Funding & Plan Design Strategies – Part 2

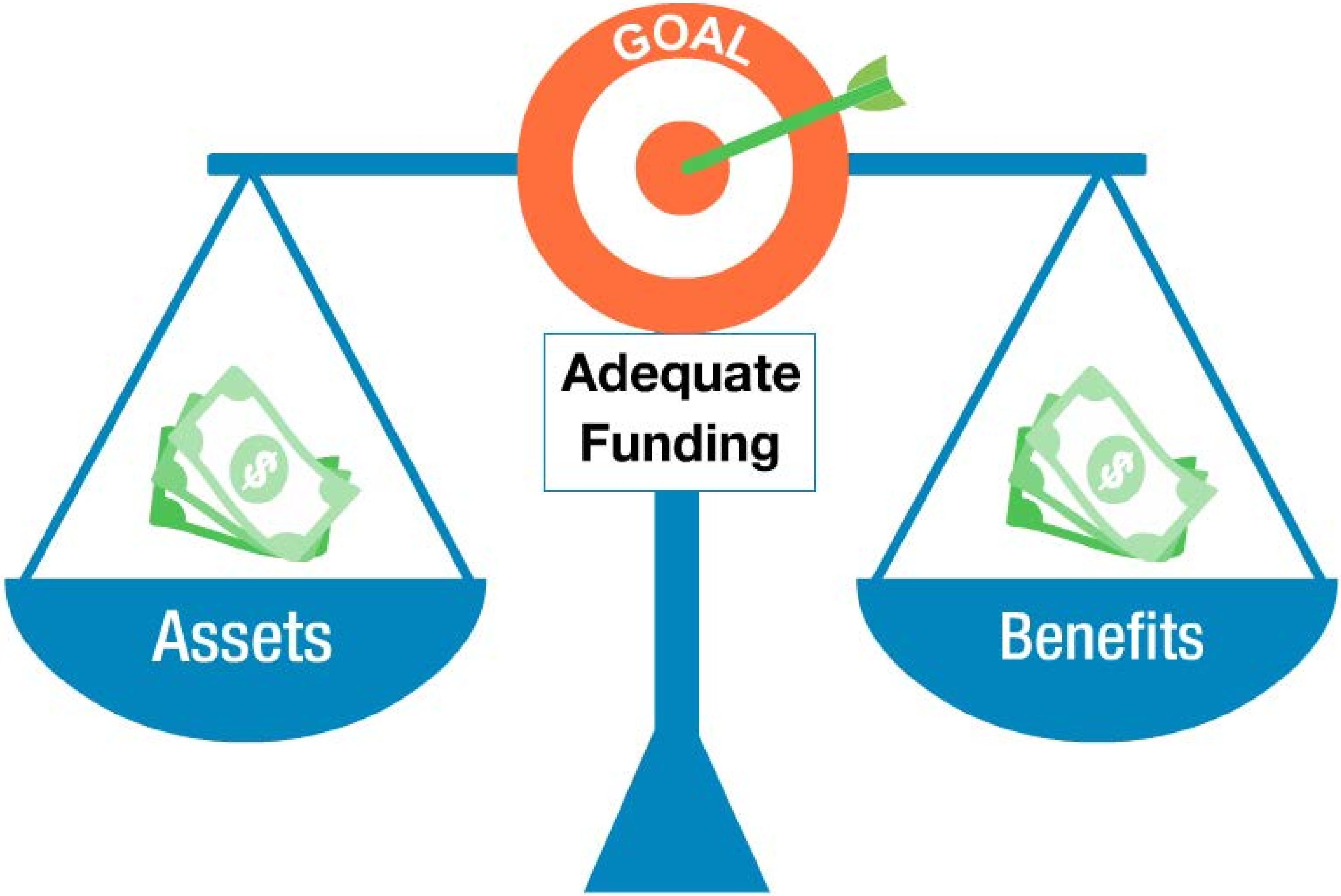
Presented By: Sue Feinberg, Regional Manager

Today's Agenda

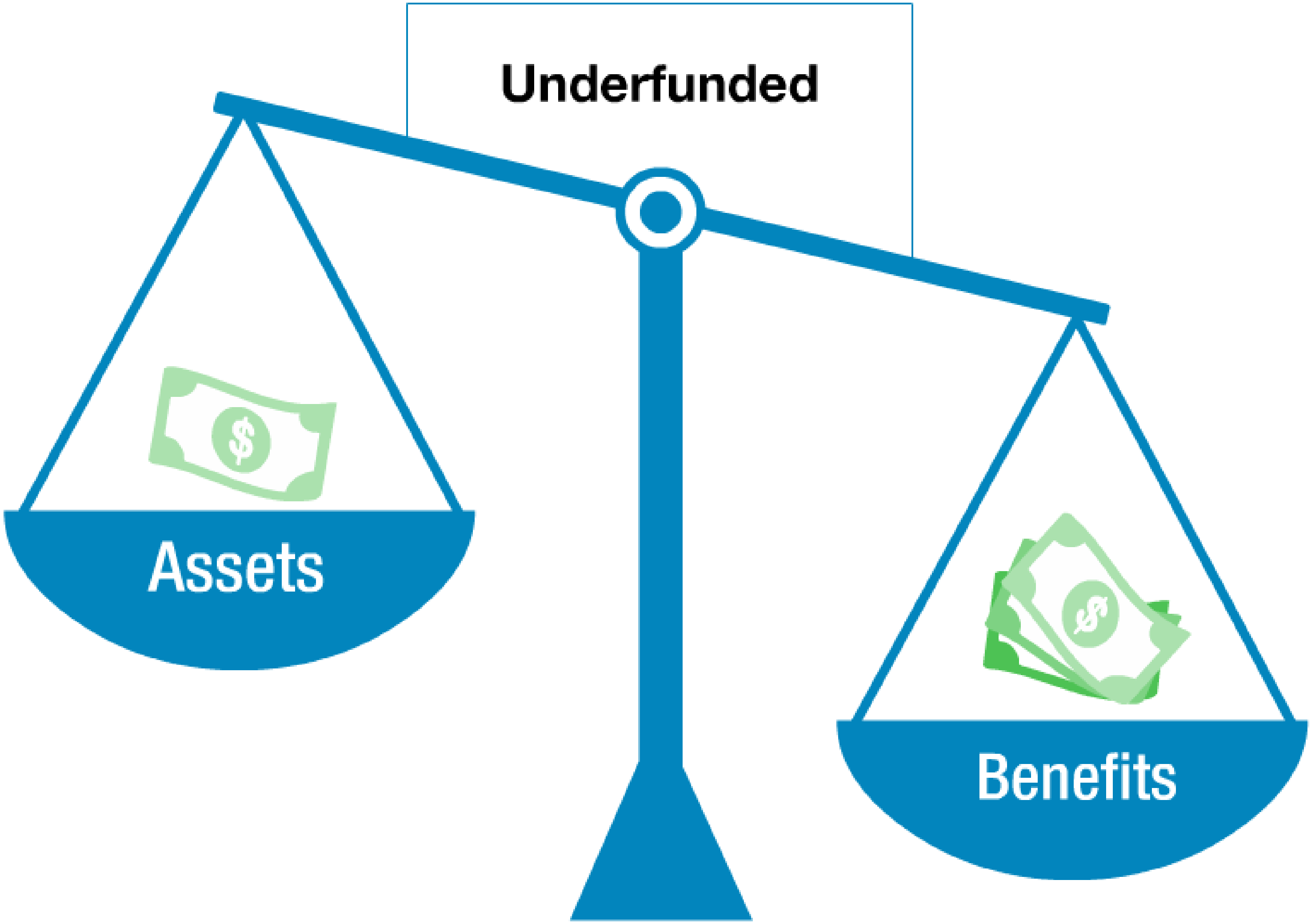
- Unfunded Accrued Liability (UAL)
- Options for Managing/Reducing UAL
  - Plan Design Strategies
  - Funding Strategies

Unfunded Accrued Liability (UAL)

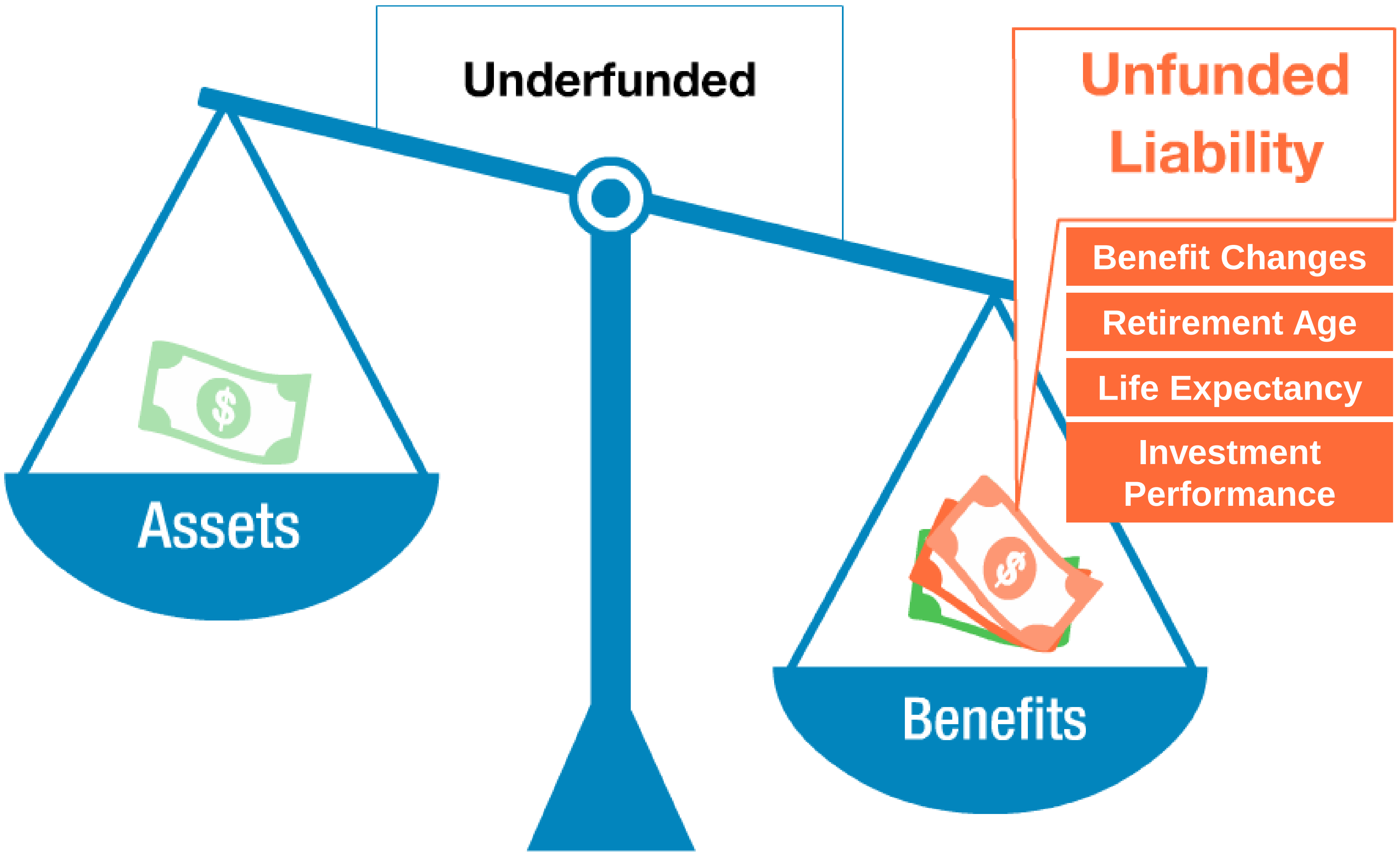
A Fully Funded Plan



An Underfunded Plan



Unfounded Accrued Liability



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

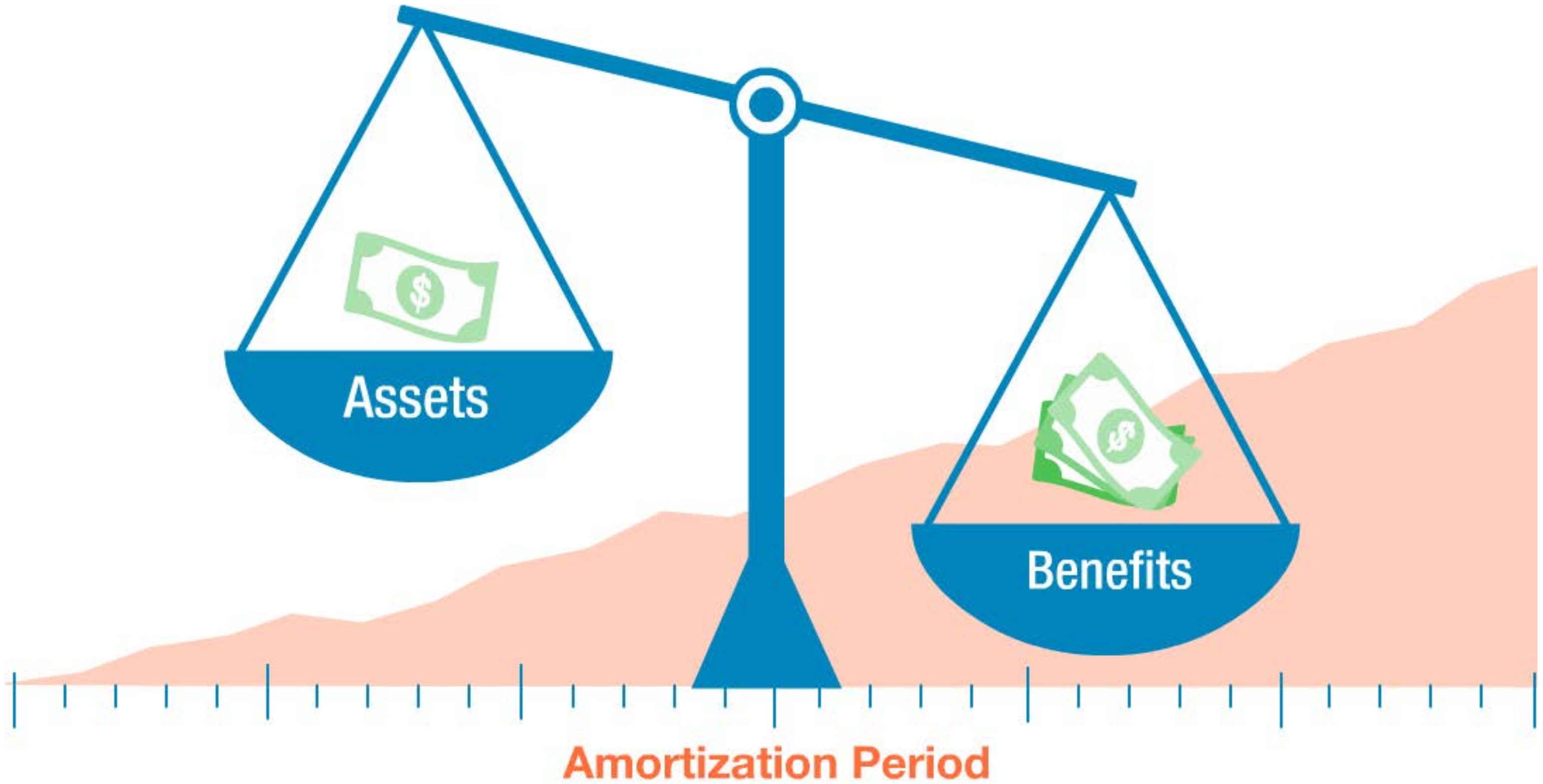
- The dollar value of the benefits is actuarially determined each year for pension
- Unfunded liability is paid off over a period of years

Employer Normal Cost + Amortization Payment of the UAL = Employer Contribution

Why Unfunded Liabilities Develop

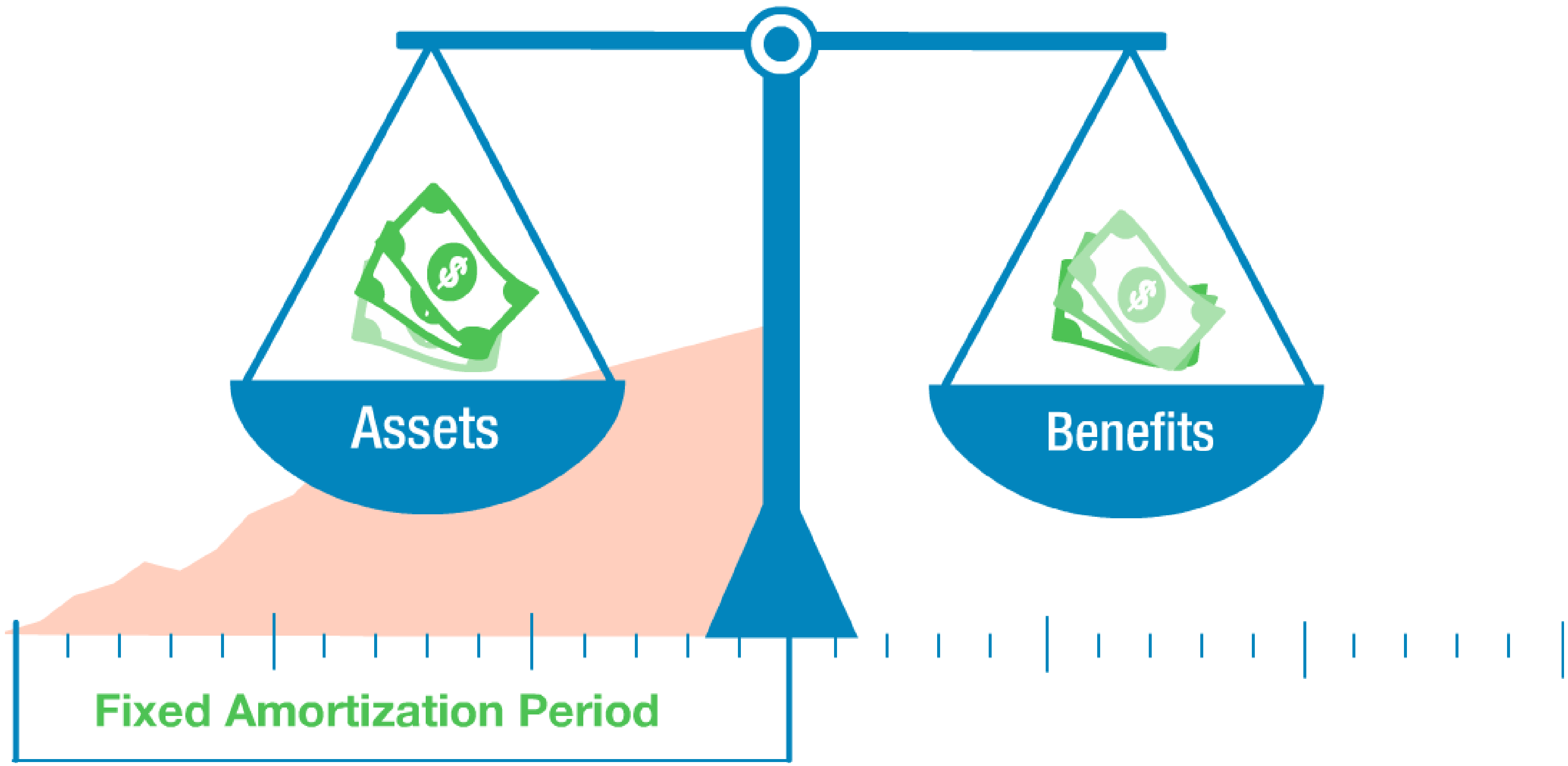
- Actual experience is different than assumed (liabilities and assets)
  - Market performance
  - Demographic experience
  - Rates of retirement
- Benefit enhancements adopted and not entirely funded
  - Early retirement windows
  - Increased benefit multiplier
  - Cost of Living Adjustment (COLA)
-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

Paying Down Unfunded Liability



Unfunded liability is paid off over a fixed period of time known as the amortization period.

Fixed Amortization Period



MERS uses a fixed amortization period, as recommended by actuarial firms and the Government Finance Officers Association.

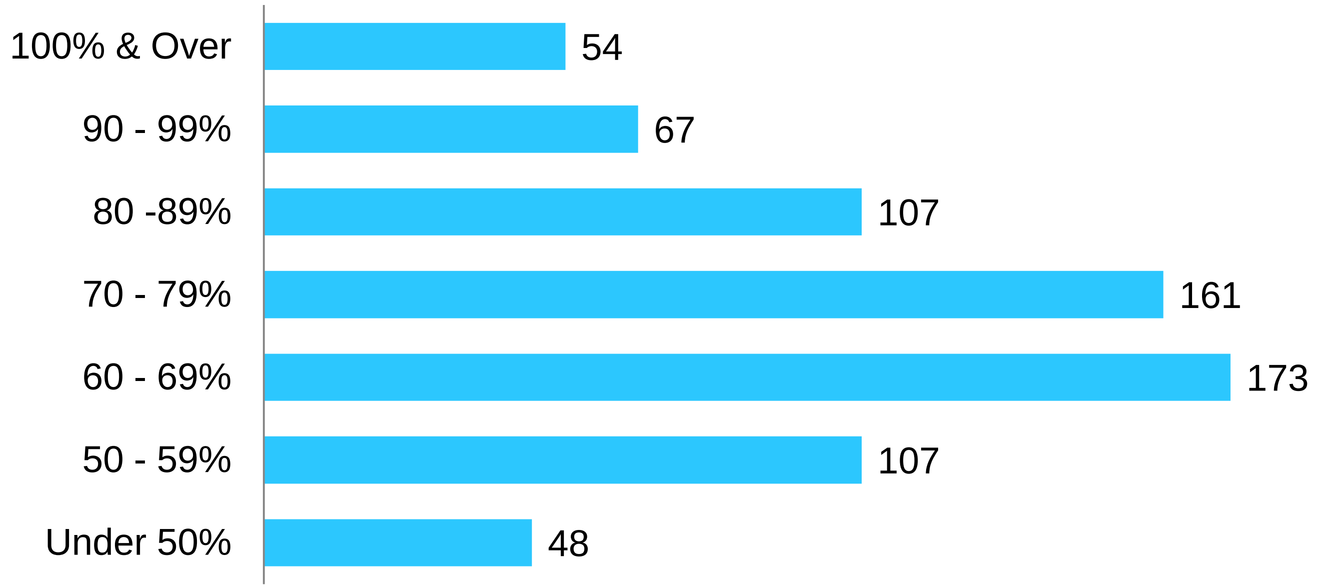
Plan Funding

- While funding ratio may be a useful measure, understanding a pension plan's funding progress should not be reduced to a single point in time
- Pension plans should have a strategy in place to reach or maintain a 100% funded level or greater over a reasonable time frame

Distribution of Funded Percentage

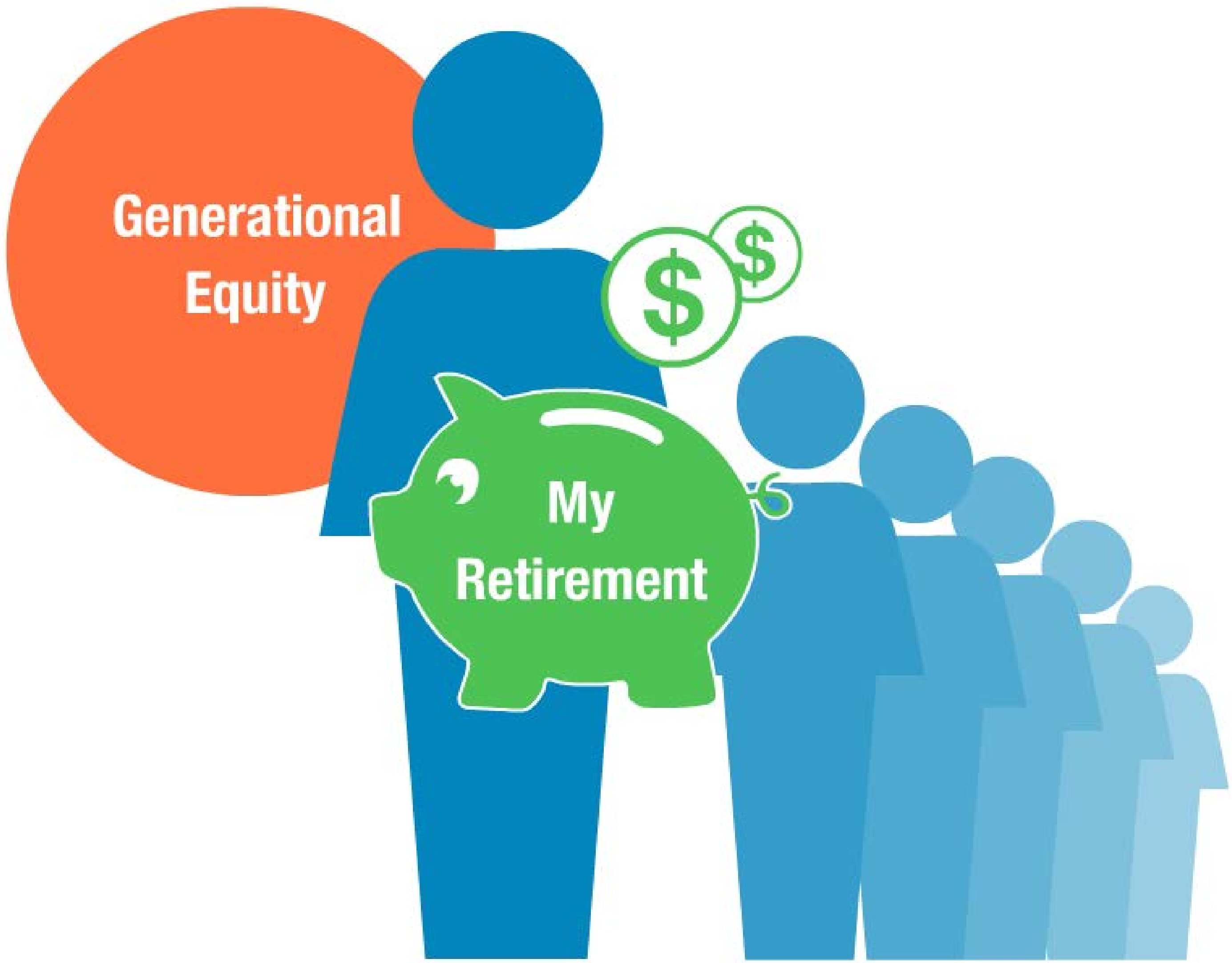
Our Defined Benefit Plan is a multiple-employer plan

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



As of 12/31/15

Generational Independence



Options for Reducing UAL

Reducing UAL

There are several ways a municipality can close its unfunded liability gap

Increase assets to close the funding gap
- Funding strategies

Reduce or eliminate liability moving forward
- Plan design strategies

Considerations

Purpose	Why do you offer your employees a retirement plan?
Benefit	Do you understand the benefits you have in place today?
Cost	When comparing the costs of your current and proposed retirement plans, ensure you're comparing apples to apples
Cash Flow Urgency	*Consider your budget goal* for both your current and proposed retirement plans

Lower Benefit For New Hires

Action

Lower Tiered Benefits for New Hires

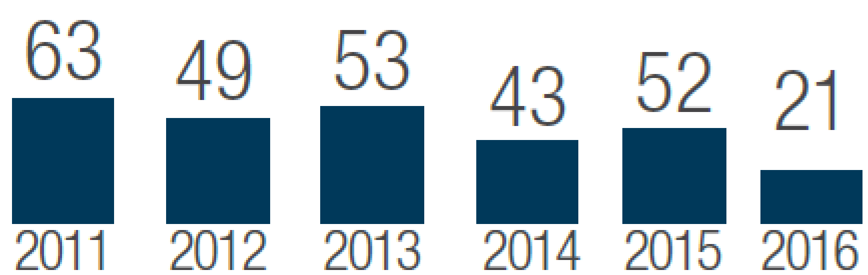
- Lower multiplier
- Removed cost of living adjustments
- Removed early retirement options
- Increased vesting period
- Increased retirement age

Impact

Reduces the Future Liability Accrual

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

Trend



Lower Defined Benefit for 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	**Tier II**
• 2.5% Benefit Multiplier	• 1.70% Benefit Multiplier
• FAC 3	• FAC 5
• Vesting of 8 years	• Vesting of 10 years
• Early Retirement Age 55 with 15 years of service	• Early Retirement Age 55 with 25 years of service
• COLA	• No COLA

Hybrid Plan For New Hires

Action

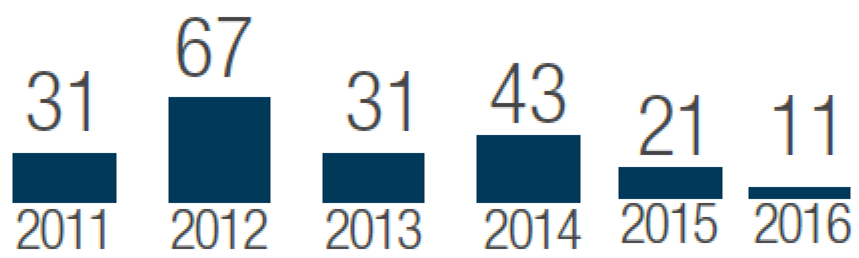
Impact

Hybrid Plan for New Hires

Reduces the Future Liability Accrual

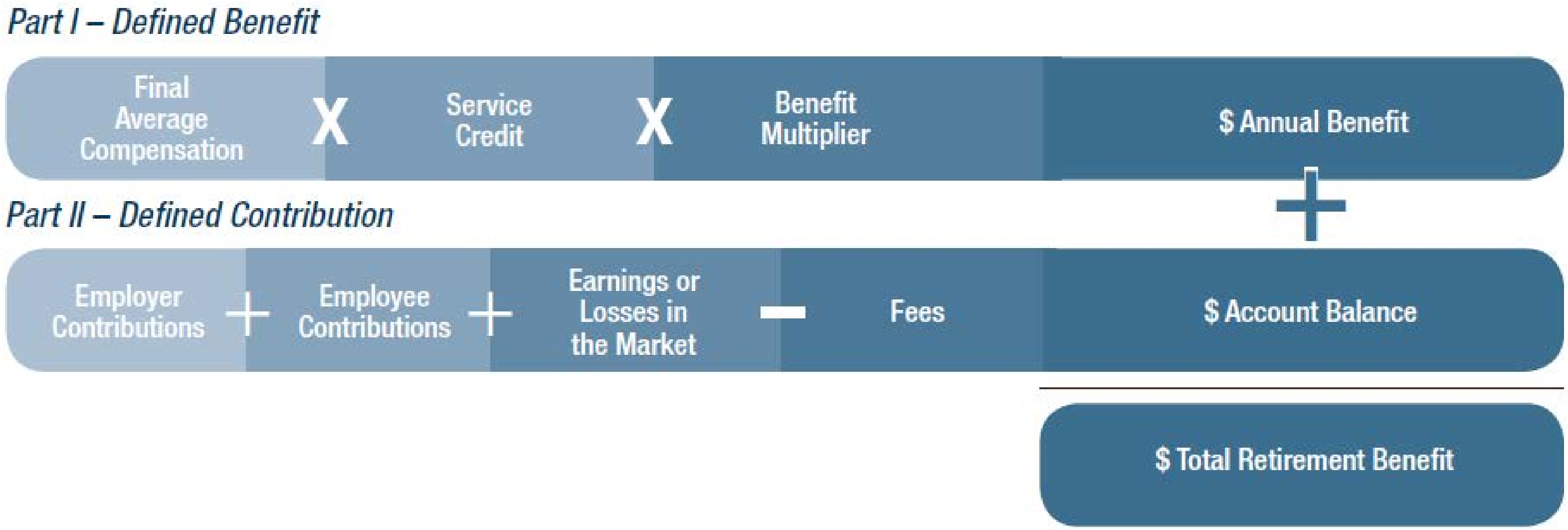
Future benefits will be lower and potentially less expensive than the previous benefits

Trend



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



Example

- A municipality is adopting a hybrid plan for new hires
- The employer normal cost is currently 9.81%

Defined Benefit Plan

- 2.25% Multiplier
- FAC 3
- 10 year vesting
- 9.81% Normal Cost

Hybrid Plan

Part I
- 1.50% Multiplier
- FAC 3
- 6 year vesting
- 6.27% Normal Cost

Part II
- Employer contribution 1%
- Employee contribution 5%
- 6 year vesting

- The new cost for the municipality is 6.27% normal cost for the defined benefit portion plus the 1% employer contribution to the defined contribution portion, **totaling 7.27%**
- This reflects a savings of 2.54% of payroll

Defined Contribution Plan for New Hires

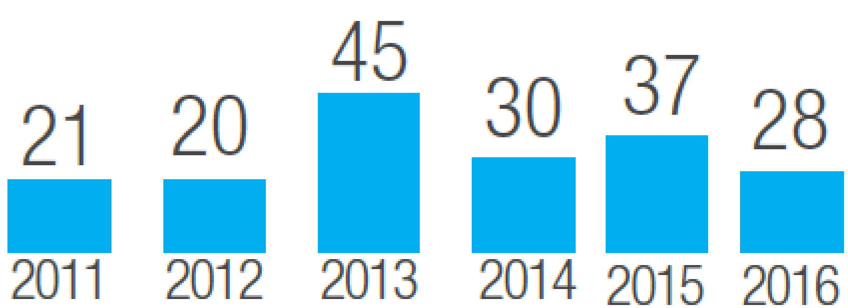
Action

Impact

Defined Contribution Plan for New Hires

Eliminates future accrual of liabilities for new hires

Trend



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
- A projection study is required
  - There is no longer a funding requirement to close your plan
  - Study will show the long-term cost of the current benefit plan compared to the long-term cost of the proposed benefit plan, and will indicate what amortization period is needed
  - Shows how employer contributions would be affected 20 years into the future

Comparing Cost

- When closing a defined benefit plan, the accrued benefits of the active participants in that plan remain and will continue to accrue
  - You will continue to contribute a normal cost payment, plus any payment toward any UAL, until the last retiree/beneficiary stops drawing a benefit
  - The payment toward UAL will not go away by changing plans
- Implementing defined contribution for new hires is not an immediate cost savings
- To compare your long term cost savings, compare the *normal cost* of the defined benefit plan (found on Table 1 of your AAV) to the *proposed employer contribution* of the defined contribution plan
- Once accrued benefits of the past have been fully funded in the defined benefit plan, you will only contribute the normal cost

Bridged Benefit for Existing Employees

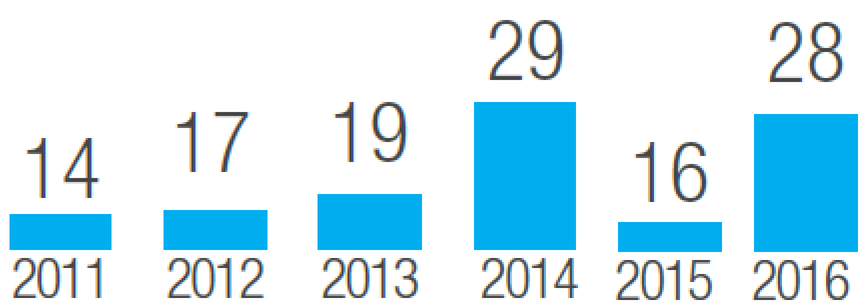
Action | **Impact**

Bridged Benefit for Active Employees

Reduces Future Accrual of Liabilities

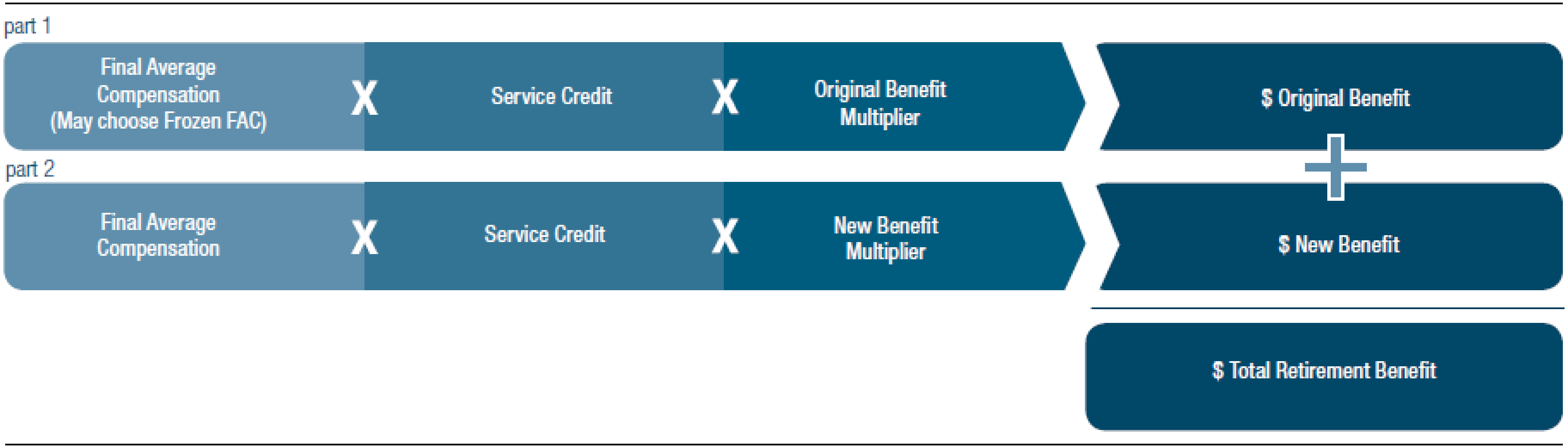
Active employees accrue liability at a lower rate and may reduce existing liability. New hires receive the reduced multiplier

Trend



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



Cost Example

Bob's municipality has 29 employees, a current annual payroll of $1,532,757, a monthly contribution of $23,867 and a 2.5% benefit multiplier. Below are the results of their bridging from a 2.5% benefit multiplier to a 1.5% benefit multiplier:

Frozen FAC Calculation for Part 1 of the Bridge

Actuarial Accrued Liability	
Current Benefits	$ 9,615,809
Proposed Benefits	8,416,803
Difference	(1,199,006)
Division Percent Funded	
Current Benefits	73.1%
Proposed Benefits	83.5%
Difference	10.4%
Long-Term Employer Contribution (Annual)	
Current Benefits	$286,404
Proposed Benefits	128,604
Difference	(157,800)

Not Frozen FAC Calculation for Part 1 of the Bridge

Actuarial Accrued Liability	
Current Benefits	$9,615,809
Proposed Benefits	9,316,155
Difference	(299,654)
Division Percent Funded	
Current Benefits	73.1%
Proposed Benefits	75.4%
Difference	2.3%
Long-Term Employer Contribution (Annual)	
Current Benefits	$286,404
Proposed Benefits	198,936
Difference	(87,468)

Benefit Impact – Frozen FAC

Before the Bridge

FAC 50,000	X	**Service** 25 years	X	**Multiplier** 2.5%	=	**Annual Straight Life Benefit $31,250**

After the Bridge – Frozen FAC

FAC 40,000	X	**Service** 10 years	X	**Multiplier** 2.5%	=	$10,000
FAC 50,000	X	**Service** 15 years	X	**Multiplier** 1.5%	=	$11,250

Annual Straight Life Benefit = $21,250

70 YEARS

Benefit Impact – Not Frozen FAC

After the Bridge – Not Frozen FAC

FAC 50,000	X	**Service** 10 years	X	**Multiplier** 2.5%	=	$12,500
FAC 50,000	X	**Service** 15 years	X	**Multiplier** 1.5%	=	$11,250

Annual Straight Life Benefit = $23,750

70 YEARS

Funding Strategies

- Additional, voluntary contributions
- Cost sharing with active employees
- Bonding

Funding Strategies to Reduce Liability

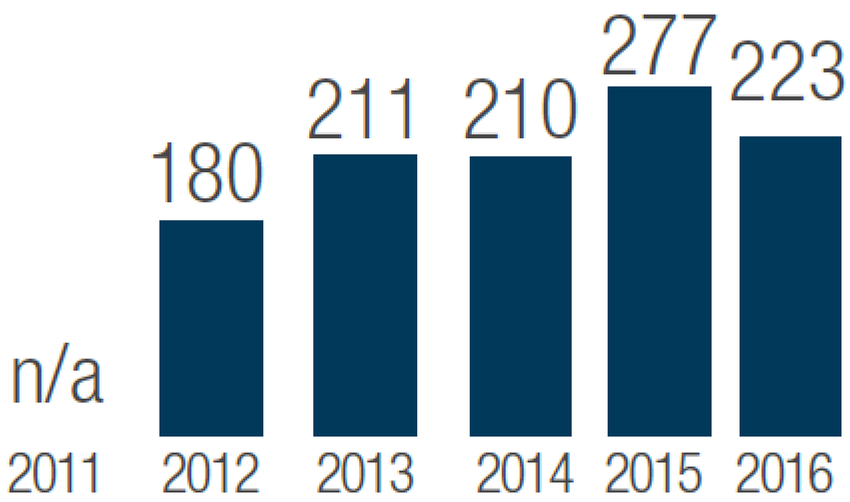
Action	Impact
Contribute Annual Required Contribution (ARC)	**Contributes to Unfunded Liability** The actuarial determined contribution is a formula based on Employer Normal Cost and Amortization Payment of Unfunded Accrued Liability
Contribute Above Annual Required Contribution (ARC) • Extra percentage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

70 YEARS

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
  - The amount of additional voluntary contributions

Trend



Example of Accelerated Funding

For a municipality that is 78% funded and currently paying estimated $35,000 monthly t**o accelerate to 100% funding:**

Over 10 years

Estimated monthly contributions would be estimated $47,000

Over 20 years

Estimated monthly contributions would be estimated

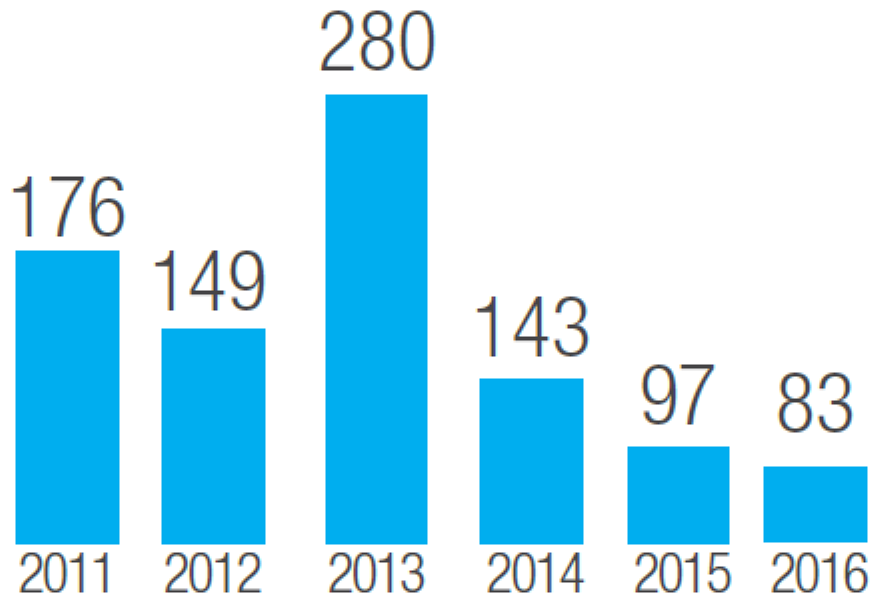
$36,000

- Contribution based on assuming plan meets actuarial assumptions
- MERS strongly encourages employers to contribute more than the minimum contribution required

Cost Sharing

- Employees contribute to help fund the overall cost of plan
- Reduces the employer cost, but does *not* affect total cost or the plan's unfunded liability

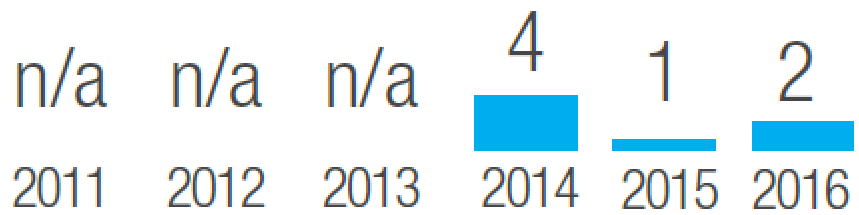
Trend



Bonding

- Municipalities may currently bond for all or a portion of their unfunded accrued liabilities
- Bond proceeds are deposited and may fully fund the accrued liability
- No guarantee that future unfunded liabilities won’t occur

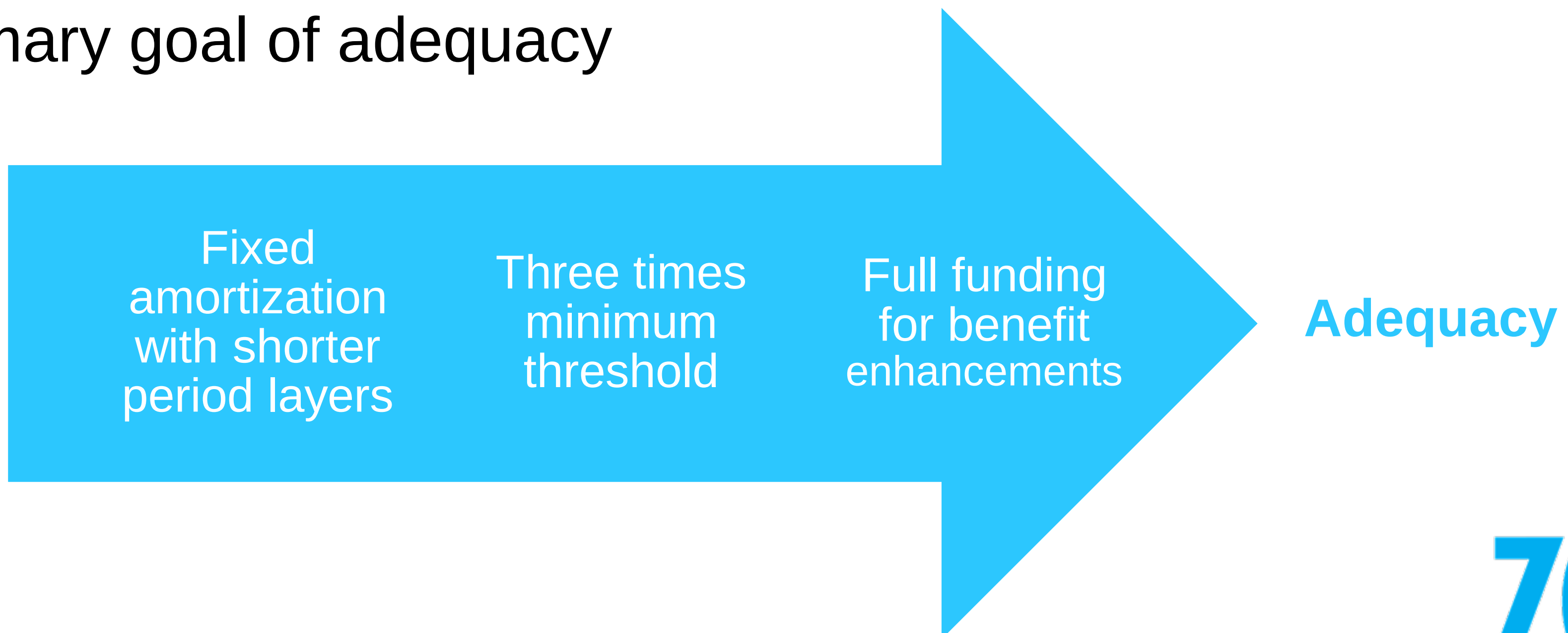
Trend



New Amortization Options

Sound Funding Policies

- For 70 years our customers have been making the payments required of them, which historically has a focus on stable contributions, rather than adequacy
- To date 73% of our customers have adopted at least one plan modification to manage UAL
- We have sound funding policies in place that support the primary goal of adequacy



Listening to Your Feedback

- While our current policies are in alignment with our funding goals, some customers need flexibility with the timeframe in which we are getting them to full funding
- Additional time for funding UAL may be appropriate in some situations
- All plans have unique funded levels and demographics

Optional Amortization Period Extension

- One time opportunity by request
- Open groups could reset their **existing** UAL amortization period ***up to*** 30 years fixed
  - New UAL would continue to be amortized at the current amortization period before any reset (12/31/15 the period is at 23 years)
- Closed groups could reset their **existing** UAL amortization period ***up to*** 25 years fixed
  - New UAL would continue to be amortized at the current amortization period before any reset (periods vary depending on when the division closed)
- Approval would be provided by MERS based on a sustainability analysis with established criteria by the consulting actuaries

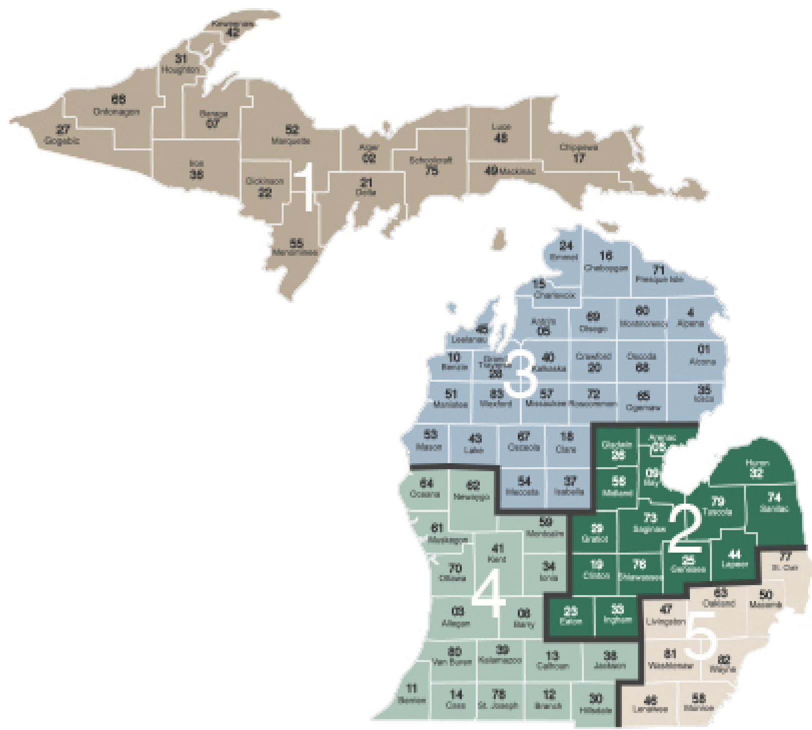
Implementation and Process

Using the existing process we have in place today for benefit modifications:

- Customer would request actuarial analysis
- Sustainability analysis completed, at customer's cost, to ensure criteria are met
- The analysis is reviewed with and an agreement is signed by the authorized designee of the governing body of the municipality (or Chief Judge of court) acknowledging the risks (lower funded levels, market volatility, etc.) and the continued recommendation to use a shorter amortization period
- Any approved request would impact future fiscal year contributions

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*.



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