



Four Letter Words Frequently Entering The Pension Conversation

Plus
Other Trends

Presented by Amy Crouse and Bob Hazy
GFOA-PA Annual Statewide Conference | May 2024

“Government Finance Officers Association (GFOA-PA)”



GFOA

“The Government Finance Officers Association of Pennsylvania is the premier organization for individuals working in financial positions at all levels of government throughout Pennsylvania.”

Membership Benefits

- Networking
- Mentoring
- Continuing Education
- Jobs

Source: gfoapa.org

“Governmental Accounting Standards Board”

A graphic featuring the acronym "GASB" in a bold, black, sans-serif font. The text is centered within a white, jagged-edged shape that resembles a starburst or a speech bubble. This shape is surrounded by a blue outline and a pattern of small, dark blue dots. To the right of the main graphic is a smaller, four-pointed starburst shape, also outlined in blue.

GASB

Establishes accounting and financial reporting standards for U.S. state and local governments

Statements are numbered: Currently 1 through 102

Key GASBs for retirement actuaries:

- 67/68 – Pension Accounting
- 74/75 – OPEB Accounting

GASB Update Session Tomorrow

“Cost of Living Adjustment”



COLA

Purpose

Features

- Frequency
 - Automatic vs. Ad hoc
 - Annually on January 1 for all vs. Anniversary of Retirement
 - Waiting Period
- Basis
 - Flat percentage vs. Index
- Limitations
 - Annual and/or Lifetime

Costs

- Any benefit improvement for an inactive participant must be paid for in the MMO following its adoption.

Cost of Living Adjustment (cont.)



COLA

Legislative News

- PA House Bill 1379 / Senate Bill 854 (introduced June 2023)
 - Revival, with modification, of HB 2237 (intro. Jan 2022)
- Adjustment Amount
 - \$75/\$150/\$300 per month if retired at least 5/10/20 years
 - Partial offset equal to 65% of total adjustments provided after January 1, 2002 and prior to new legislation
- Reimbursement Method
 - Concern for full reimbursement
 - Contact your state representative

“Qualified Domestic Relations Order”



QDRO

Overview

- Participant vs. Alternate Payee
- Marital Property
- Separate or Shared Interest
 - Optional payment forms
 - Death provisions (pre-/post commencement)

Requirements

- Determining Qualification
 - Review of DRO
 - Template
- Name, SSN, Birth Date, and Current Address of Parties
- Pension Plan Documents
- PA Divorce Code
- Municipal State Pension Laws (e.g., Act 600)

Qualified Domestic Relations Order (cont.)



QDRO

Challenges

- Calculation of Benefits
 - Share of subsidies
 - Taxable/non-taxable payments
 - Actuarial adjustments for life expectancies
- Impact on Non-Pension Benefits
 - Social Security
 - OPEB
- Terminology Misunderstandings
 - E.g., “Post-separation”
- Administration

“Other Post-employment Benefits”



OPEB

Quick Survey

Provision Considerations

- Gap Coverage vs. Lifetime Coverage
- Life Insurance
- Medical and Rx Drug
- Dental and Vision
- Dependent Coverage

Trends

- Healthcare Costs
- Marketplace
- Reimbursement/HSA Funding
- Buyouts

Pension Service Crediting



**Buy
Back**

Military Service

- Intervening vs Non-intervening
- Required or optional?
- 5 years maximum

Other Service

- PA Senate Bill 464 – *Proposed (re-introduction of 669)*
- Part-time service
- Service at another municipality

Cost Neutrality?

- Act 600 (Police)
 - Normal cost rate limited to 10%
 - Interest crediting vs actual investment returns
- TCCC

“Deferred Retirement Option Plan”



DROP

Intended to allow a retirement-eligible employee to continue working

- Retention tool
- Can be added as a temporary or permanent provision of the pension plan

Typical operation:

- Pension benefit is frozen as of DROP effective date.
- Monthly benefits that would have been paid are credited to a book account (DROP account).
 - No cash payouts – they will be taxed!
- Interest is typically credited to the DROP account.
- Upon actual termination of employment:
 - DROP account is paid out as a lump sum; can be rolled over.
 - Monthly payout of frozen pension begins.

Deferred Retirement Option Plan (cont.)



DROP

Can this be cost-neutral?

- If it alters retirement patterns, probably not.
- Features that will add to employer cost:
 - Continuation of pension benefit accrual
 - Interest credit that exceeds the trust's rate of return

Act 205 includes requirements for DROPs

- Added via Act 44 of 2009

Other considerations

- Window for DROP elections
- Limit period for DROP participation (2 years? 5 years?)
- DROP participants do not contribute to the plan
- DROP participants are not certifiable for State Aid
- Status of other benefits during DROP period

Shorthand for “Actuarial Experience”



**Gain/
Loss**

Comparison of actual plan experience vs. the actuarial assumptions

Can include but is not limited to:

- Mortality
- Retirement
- Termination before retirement
- Disability
- Form of payment election
- Percent married and age difference (for survivor benefits)
- Salary increases
- Expenses
- And, of course, investment return

Actuarial Experience (cont.)



**Gain/
Loss**

Ideally, a gain or loss would be calculated for each assumption every year.

- Gain = actual liability is lower than expected liability
- Loss = actual liability is higher than expected liability
- Precise calculation for each assumption would be prohibitively expensive

Typically, gain/loss will be presented in a valuation report as:

- Asset related (investment return)
- Liability related (people changes)

Assumptions are monitored at a high level with each valuation, to identify the largest sources of change.

Actuarial Experience (cont.)



**Gain/
Loss**

A formal experience review is recommended periodically

- Act 205 requires an experience investigation every four years for plans with 1,000 members
 - Looking back over a 5-year period

Traditional Usage (i.e., Investment Performance)



**Gain /
Loss**

Recent history:

- 2023: 10%-20% gains
- 2022: 10%-20% **losses**
- 2019-2021: 10%-20% gains
- 2018: 1%-5% **losses**

[If your 2023 actuarial valuation isn't completed yet...]

What will 2022's abysmal performance do to my next MMO?

Asset smoothing mitigates the impact

Commonly-used method spreads gains & losses over five years

Investment Performance (cont.)



**Gain/
Loss**

Asset smoothing example for an actual plan:

- 2022 investment loss was 16%
- 2018-2021 performance similar to prior slide
- Smoothing results in a 5.9% positive return for 2022
 - This is still an “actuarial loss”, because 5.9% is lower than the plan’s funding interest assumption of 7.0%.
- MMO increase from prior year:
 - With smoothing: \$160,000
 - Without smoothing: \$3,800,000
- Actuarial (smoothed) value of assets:
 - At 1/1/2022: 88% of market value
 - At 1/1/2023: 111% of market value

Smoothing is used for funding, not for GASB 68 balance sheet disclosure.

“Actuarial Standards of Practice”

A graphic featuring the text "ASOPs" in a bold, black, sans-serif font. The text is centered within a white, jagged-edged shape that resembles a starburst or a speech bubble. This shape is surrounded by a blue outline and a pattern of small, dark blue dots. To the right of the main graphic is a smaller, four-pointed starburst shape, also outlined in blue.

ASOPs

Adherence to ASOPs is a requirement under the Code of Professional Conduct for U.S. actuaries.

They are numbered: Currently 1 through 57.

Key ASOPs for retirement actuaries:

- 4 – Pension Obligations and Costs
- 6 – OPEB
- 23 – Data Quality
- 27 – Selection of Economic Assumptions
- 35 – Selection of Demographic Assumptions
- 41 – Actuarial Communications
- 51 – Risk Disclosure
- 56 – Modeling

Actuarial Standards of Practice (cont.)

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ASOPs

ASOPs provide “guidance.”

- Actuary may deviate from the guidance *but* must provide a rationale for doing so.
- “Professional judgment” is part of the process.

ASOPs are updated periodically.

“Low-default-risk Obligation Measure”

A graphic featuring the text "LD-ROM" in a bold, black, sans-serif font. The text is centered within a white, jagged-edged shape that resembles a starburst or a speech bubble. This shape is surrounded by a blue outline and a pattern of small, dark blue dots. To the right of the main shape is a smaller, four-pointed starburst shape, also outlined in blue.

LD-ROM

This is an update to ASOP No. 4.

Effective for measurement dates on or after February 15, 2023.

LD-ROM = Liability using a discount rate derived from low-default-risk fixed income securities.

- Whose cash flows are consistent with the pattern of benefits expected to be paid.

Discount rate examples:

- US Treasury yields
- Implicit rate for annuity purchase or lump sum settlement
- Corporate or municipal bond rates with highest ratings

Low-default-risk Obligation Measure (cont.)

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LD-ROM

So what?

- A new number will appear in the funding valuation report.
- This does not change the existing funding requirement.
- Intended to illustrate liability if sponsor were to invest against expected future cash flows using investments that have a low default risk.
 - Lower discount rate (compared to funding interest rate) = higher liability
 - Higher expected future contributions to offset lower expected future return
 - Potentially more stable funded status
 - Potentially improved benefit security for participants
- Actuary is required to provide commentary on the significance of LD-ROM.

“Municipal Pension Reporting Program”

A graphic featuring the letters 'MPRP' in a bold, black, sans-serif font. The text is centered within a white, jagged-edged shape that resembles a starburst or a speech bubble. This shape is surrounded by a blue outline and a pattern of small, dark grey dots that fade out towards the edges. To the right of the main graphic is a smaller, four-pointed starburst shape with a blue outline.

MPRP

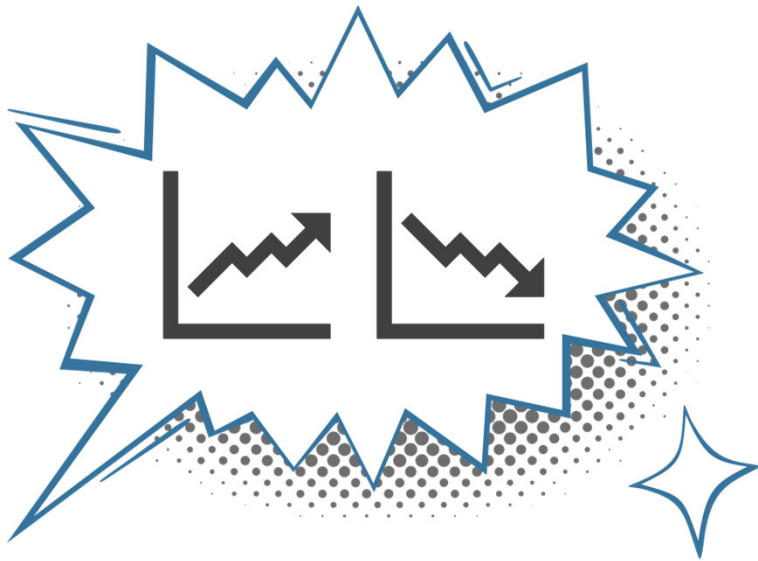
Pension reporting and analysis under Act 205 of 1984 (municipalities) and Act 293 of 1972 (counties)

- Act 205 biennial reporting forms
- Publishes distress scores for municipal systems
- Certifies actuarial parameters that are used for state aid calculation (“needs” test)
 - State aid administration and distribution is handled by other members of the AG’s office.

Originally “PERC”

- Standalone “Public Employee Retirement Commission”
 - Established by Act 205 of 1984
- Duties transferred to Auditor General’s Office of Budget and Financial Management in 2016

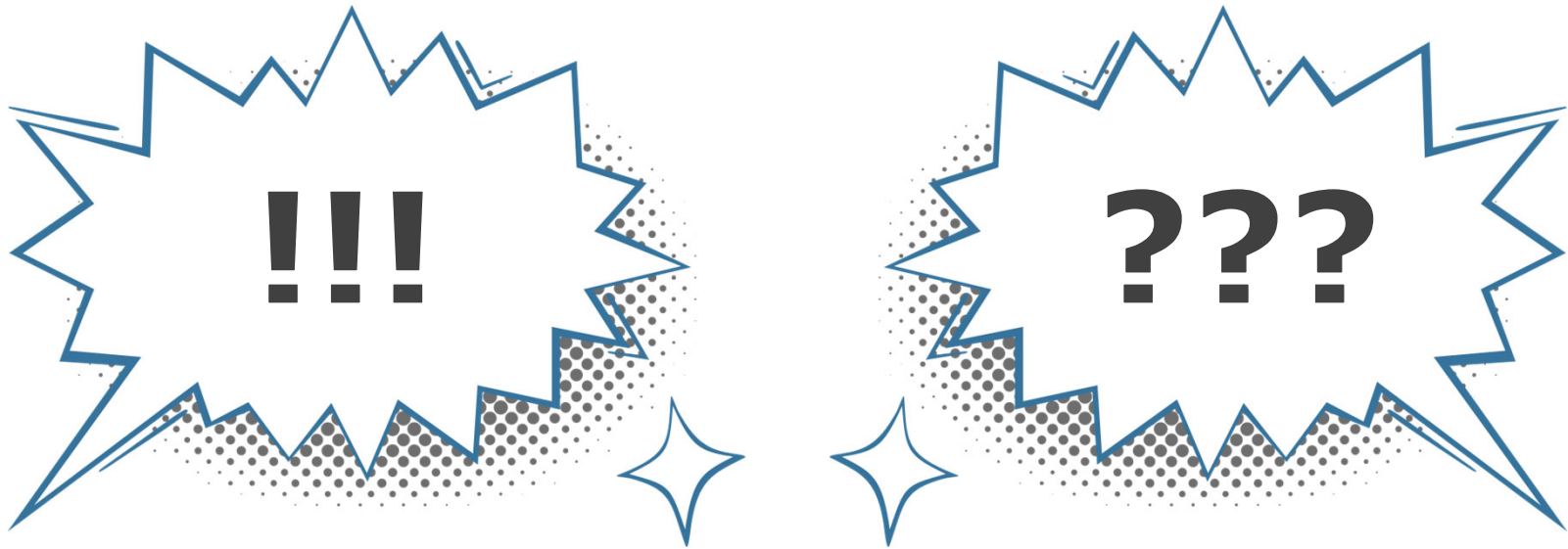
Trends



“De-risking” (again) is seeing more activity due to higher interest rates.

- Annuity purchases
- Lump sum windows
- “Plan term” (more 4-letter words!!!)
 - What does that involve?

Comments / Questions





**Thank
You!**

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