Strategies to Reduce Pension UAL

MERS Regional Managers

Municipal Employees' Retirement System

Today’s Agenda

- Welcome and Overview of MERS
- Defined Benefit Plan funding
- Unfunded Accrued Liability (UAL)
- Options for Managing/Reducing UAL

About MERS

- Independent nonprofit retirement services organization that serves municipal members in Michigan
- Manages more than 2,000 retirement and employee benefit plans for nearly 800 municipal members
- More than 100,000 participants in MERS
- Assets total more than $9 billion

BY THE NUMBERS

72 Michigan counties represented

800 municipalities enrolled in MERS programs

100,000+ participants

$9 Billion+ in combined total assets

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About the MERS Retirement Board

Nine-member Retirement Board consists of the following members:

- Three Officer Board members
- Three Employee Board members
- Two appointed members
- One Retiree Board member

Responsibilities of MERS Retirement Board

- Commitment to accountability and transparency for members
- Adheres to strong conflict-of-interest provisions
- Serves as the fiduciary of the funds and has oversight of the system
- Performs experience study every 5 years

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Defined Benefit Plans

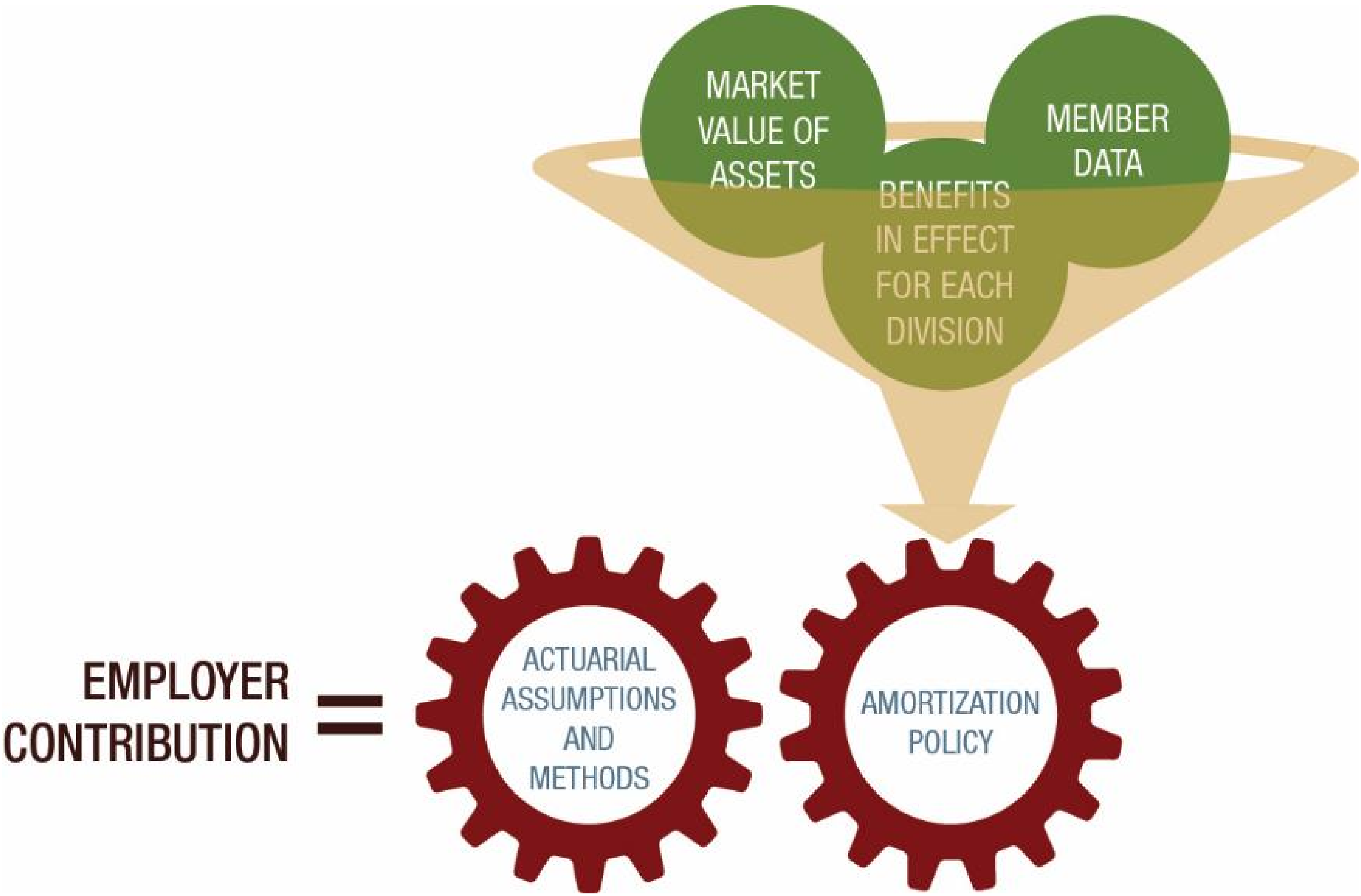
How Defined Benefit Works

Final Average Compensation	X	Service Credit	X	Benefit Multiplier	=	$ Annual Benefit

The benefit formula is comprised of three components:

- Final Average Compensation (FAC) is average of highest consecutive wages
- Service Credit is earned for each month of work that meets the employer’s requirements
- Benefit Multiplier is a specific percentage adopted by the employer ranging from 1.0% to 2.5%

How is the Employer Contribution Calculated?



Actuarial Assumptions and Methods established by the Retirement Board

Employer Contribution

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

Employer Normal Cost + Amortization Payment of the Unfunded Actuarial Accrued Liability = Employer Contribution

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Defined Benefit Plan Costs

- The cost of the Defined Benefit Plan is determined annually and provided in the Annual Actuarial Valuation
  - DB Plan costs vary by each municipality and depend on the **benefit plan design** and other plan specific details
  - The ultimate cost will not be known until the last retiree/beneficiary stops drawing
- There are also MERS administrative and investment costs, which are charged to your plan as basis points and are found on your quarterly statements
- MERS administrative & investment costs have decreased over the last 5 years by 39.1%

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Unfunded Accrued Liability (UAL)

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

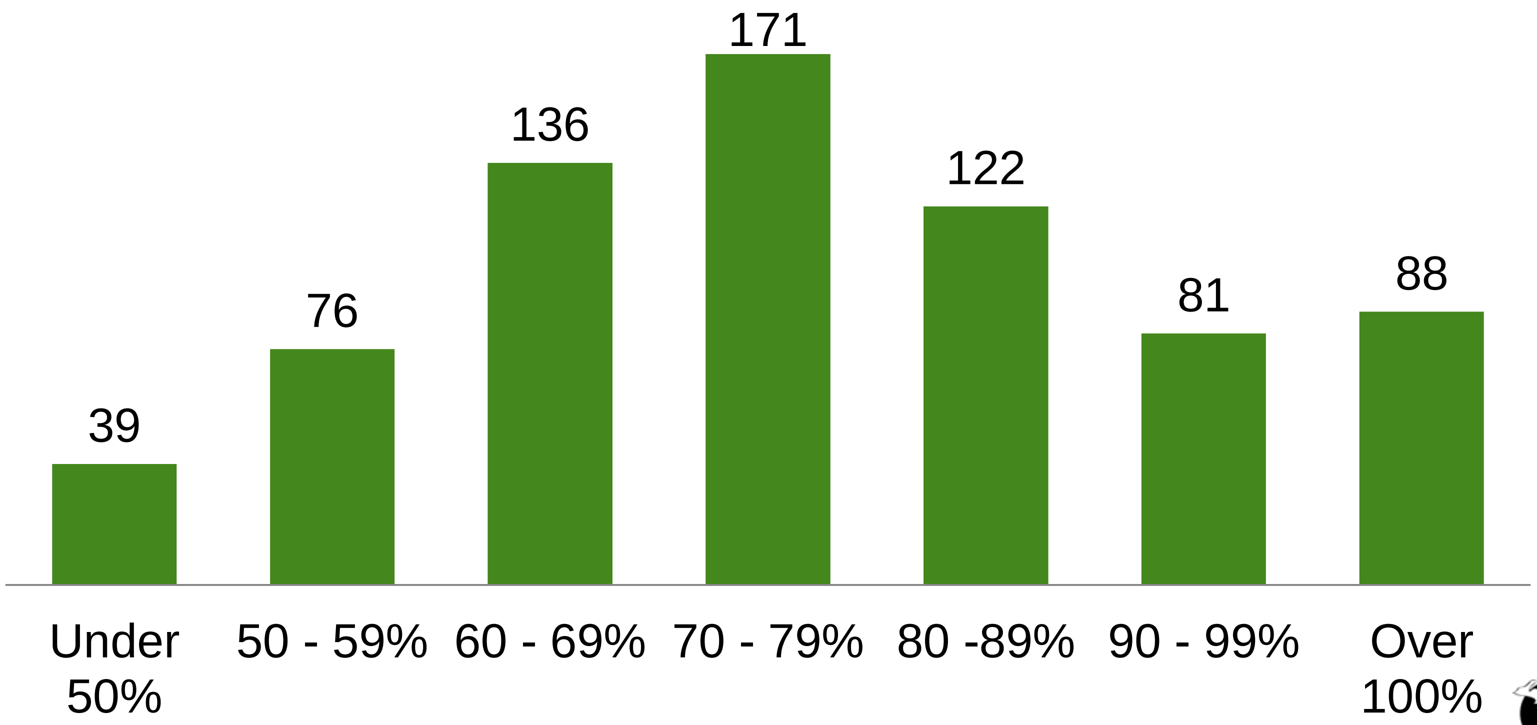
Why Unfunded Liabilities Occur

- 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

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



As of 12/31/14

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Options for Reducing UAL

Municipal Employees' Retirement System

MERS Governance and Oversight

- MERS' Fiduciary Duty
  - Experience Study
- Funding Policy
- Fiscal Responsibility Policy
- Investment Policy and Oversight

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Experience Study

- Part of MERS' Fiduciary Responsibility
- Conducted with our actuarial firm every five years
- Compares actual experience of the plan with the current assumptions to determine if changes are necessary

Experience Study Goals & Priorities

- Adequacy
  - Ensuring each plan's assets are sufficient to provide for the benefits that are expected to be paid and that each plan is making reasonable progress to achieve full funding
- Intergenerational Equity and Transparency
  - Each generation should incur the cost of benefits for the employees who provide service in that generation, rather than deferring those costs to future employees. In addition, a funding policy should be easily understood.
- Contribution Stability
  - Contribution volatility should be balanced with the commitment to ensure plans are properly funded.

Experience Study – Key Changes

- Funding Policy Changes
  - Amortization Policy
  - 5 year smoothing
- Economic Assumptions
  - Investment Return Assumption– moved from 8% to 7.75%
- Mortality Tables
  - Updated rates to reflect longer life expectancies
- Overall, changes will result in higher contributions for all groups

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Plan Design Strategies

- Different Plan for New Hires
  - Lower Tier of Defined Benefit
  - Hybrid or Defined Contribution Plan
- Changes to Active Plan
  - Bridging Benefits down

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Funding Strategies

- Additional, voluntary contributions into the Plan
- Cost Sharing with active employees
- Bonding

Municipal Actions– Annual Trends

Strategy	Description	Trend 2011	Trend 2012	Trend 2013	Trend 2014	Trend 2015	Impact
Cost Sharing for Existing Employees	Employees contribute to help fund the overall cost of the plan	176	149	280	143	60	• 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	63	49	53	43	38	• Existing employees are not affected • Reduces the liability for new hires
Bridged Benefits for Existing Employees	Benefits are offered in parts to existing employees Multiplier is then lowered on a going-forward basis	14	17	19	29	11	• Leaves earned benefits unchanged • Reduces the liability for new hires and existing employees
Hybrid for New Hires	New hires receive a Hybrid Plan	31	67	31	43	8	• Existing employees are not affected • Reduces liability for new hires
Defined Contribution for New Hires	New hires receive a defined Contribution Plan	21	20	45	30	31	• Existing employees are not affected • Eliminates liability for new hires
Bonding	Municipalities may bond for all or a portion of their unfunded accrued liabilities—pension or OPEB	0	0	0	4	0	• Proceeds of the bond are deposited and potentially will fully fund the unfunded accrued liability • No guarantee that future unfunded liabilities may not occur
Voluntary Contributions	Additional payments made into plan toward unfunded liability		180	211	200	170	• Reduces existing liability • Extra dollars are invested and recognize market returns

Example– Plan Design & Funding Strategy

- Different Defined Benefit Plan provisions for new hires
- Bridged actives to a lower multiplier on a going forward basis
- Increased employee contributions
- Limited what was included in Final Average Compensation

- **Result:**
  - Increased funding level by over 20%

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Example – Plan Design Strategy

- Changed Defined Benefit Plan provisions for new hires
- Bridged actives to a lower multiplier on a going forward basis

- **Result:**
  - Increased funding level by 8.5%

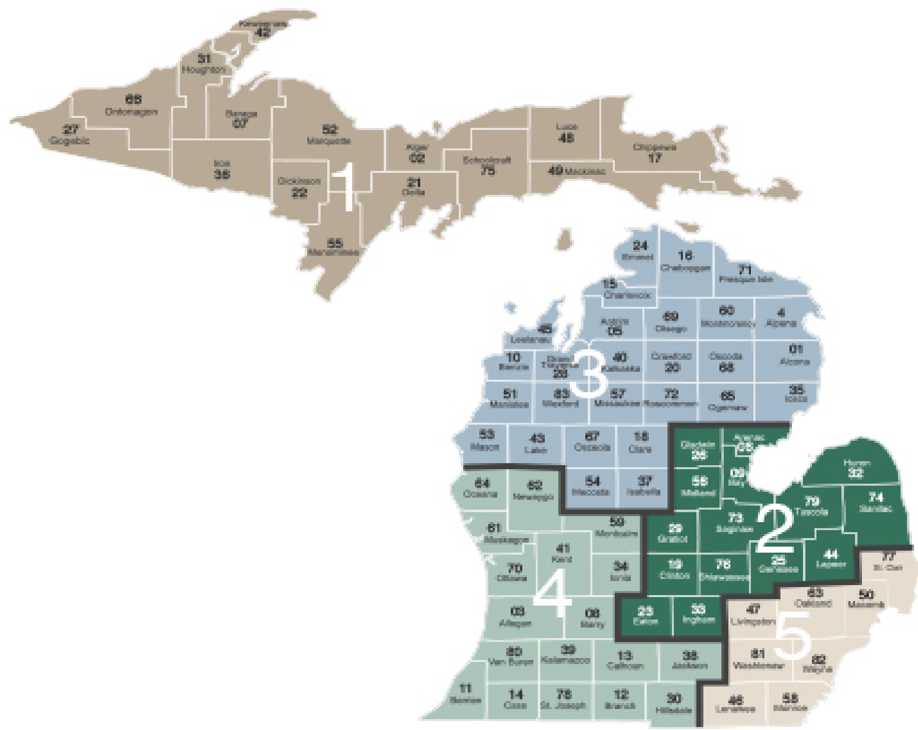
Example– Funding Strategy

- No change or increases to Plan in the last 10 years
- Cost sharing with employees
- Consistently paid above the minimum required contribution each month
- Made periodic lump sum contributions

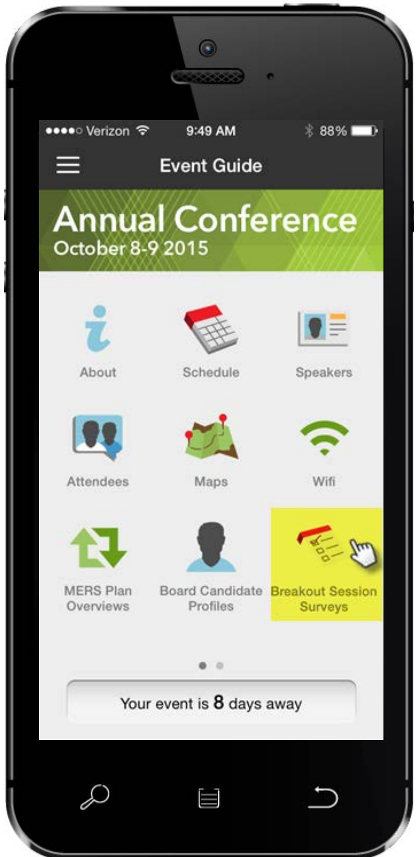
- **Result:**
  - 27% increase in funding level over the past 10 years

MERS Regional Teams

- Your **MERS Regional Team** provides personal and localized service and consists of a *Regional Manager*, *Benefit Plan Advisor*, *Benefit Plan Coordinator*, and *Benefit Education Specialist*.

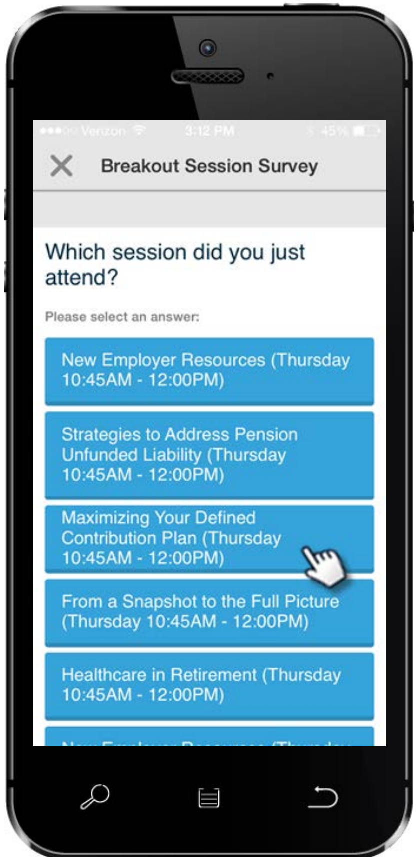


Please Complete a Session Survey!



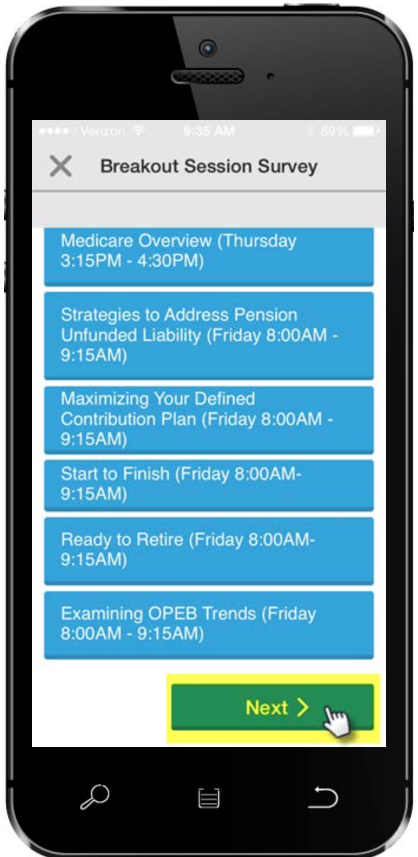
Step 1:

Locate and access the "**Breakout Session Surveys**" Icon



Step 2:

Select the date and time of the session you just attended



Step 3:

Scroll down and click "**Next**" to complete the survey

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