Pension Funding Part I

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Presentation to: LEOFF Plan 2 Retirement Board

Office of the State Actuary
"Supporting financial security for generations."

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Today's Presentation

- What is pension funding?
- What is an actuarial cost method?
- The most common public plan cost methods
- LEOFF 2's actuarial cost method
- Considerations for the Board

- No Board action required today

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What Is Pension Funding?

- Accumulating assets to pay for the benefits provided under the plan
- Pension funding goals in statute (RCW 41.45.010)
  - Fully fund the plan as provided by law
  - Establish long-term employer rates that remain relatively predictable proportion of future state budgets
  - Intergenerational equity
- Two key components
  - Actuarial cost method (Part I)
  - Board funding policy (Part II)

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What Is An Actuarial Cost Method?

- A procedure that allocates the cost of a pension plan to different time periods
- Developed by actuaries to produce rates that will fully fund the plan
  - When the benefit payments are due
  - If all assumptions are realized
- Different actuarial cost methods can vary in how quickly they fund the plan
  - Higher contribution rates earlier or later in a member's career
  - Pay for unexpected costs over shorter or longer periods

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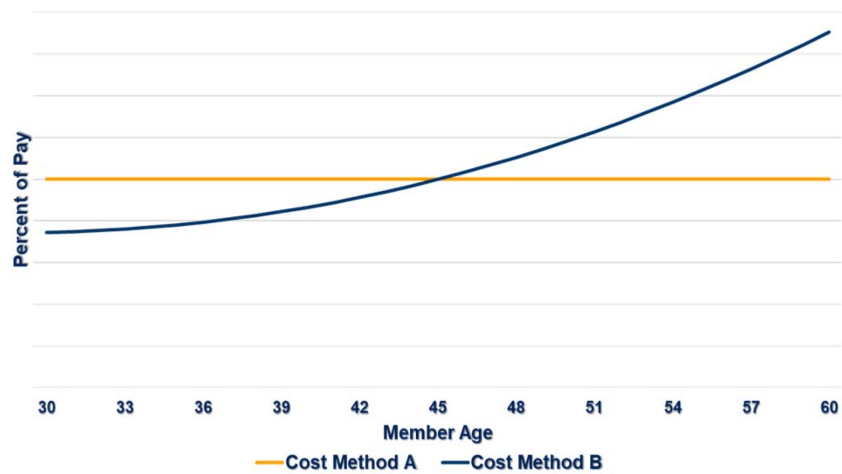
Contribution Rates Under Different Actuarial Cost Methods



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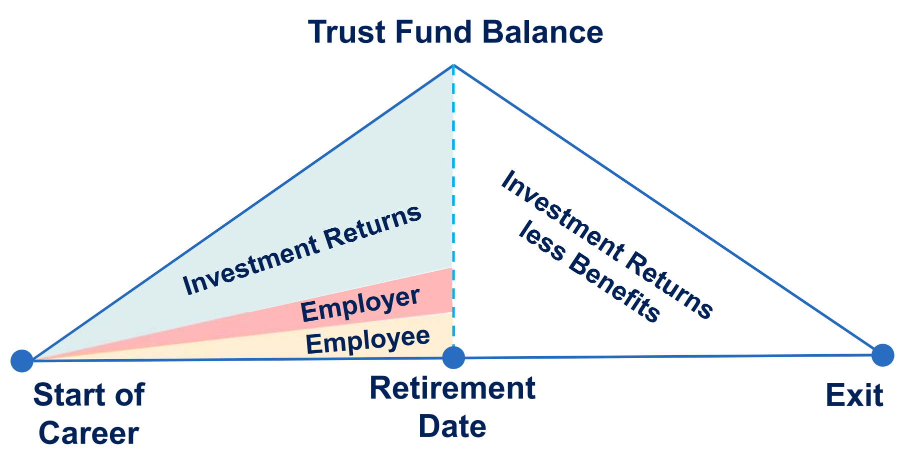
Goal Of An Actuarial Cost Method



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Every Cost Method Includes Past And Future Costs

- Past costs
  - The cost of any past experience that is different than expected
    - Actuarial gains and losses
  - Changes to plan provisions or assumptions
- Future costs
  - The cost of next year's benefits all active members are expected to earn

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Common Cost Methods Used In Public Pensions

- Entry Age Normal (EAN) Cost Method
  - Calculates two separate contribution rates
    - Past costs = UAAL
      - Requires an amortization policy
    - Future costs = Entry Age Normal Cost
- Aggregate Cost Method
  - Rolls both the past and future costs into one contribution rate = Aggregate Normal Cost

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LEOFF 2 Uses The Aggregate Actuarial Cost Method

- Calculate contributions required to fully fund the obligations of the plan
- LEOFF 2 pension statutes (RCW 41.26.720) would also allow for use of the EAN Cost Method

> "The actuary retained by the board shall utilize the aggregate actuarial cost method, or other recognized actuarial cost method based on a level percentage of payroll, as that term is employed by the American academy of actuaries."

The LEOFF 2 Board Has Also Adopted Funding Policies

- Funding policies used in conjunction with the plan's actuarial cost method (Aggregate) to achieve specific goals
  - Asset smoothing method
  - Minimum contribution rate policy
- Funding policies can address
  - Adequacy, stability, and affordability of contribution rates
  - Risk management
- Policies can achieve similar outcomes even when applied to different actuarial cost methods
- Funding policy addressed in "Pension Funding – Part II"
  - October Board meeting

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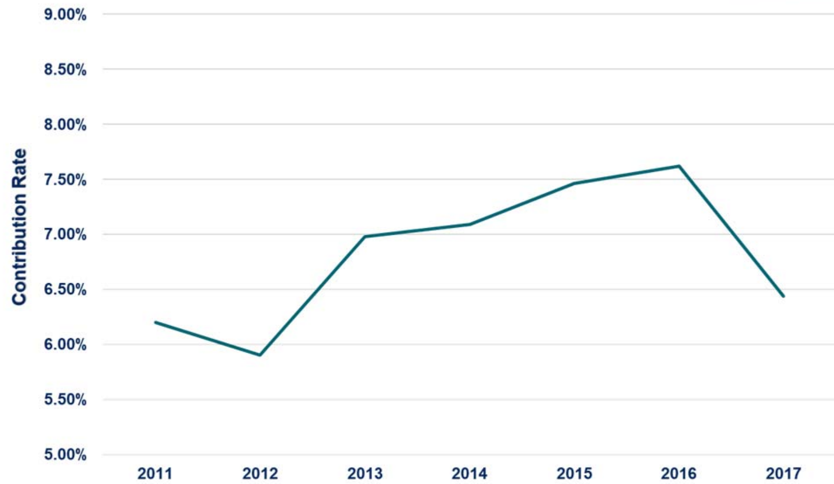
Why Might The Board Choose To Continue Using The Aggregate Cost Method?

- Maintain status quo
- Aggregate is used for all other Washington State retirement plans that are open to new hires (RCW 41.45.060)
- One contribution rate that rolls all plan costs together
- No UAAL (or surplus) amount separately identified and requiring an amortization policy
- Achieves intergenerational equity
- Has provided a solid foundation for LEOFF 2 historical funding

Why Might The Board Choose To Switch To The EAN Cost Method?

- One component of this cost method is currently used in the Board's adopted minimum rate funding policy
  - Over the past several biennia, the Board has adopted contribution rates equal to the Normal Cost under the EAN Cost Method
  - Normal Cost is a relatively stable contribution rate
- Used by majority of public pension plans nationally
- Method required for financial reporting, as adopted by GASB
- Can achieve intergenerational equity with amortization policy

Historical LEOFF 2 Aggregate Contribution Rates



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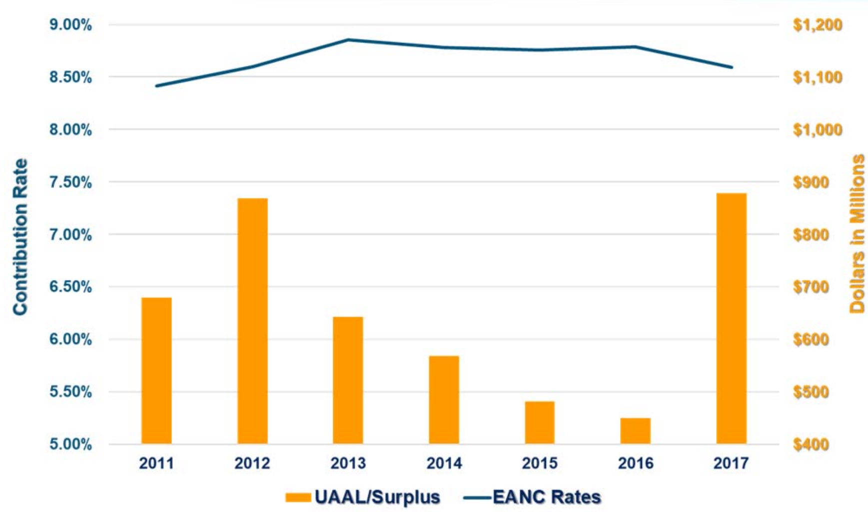
Historical LEOFF 2 EAN Data



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Summary – Pension Funding Part I

- Actuarial cost methods form the backbone of pension funding
  - Determines the contributions required to meet all pension obligations
- The current cost method (Aggregate) remains a reasonable approach to plan funding
- Changing to the EAN Cost Method would also be reasonable
- Either cost method, along with funding policies, can achieve the Board’s goals

Next Steps

- Board has opportunity to adopt new actuarial cost method
  - September meeting
- OSA provides educational briefing on “Pension Funding – Part II”
  - Funding policy options
  - October meeting
- Board has opportunity to adopt new funding polices
  - November or December meeting
- OSA available to provide consulting or additional information throughout process

Questions?

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