Innovative Funding Policies to Strengthen Plans

2019 PUBLIC PENSION FUNDING FORUM

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Key Goals

1. Strengthen funding/closing gaps
2. Reduce contribution volatility
3. No added pressure on benefits

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Funding with Risk Free Rate Does Not Eliminate Volatility

	Plan A: 100% Funded at 3% Return Assumption	Same Plan: 100% Funded at 7% Return Assumption
Liabilities	$5 B	$3 B
Assets	5 B	3 B
UAL	$ 0	$ 0
Payroll	$2 B	$2 B

What happens if you lose 7% during the next year?

- 3% Return: Missed assumption by $500 million/25% pay
- 7% Return: Missed assumption by $420 million/21% pay
- Trailing results will be better, but not exactly "risk-free".

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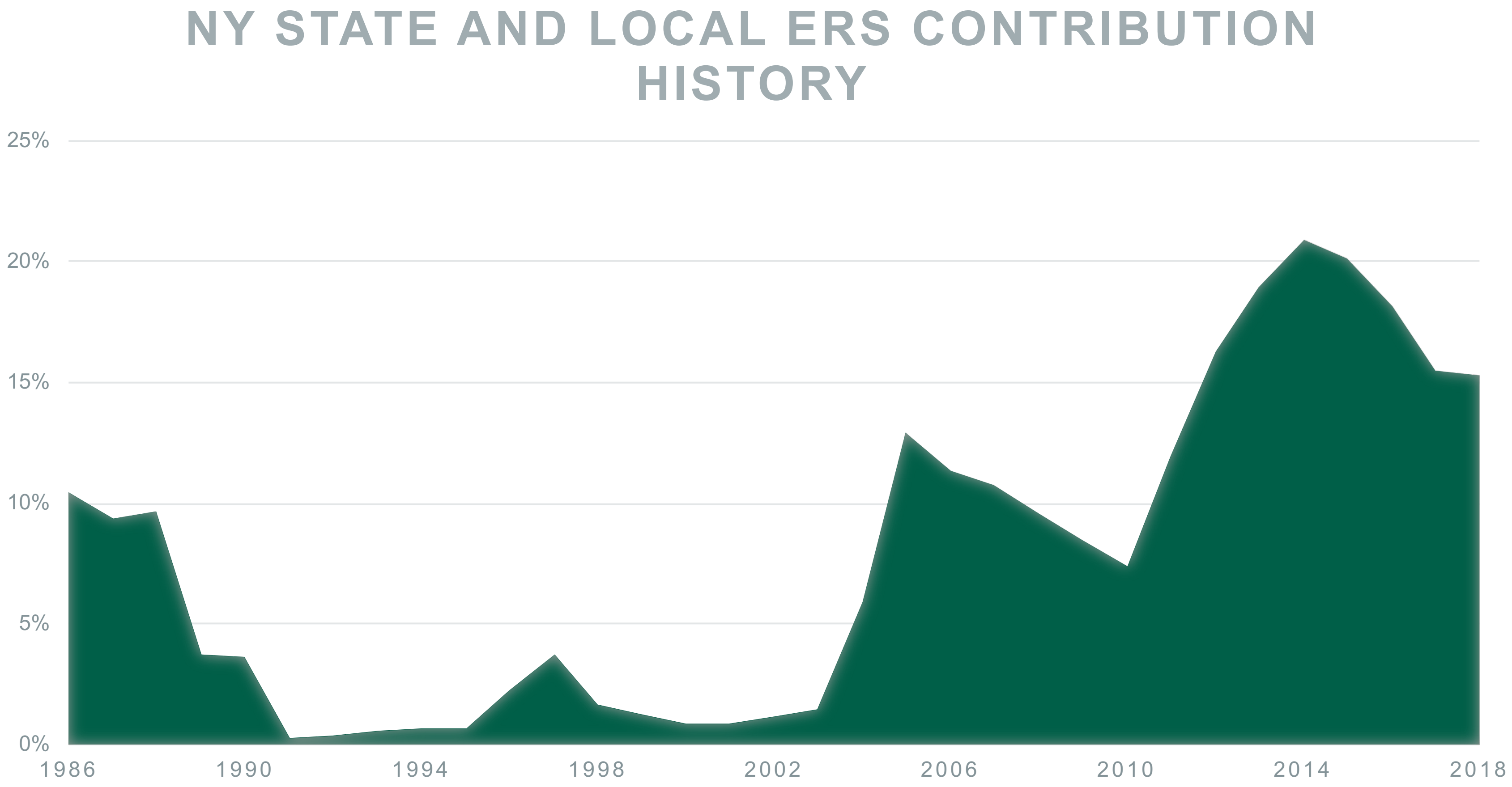
Big Picture Challenge: Allocation of Costs Over Time



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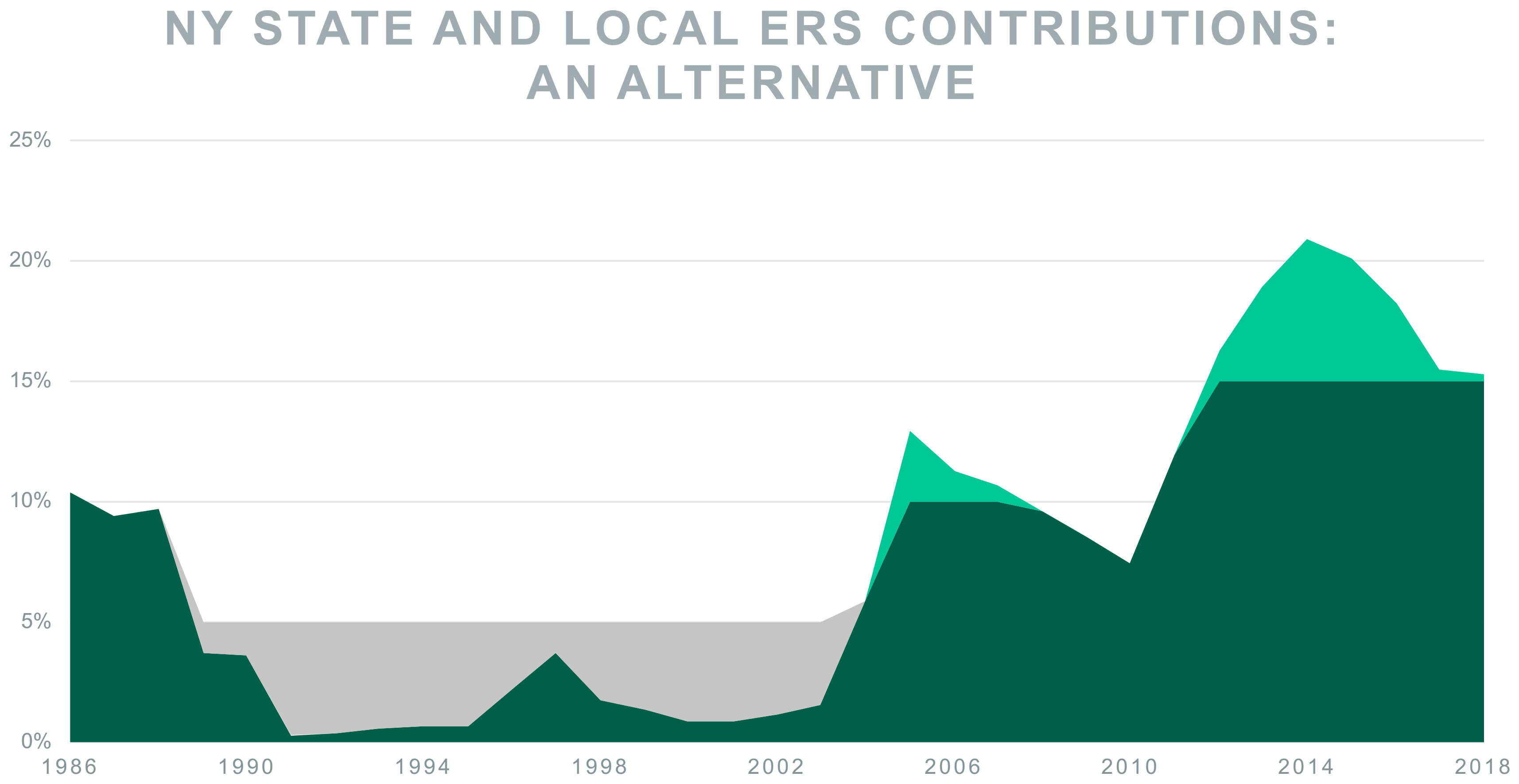
Big Picture Challenge:
Filling Valleys & Reducing Peaks



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Two Concepts to Explore

1. Funding and reporting have been divorced: What opportunities does this present?

2. Should public, multi-employer plans manage employer rainy day pension funds?

First Concept: Discovering Opportunity in Funding/GASB Divorce

1. GASB guides reporting, not funding.
2. Reporting can be done based upon expected returns.
3. Funding and reporting discount rates are typically still linked together.
4. Now possible to fund the plan using a discount rate that leans conservative, while reporting using the 50th percentile.

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Hypothetical Example of Capital Markets Expectations

Assume you are told the following about future returns:

- 50^{th} percentile - 7.25%
- 35^{th} percentile – 6.20%

In the past, funding on a 6.2% return assumption generally meant your reporting would also use 6.2%.

Today, you can develop contributions using 6.2%, while continuing to use 7.25% for reporting.

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Won’t That Eventually Overfund the Plan?

1. It would, if your expectations are correct and you never use excess contributions to reduce peaks.

2. However, your funding policy could track excess contributions and use it to reduce peaks.
   - Private sector pensions track ‘credit balances’

3. Creates flexibility; Stress testing can be more useful.

4. Alternatively, overfunding could be used to transition to a less risky portfolio.

➔ ***Federally funded positions/contracts will present challenges***

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Second Concept: Give Employers Flexibility to Contribute Ahead

1. Plans could offer participating employers the option to contribute more than the ADEC.

2. Contributions ahead of schedule would be tracked, and credited to employers, with actual plan returns.

3. Employers could use those credits in the future to reduce costs/volatility at opportune times.

4. This could allow participating employers more time to adjust after a major market event, when revenues may have rebounded, while maintaining a higher funding ratio and better liquidity.

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Oregon PERS Manages Side Accounts

1. Employer prepayments are placed in "side accounts" and attributed solely to the employer. Held separate from other employer reserves.

2. 144 employers have side accounts holding almost $6 billion.

3. Interest is credited with ***actual returns***, not expected (no transfer of risk)

4. Senate Bill 1566 (2018) established 25% state match, allows amortization over 6, 10 or 16 years, in addition to 20 year default.

Sources:
- https://www.oregon.gov/pers/EMP/Pages/Employer-Rate-Relief-Programs.aspx;
- https://www.oregon.gov/PERS/Pages/General-Information/Side-Accounts-by-the-Numbers.aspx

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CalPERS Offers New Program to Help Public Employers Offset Future Pension Costs

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SACRAMENTO, Calif. – CalPERS has implemented a new trust fund that allows public employers to prefund their future pension costs. The new program, known as the California Employers' Pension Prefunding Trust (CEPPT), provides the state and public agencies an additional investment vehicle to accumulate assets over time to help manage long-term costs.

"This new fund gives public agencies an opportunity to save and plan ahead," said Marcie Frost, CalPERS CEO. "Prefunding is a smart and efficient approach for employers to mitigate rate increases and temper contribution volatility. Benefits are only as secure as our employers' ability to pay them."

Established by Senate Bill 1413, participation in the fund is voluntary and mirrors the functions of CalPERS California Employers' Retiree Benefit Trust (CERBT) Fund by providing employers flexibility to determine the amount of their investment contribution, risk tolerance, and time horizon. The fund also offers employers:

Discussion & Questions

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