Original Benefit Multiplier X Final Average Compensation (Termination or Frozen FAC) X Service Credit = $ Original Benefit

+

New Benefit Multiplier X Final Average Compensation (Termination FAC) X Service Credit = $ New Benefit

=

$ Total Retirement Benefit

# Funding Strategies to Reduce Liability

| Action | Impact |
|---|---|
| **Contribute Annual Required Contribution (ARC)** | **Contributes to Unfunded Liability**<br><br>The actuarial determined contribution is a formula based on Employer Normal Cost and Amortization Payment of Unfunded Accrued Liability |
| **Contribute Above Annual Required Contribution (ARC)**<br>• Extra percentage above minimum<br>• Lump sum payment | **Contributes to Unfunded Liability**<br><br>Extra dollars are invested and have ability to recognize market returns |

# Accelerated Funding Options

As a result of the plan's funding policy, the funded ratio is expected to approach 100% over time. How quickly a plan attains the 100% goal depends on many factors such as:

- The current funded ratio
- The future experience of the plan
- The amortization period

It is more important to look at the trend in the funded ratio over a period of time than at a particular point in time

# Example of Accelerated Funding

For a municipality that is 78% funded and currently paying estimated $35,000 monthly,

**To accelerate to 100% funding:**

Over 10 years

Estimated monthly contributions would be estimated $47,000

Over 20 years

Estimated monthly contributions would be estimated

$36,000

Contribution based on assuming plan meets actuarial assumptions

MERS strongly encourages employers to contribute more than the minimum contribution required.

Required contributions vary from year to year, because assumption are for the long term and plan experience will not match the actuarial assumptions in any given year (except by coincidence). Each year contributions are adjusted based on the prior year's actual experience.

# For More Information

Please contact your Regional Manager to set up a meeting to review your current plan design and discuss which options might be a good fit for reducing your liabilities in the future

# Regional Team

## Quick Information Sheet

MERS Municipal Employees' Retirement System

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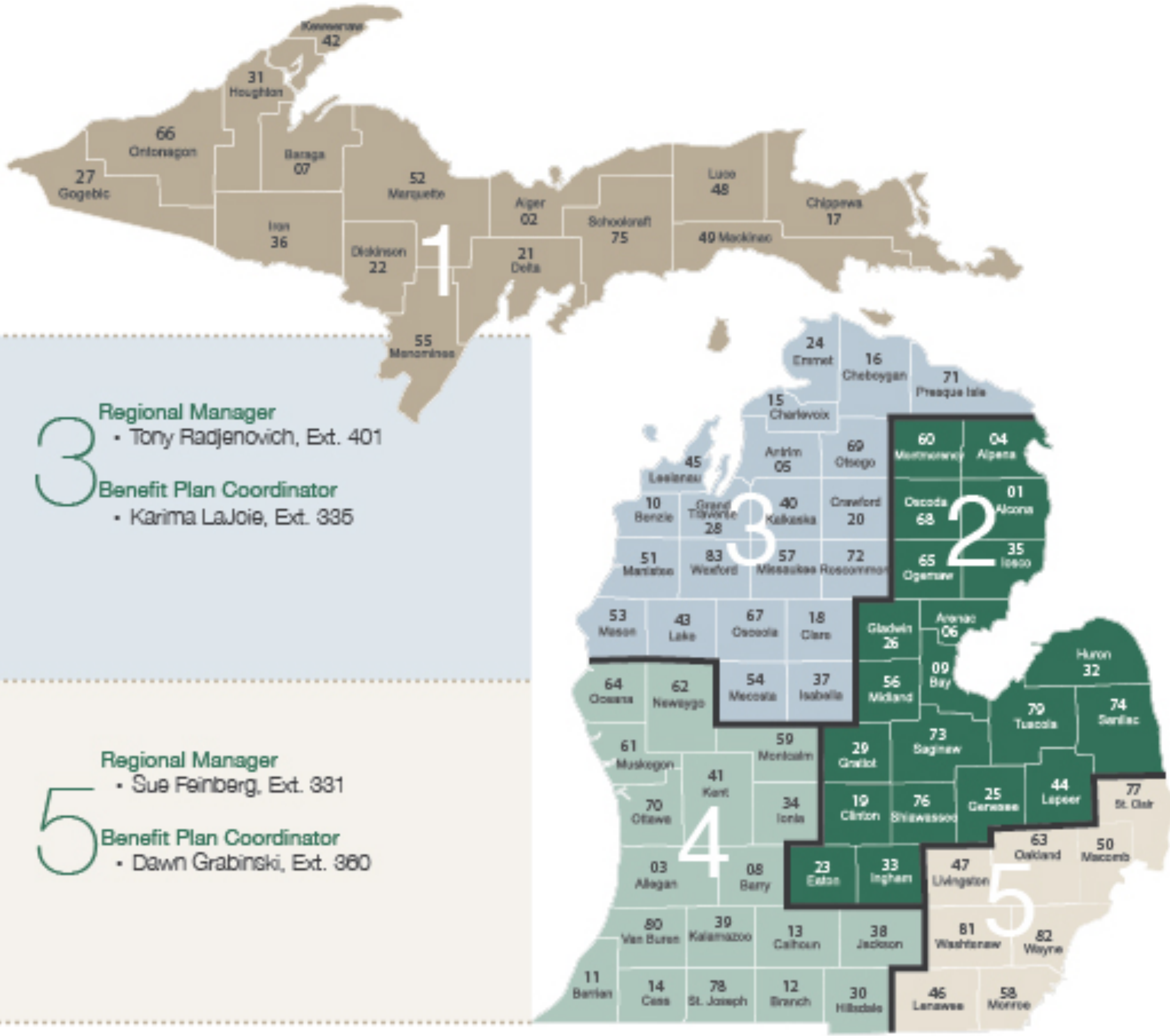


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