# Texas Municipal Retirement System - Exploring the New GASB Changes

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# Today's Agenda

- Quick Recap of this year's valuation results
- Brief GASB  Update
- Smoothed versus Market Assets and sensitivity to returns
- The GASB Discount Rate
- Ad hoc COLAs: *"Substantively" Automatic Benefits*
- Implementation Status Update



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# New Methods and Assumptions

- Last December, the TMRS Board of Trustees approved the following for inclusion in the December 31, 2013 actuarial valuation of TMRS:
  - New APRs, with a thirteen (13) year phase-in to actuarial equivalence
  - New Post-Retirement Mortality Assumptions
  - Move to the Entry Age Normal (EAN) Cost Method



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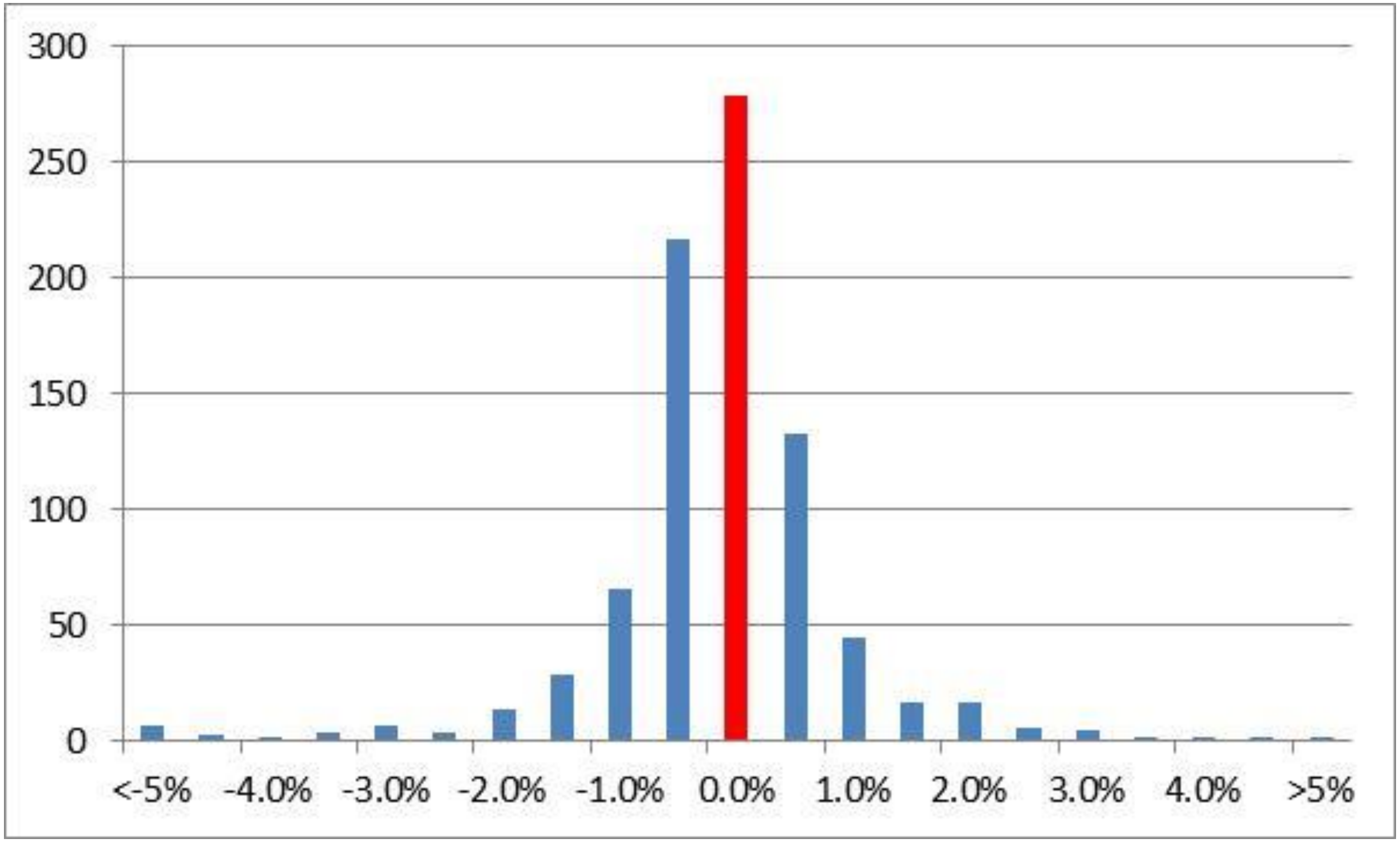
# Change in Cost Method

- The Board adopted the change in funding cost method from Projected Unit Credit (PUC) to Entry Age Normal (EAN)
- For many reasons, it was preferable to move to EAN
  - Removes bias for increasing normal cost rates inherent in PUC
  - Cities will have even more stability in contribution rates from year to year
  - Increases likelihood cities will be able to maintain current benefit levels
  - Improves transparency and predictability for cities joining TMRS
  - EAN is the only method allowed under the new GASB standards
- Combined with the changes in annuity purchase factors and the change in valuation mortality, many cities saw only a small increase in its contribution rate and most cities saw no rate increase

# Distribution of Changes: By City
# Total Changes in Full Retirement Rate




Comparison of 2015 rates after assumption changes to 2014 rates

*Only 57 cities had net increases of 1.0% or more*



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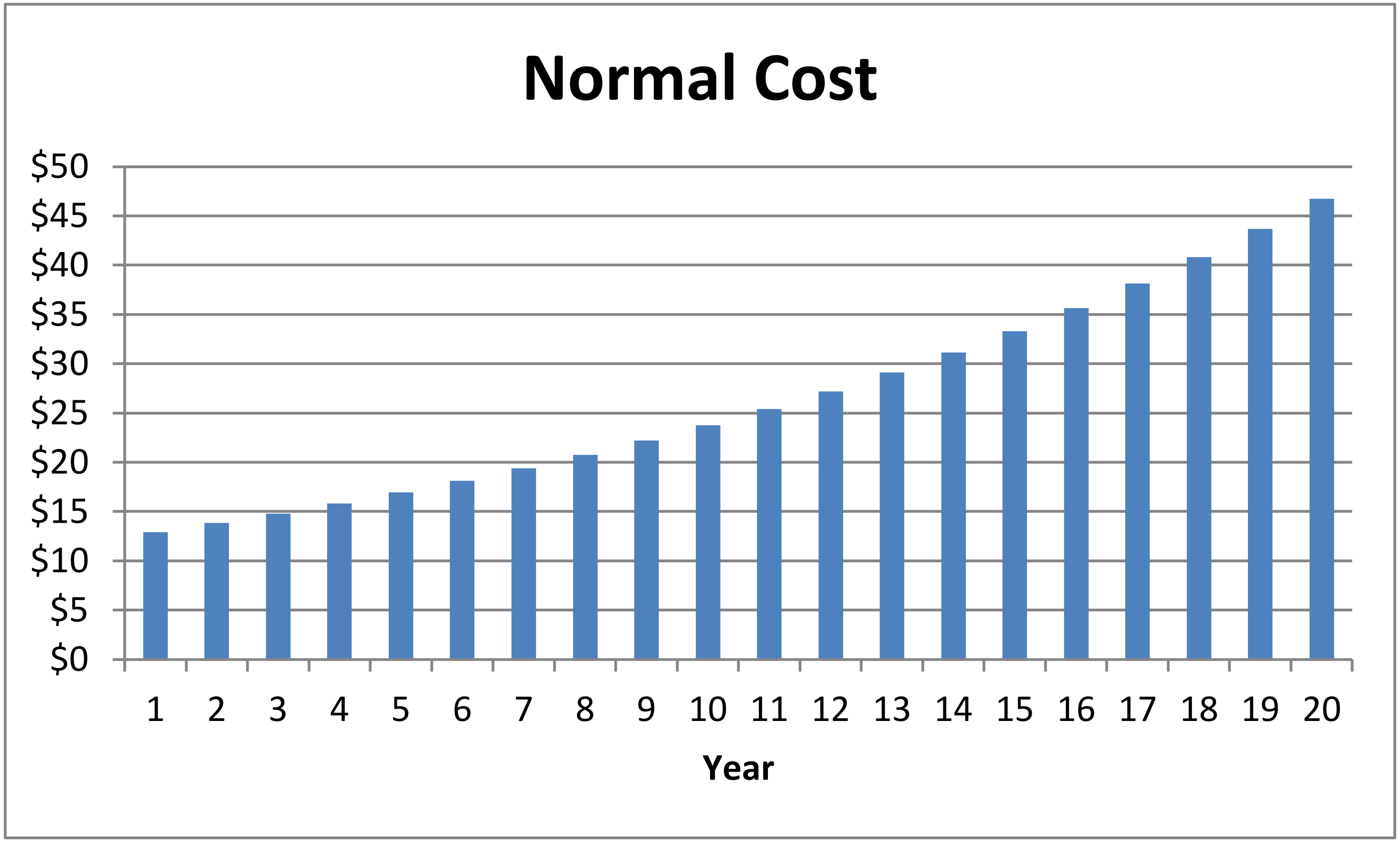
# PUC Normal Costs over time for a sample employee



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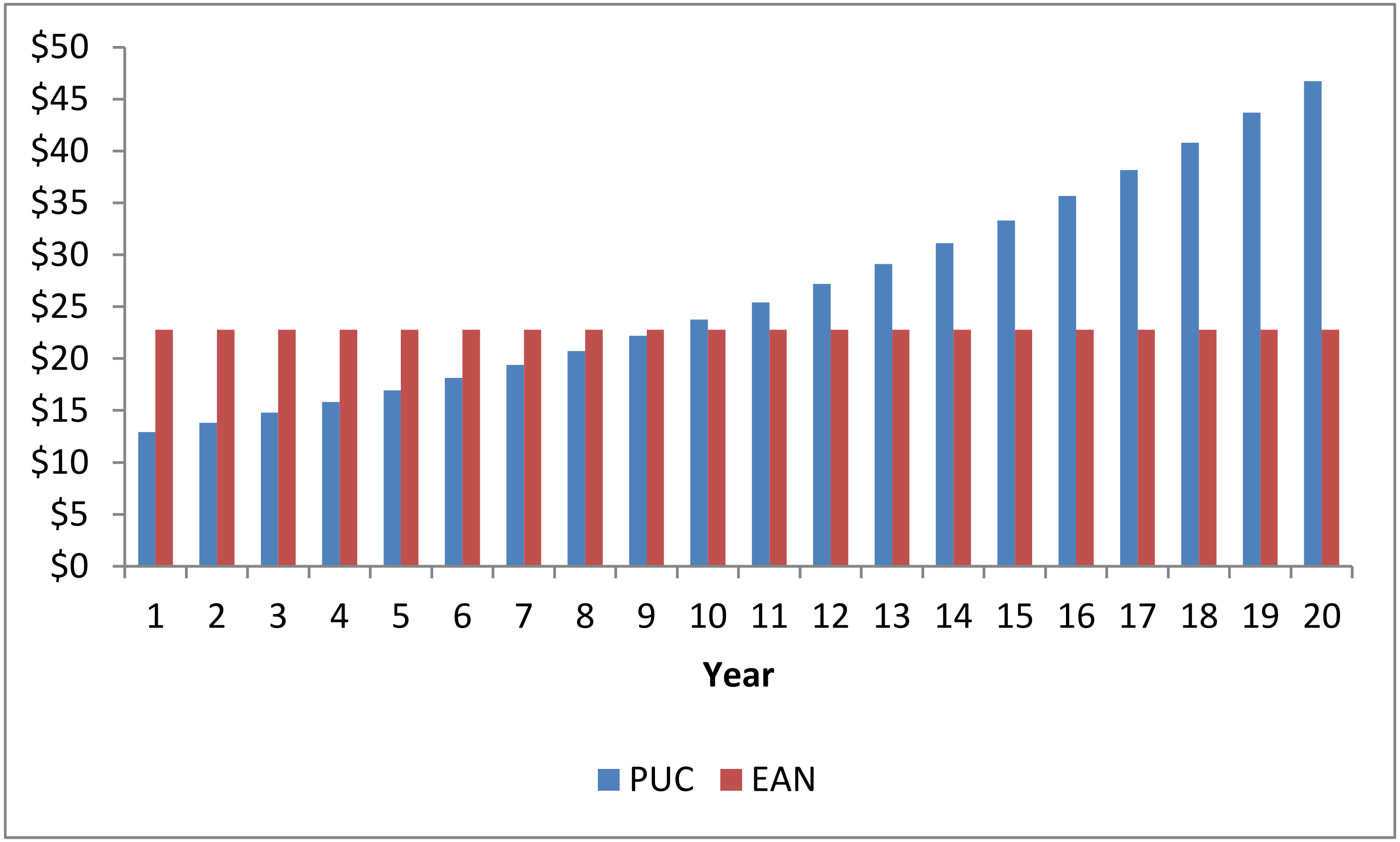
# Comparison of Normal Costs over time for a sample employee



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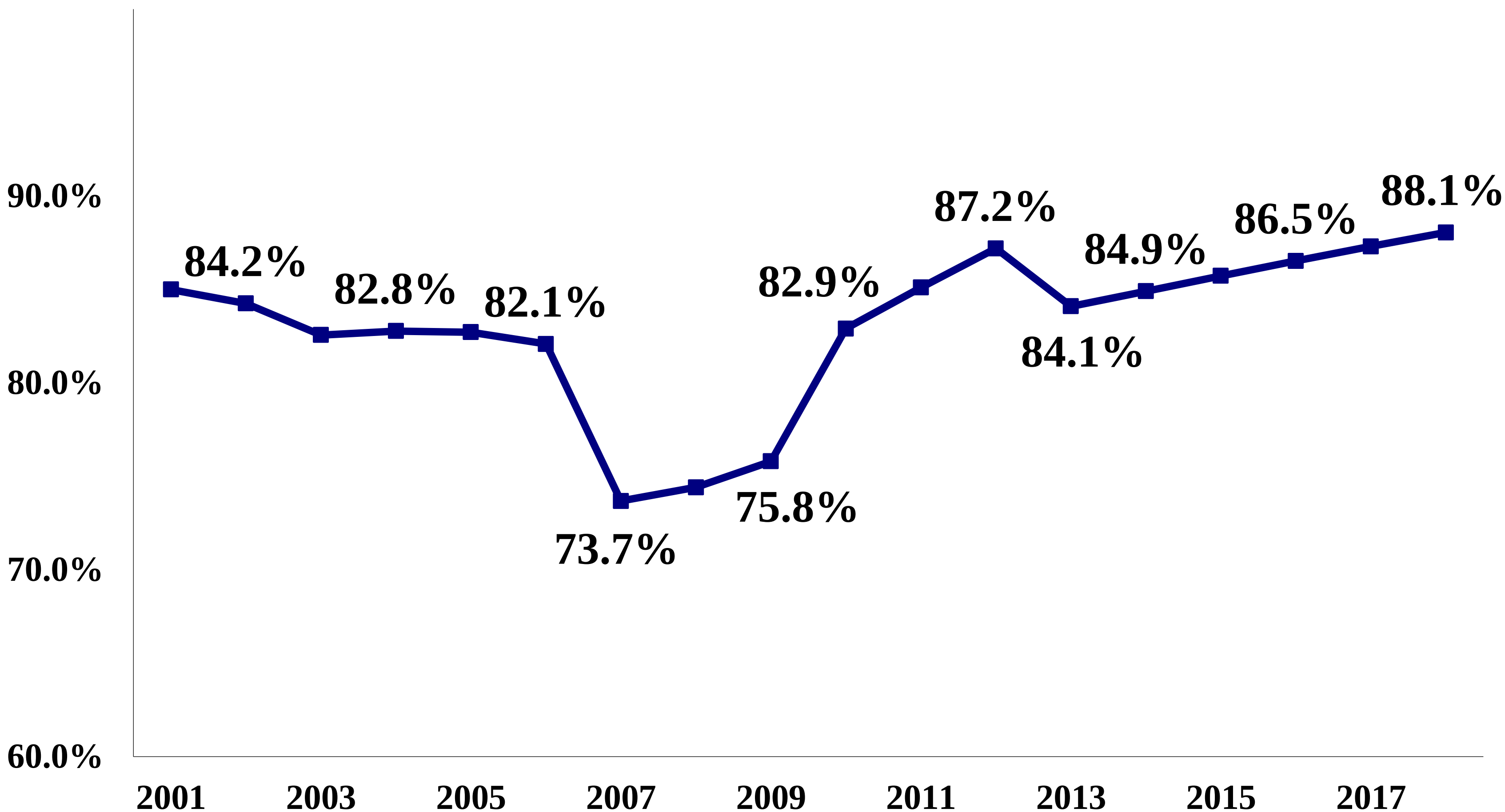
# Projected Funded Ratio




*Assumes all assumptions are met in future years*



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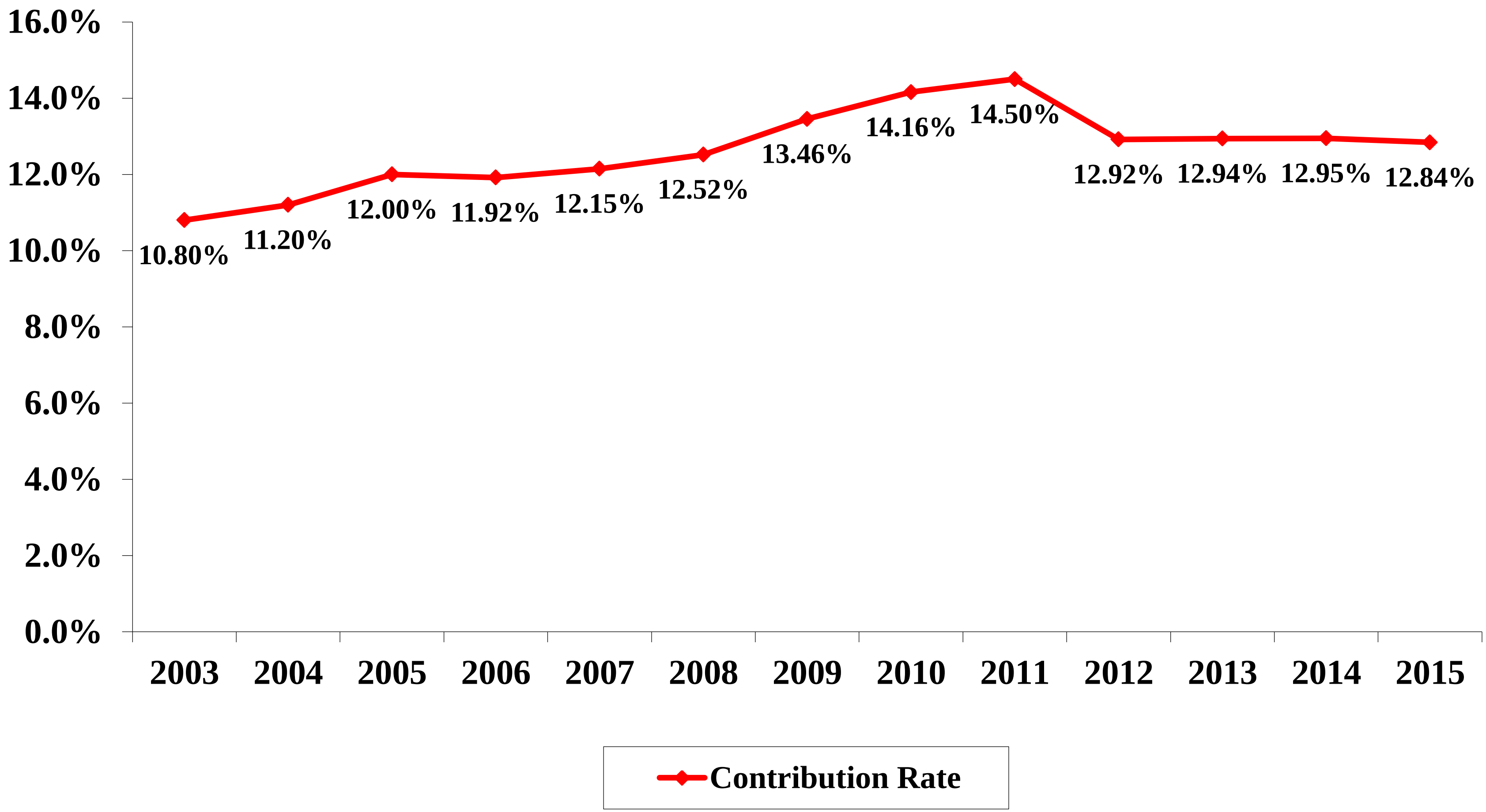
# Historical Dollar Weighted Contribution Rates for TMRS



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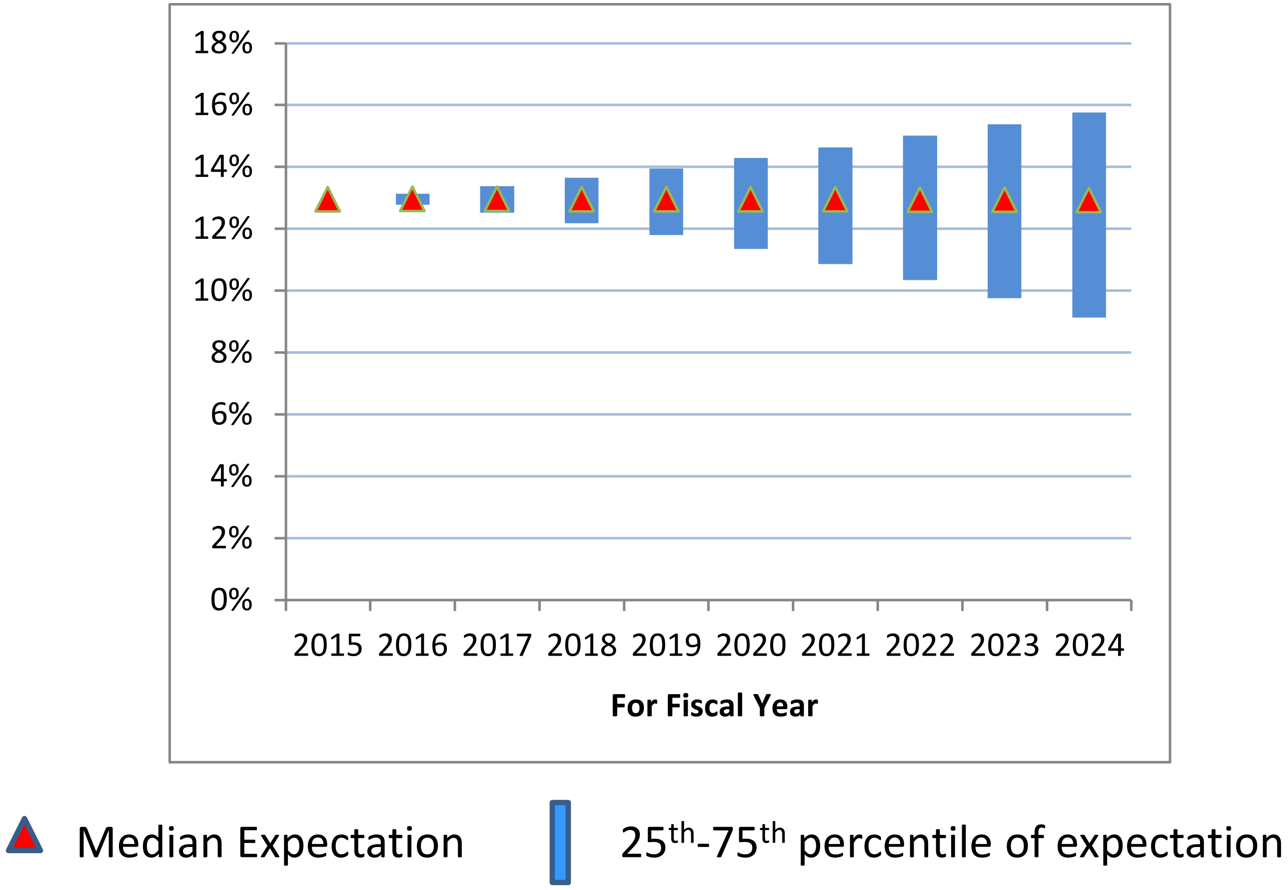
# Projected Aggregate Employer Contribution Rate




- **Investment returns are variable in this stochastic projection**



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# In Summary

- Overall System-wide "health" continues to improve
  - Overall assets growing faster than expected
  - Overall liabilities growing slower than expected
  - TMRS has a strong funding policy
- Expectation is for an increasing funded ratio over the next few valuations and continued stability in the contribution rates, System-wide

# Timing of new GASB standards

- GASB No. 67 Plan Reporting
  - Effective for fiscal years beginning after June 15, 2013
  - For TMRS, December 31, 2014 financial statements
- GASB No. 68 Employer Reporting
  - Effective for fiscal years beginning after June 15, 2014
  - For TMRS member cities: fiscal years ending in June 30, 2015 through May 31, 2016 financial statements
    - Includes TMRS as an employer
    - Local employers could vary depending upon their fiscal year end

# What has GASB done?

- The Statements change current pension accounting and financial reporting standards for governments
  - Disconnect pension accounting from pension funding
  - Total Pension Liability (TPL), GASB term for what is now known as Actuarial Accrued Liability (AAL)
  - Requires the employer to recognize the Net Pension Liability (NPL) on its balance sheet [NPL is a GASB term for the Unfunded Actuarial Accrued Liability (UAAL) based on Market Value of Assets]
  - Requires the employer to recognize a new measure of the Pension Expense (PE) on its income statement, which will be different from the current actuarially determined contribution (ARC)
  - New required supplementary information (RSI) must be disclosed



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# Big Picture

- There could be a liability on the employers' books that is larger than ever seen before
  - It also could be an asset!
  - It will impact all retirement systems and all TMRS cities
  - This will be a potential volatile liability; changing each year with a new market value of assets
- There could be an expense on the employers' books that is a larger expense than ever seen before
  - There could be income!
  - The shorter amortization period will accelerate recognition of pension cost
- Keep in mind: these changes only impact accounting, NOT funding

# The GASB Discount Rate

- It is expected that the discount rate used in determining the Total Pension Liability (TPL) for the GASB disclosures will be the long-term expected rate of return on plan investments
  - This rate is the same as the funding valuation
  - 7.00% for TMRS



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# Pension Expense Examples

| | GASB 67/68 | GASB 25/27 |
|---|---|---|
| **Expense** | | |
| 1. Service Cost | $ 5,511,524 | $ 5,511,524 |
| 2. Interest on the Total Pension Liability | 22,610,893 | - |
| 3. Current-Period Benefit Changes | 0 | 0 |
| 4. Employee Contributions | (3,305,372) | (3,305,372) |
| 5. Projected Earnings on Plan Investments | (21,349,330) | - |
| 6. Pension Plan Administrative Expense | 194,014 | 0 |
| 7. Other Changes in Plan Fiduciary Net Position | 0 | 0 |
| 8. Recognition of Outflow (Inflow) of Resources due to Liabilities | (45,207) | - |
| 9. Recognition of Outflow (Inflow) of Resources due to Assets | 0 | - |
| Amortization of UAAL (20 Year) | | 2,082,809 |
| **10. Total Pension Expense** | **$ 3,616,522** | **$ 4,288,961** |
| | | |
| **Net Pension Liability** | | |
| Total Pension Liability | $ 341,764,756 | |
| Plan Fiduciary Net Position | 323,356,369 | |
| Net Pension Liability | $ 18,408,387 | |
| Plan Fiduciary Net Position as a Percentage of Total Pension Liability | 94.61% | |
| | | |
| Actuarial Accrued Liability | | $ 341,764,756 |
| Smoothed Value of Assets | | 313,036,550 |
| UAAL | | $ 28,728,206 |
| Funded Ratio | | 91.59% |

# Difference in Asset Values

- Currently, the market value of assets of TMRS cities are higher than the smoothed assets
- In this situation, the accounting "NPL" will be smaller than the funding "UAAL"
- Therefore, the accounting NPL next year is *expected* to be smaller than the funding UAAL
- However, this is not going to be consistently true. There will be times that the opposite is true. Also, the accounting NPL will be substantially (literally 10x) more volatile than the funding UAAL



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# Sensitivity to Market Returns

| Investment Earnings for Year | 17% | 7% | -3% |
|---|---|---|---|
| **Expense** | | | |
| 1. Service Cost | $ 5,511,524 | $ 5,511,524 | $ 5,511,524 |
| 2. Interest on the Total Pension Liability | 22,610,893 | 22,610,893 | 22,610,893 |
| 3. Current-Period Benefit Changes | 0 | 0 | 0 |
| 4. Employee Contributions | (3,305,372) | (3,305,372) | (3,305,372) |
| 5. Projected Earnings on Plan Investments | (21,349,330) | (21,349,330) | (21,349,330) |
| 6. Pension Plan Administrative Expense | 194,014 | 194,014 | 194,014 |
| 7. Other Changes in Plan Fiduciary Net Position | 0 | 0 | 0 |
| 8. Recognition of Outflow (Inflow) of Resources due to Liabilities | (45,207) | (45,207) | (45,207) |
| 9. Recognition of Outflow (Inflow) of Resources due to Assets | (6,099,808) | 0 | 6,099,809 |
| **10. Total Pension Expense** | **$ (2,483,286)** | **$ 3,616,522** | **$ 9,716,331** |

| | | | |
|---|---|---|---|
| **Net Pension Liability** | | | |
| Total Pension Liability | $ 341,764,756 | $ 341,764,756 | $ 341,764,756 |
| Plan Fiduciary Net Position | 353,855,411 | 323,356,369 | 292,857,326 |
| Net Pension Liability | $ (12,090,655) | $ 18,408,387 | $ 48,907,430 |
| Plan Fiduciary Net Position as a Percentage of Total Pension Liability | 103.54% | 94.61% | 85.69% |
| AVA | 316,086,455 | 313,036,550 | 309,986,646 |
| UAAL | $ 25,678,301 | $ 28,728,206 | $ 31,778,110 |
| Funded Ratio | 92.49% | 91.59% | 90.70% |

# “Substantively” Automatic Benefits

- From GASB 67/68 for determining plan liabilities :
  - “Projections also are required to include the effects of ad hoc postemployment benefit changes (including ad hoc COLAs), if they are considered to be substantively automatic.”
- Thus, even Cities that are not providing repeating benefits may have to include an assumption of future ad hoc COLAs if it is determined their benefit is “substantively automatic”
- However, GASB 67/68 do not provide a definition of “substantively automatic”

# “Substantively” Automatic Benefits

- **Definition of Automatic Cost-of-Living Adjustments (automatic COLAs)**
  - Cost-of-living adjustments that occur without a requirement for a decision to grant by a responsible authority, including those for which the amounts are determined by reference to a specified experience factor (such as the earnings experience of the pension plan) or to another variable (such as an increase in the consumer price index).
- From footnote in GASB 67/68:
  - Considerations that might be relevant to determining whether such changes are substantively automatic include the historical pattern of granting the changes, the consistency in the amounts of the changes or in the amounts of the changes relative to a defined cost-of-living or inflation index, and whether there is evidence to conclude that changes might not continue to be granted in the future despite what might otherwise be a pattern that would indicate such changes are substantively automatic.
- From the GASB Implementation Guide:
  - 82. *Q*—A defined benefit pension plan’s enabling statute provides that the board of trustees can annually authorize a COLA not to exceed a specified percentage increase or the change in the consumer price index, whichever is lower. The maximum allowable COLA has always been authorized. Should the effects of this COLA provision be included in the projection of future benefit payments?
  - *A*—This COLA is not automatic because approval of the board of trustees is required to authorize the benefit increase. Therefore, the effects of the COLA provision should be included in the projection of future benefit payments only if the provision is evaluated to be *substantively automatic.*



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# "Substantively" Automatic Benefits

- Applicable definitions of substantively (from Google):
  - Having the nature or function of
  - Having a real existence



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# "Substantively" Automatic Benefits TMRS Specific

- The catch-up feature of the TMRS COLA produces a similar liability whether a City provides an ad hoc every year, every other year, or even every third year
- Thus, the COLA needs to be grouped into two categories: (1) granting them or (2) not
- Also, the USC is also a benefit provision that will need to be treated similarly

# Proposed Default Position for "Substantively" Automatic Benefits

- The following is our proposed default criteria for determining whether a USC/COLA is substantively automatic:
  - 1. Repeating provisions will be treated as substantively automatic (same as current funding valuation)
  - 2. For Cities who grant ad hoc benefits, the benefits will be defined as substantively automatic if:
    - They have been granted 1 of the last 2 years; AND
    - They have been granted 2 of the last 5 years
    - This default criteria will be applied with the first ad hoc adoption on or after January 1, 2015 – Fresh Start
      - If a City does not grant a January 1, 2015 COLA, we will not apply the criteria
      - However, if a City does grant a January 1, 2015 COLA or, the first time a City does grant one after January 1, 2015, we will apply the criteria that year, and annually thereafter

# Implementation Status Update

- Per AICPA SLGEP whitepaper for agent multiple-employer plans, best practice solution for TPL, PE and Deferred I/O's
  - 1. Plan engages its auditor to issue a service organization controls (SOC 1) Type 2 report on controls over census data maintained by the plan and fiduciary net asset additions & deductions

    and
  - 2. Plan actuary issues a separate actuarial valuation report specific to each employer, which includes an actuarial certification letter addressed to employer management



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# Employer (City) GASB Reporting Package

- GRS has provided first draft of "Employer GASB reporting package"
  - being reviewed by TMRS staff and Bob Scott (Carrollton) from *a city's perspective*

- Reporting package includes:
  - Certification letter addressed to city
  - Calculation of the discount rate
  - Calculation of pension expense and deferred I/O's
  - Numerous disclosure items

Current plan:

- distribute pdf (by City) on the TMRS website (similar to funding valuation) – June 2015



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# QUESTIONS ??

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