



2008 FGFOA Annual Conference

Hyatt Regency Jacksonville Riverfront

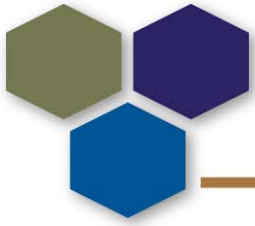
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Are Your Retirement Plans Sustainable?

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GRS

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Are Your Retirement Plans Sustainable?

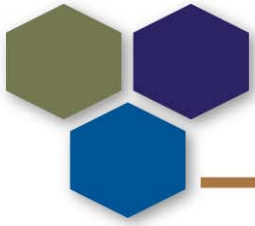
**Defined Benefit
Pension and OPEB Plans Are
For Adults Only**



Are Your Retirement Plans Sustainable?

- ◆ Defined benefit (DB) Pension and OPEB plans
 - ✓ Define the amount of monthly benefits or subsidies
 - ✓ Employer's contribution/expense to support that promise is actuarially determined

- ◆ Defined contribution (DC) Pension and OPEB plans
 - ✓ Define the fixed amount contributed/expensed by the employer
 - ✓ Ultimate benefit or subsidies supported by that contribution cannot be determined in advance



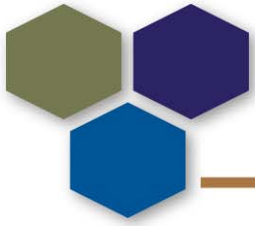
Are Your Retirement Plans Sustainable?

- ◆ Which is better,
 - a well-designed and well-managed DB plan or
 - a well-designed and well-managed DC plan?



Are Your Retirement Plans Sustainable?

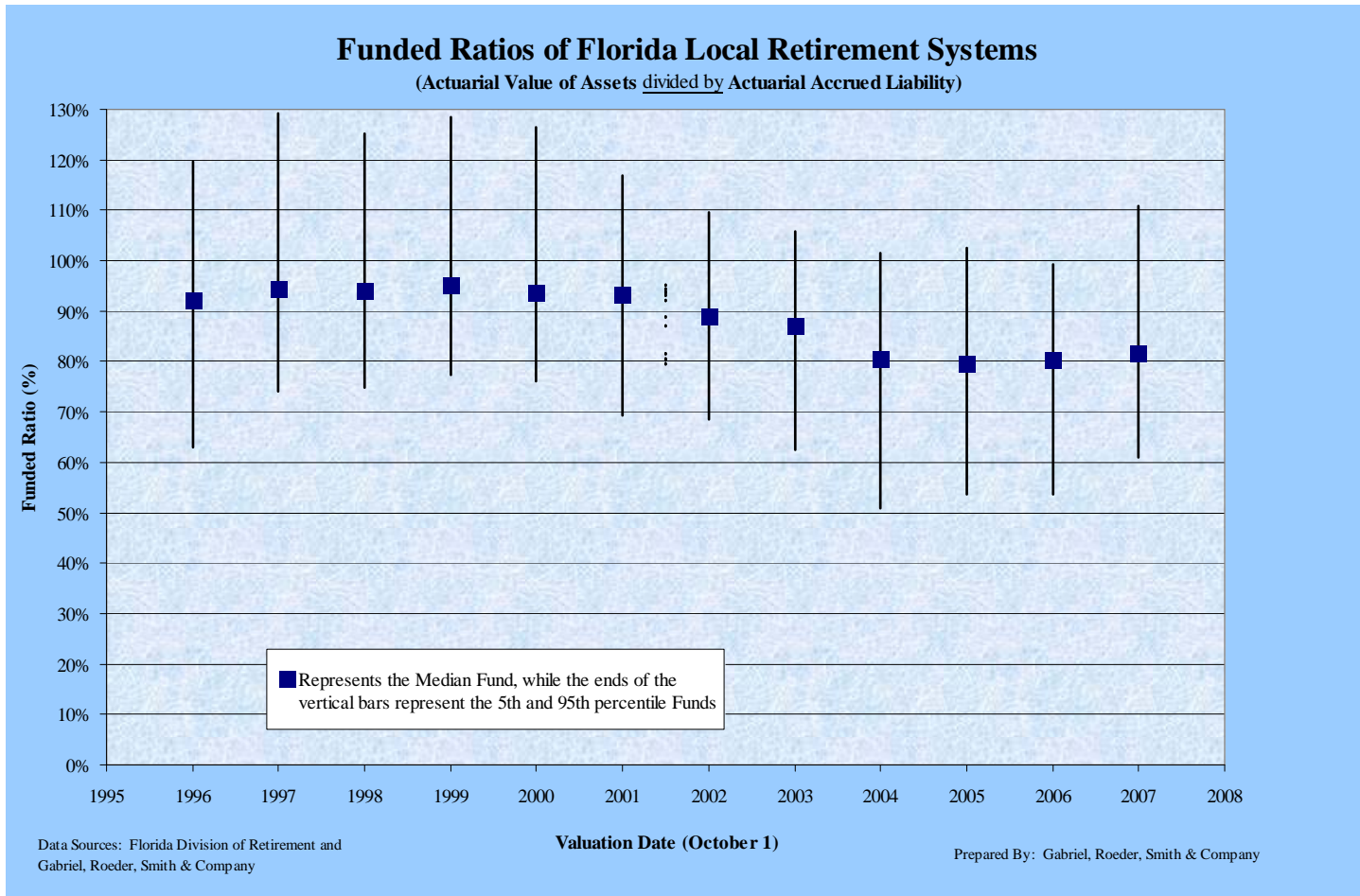
- ◆ Well-designed and well-managed
Defined benefit Pension and OPEB plans ...
 - ✓ Pay the right amounts,
 - ✓ To the right persons,
 - ✓ At the right time and
 - ✓ For the right length of time



Are Your Retirement Plans Sustainable?

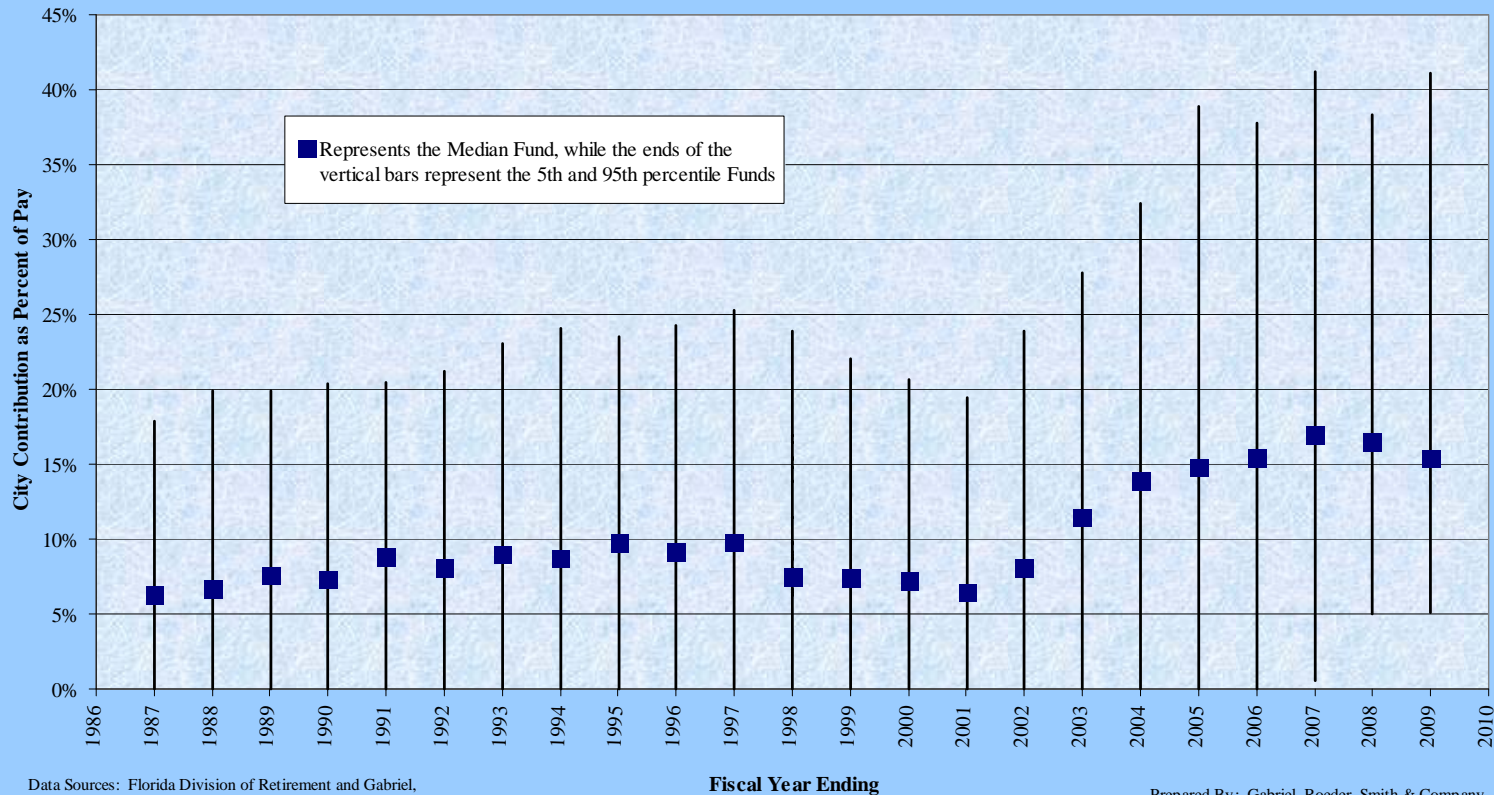
- ◆ Recent defined benefit **pension plan** deterioration
 - ✓ Falling funded ratios
 - ✓ Rising employer contributions

Falling Funded Ratios



Rising Employer Contributions

City Contribution Requirements for Florida Local Retirement Systems
(As Percent of Pay)



Data Sources: Florida Division of Retirement and Gabriel, Roeder, Smith & Company

Fiscal Year Ending

Prepared By: Gabriel, Roeder, Smith & Company



Are Your Retirement Plans Sustainable?

- ◆ Recent defined benefit **pension plan** deterioration
 - ✓ Falling funded ratios
 - ✓ Rising employer contributions
- ◆ Why?
- ◆ If you had to name two reasons why, what would they be?



Are Your Retirement Plans Sustainable?

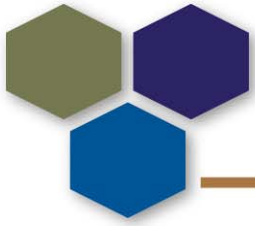
- ◆ Recent defined benefit **pension plan** deterioration
 - ✓ Falling funded ratios
 - ✓ Rising employer contributions

- ◆ Primary reasons
 - ✓ Poor investment performance
 - ✓ Repeated benefit improvements



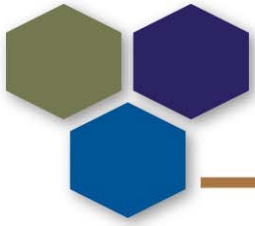
Are Your Retirement Plans Sustainable?

- ◆ Recent measurements and disclosures of defined benefit **OPEB plans** have shown
 - ✓ Large long term costs of “promised” subsidies
 - ✓ Some need to cut subsidies and/or pre-fund the subsidies
- ◆ Primary reasons
 - ✓ Promises and policies made when health costs were lower
 - ✓ Promises and policies made without actuarial analyses



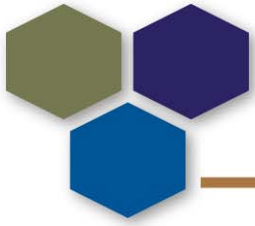
Are Your Retirement Plans Sustainable?

- ◆ Benefit improvements are generally “controllable”
 - ✓ But once you’ve made the promise.....
 - ✓ Retirement age and service requirements
 - ✓ Early retirement reduction factors
 - ✓ Cost of living increases (ad hoc or permanent)
 - ✓ Pension benefit multipliers



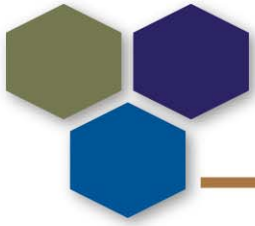
Are Your Retirement Plans Sustainable?

- ◆ Benefit improvements are generally “controllable”
 - ✓ Retroactive benefit improvements
 - ✓ Collective bargaining
 - ✓ Moral and political obligations
 - ✓ Competitive ratcheting up
 - ✓ Retiree health premiums



Are Your Retirement Plans Sustainable?

**Is there a
Pension/OPEB Bubble?**

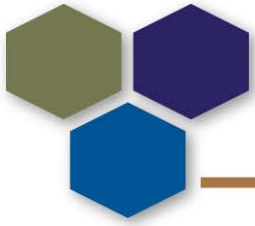


Are Your Retirement Plans Sustainable?

Will it burst?

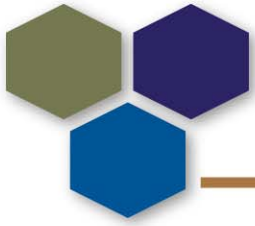
Will there be a soft landing?

Or a knee-jerk reaction?



Are Your Retirement Plans Sustainable?

**So how can we control the
Pension and OPEB costs
for the long term?**



Are Your Retirement Plans Sustainable?

Top 5 Pension and OPEB Focus Areas



Top 5 Pension and OPEB Focus Areas

5. Investment Policy



Top 5 Pension and OPEB Focus Areas

5. Investment Policy

- ✓ Adopt a formal investment policy
- ✓ Already required by statute for Pension Trusts
- ✓ The case for Index Funds
- ✓ The case for Professional Money Managers



Top 5 Pension and OPEB Focus Areas

5. Investment Policy

- ✓ Asset allocation
- ✓ Tolerance for risk vs. Funding goals
- ✓ Actuarial asset-liability modeling
- ✓ Hedging downside risk/volatility



Top 5 Pension and OPEB Focus Areas

5. Investment Policy

- ✓ Monitor the performance and compliance
- ✓ Conflicts of interest
- ✓ New OPEB Trusts



Top 5 Pension and OPEB Focus Areas

5. Investment Policy
4. Actuarial Assumptions and Methods



Top 5 Pension and OPEB Focus Areas

4. Actuarial Assumptions and Methods

- ✓ For Pension and OPEB Plans
- ✓ Economic assumptions
- ✓ Demographic assumptions
- ✓ Behavioral assumptions



Top 5 Pension and OPEB Focus Areas

4. Actuarial Assumptions and Methods

- ✓ Ranges of reasonableness
- ✓ Aim at the best estimate or expected results?
- ✓ Actuarial experience studies every 5 to 7 years
- ✓ Aggressive and conservative assumptions and methods



Top 5 Pension and OPEB Focus Areas

5. Investment Policy
4. Actuarial Assumptions and Methods
3. Benefits Policy



Top 5 Pension and OPEB Focus Areas

3. Benefits Policy

- ✓ Set the Benefits Policy in advance
- ✓ What would a Benefits Policy look like?
- ✓ Set reasonable objectives/limits for the level of benefits
- ✓ Set reasonable objectives/limits for the level of costs



Top 5 Pension and OPEB Focus Areas

3. Benefits Policy (benefit level goals)

- ✓ Pension income replacement ratios
- ✓ Percentile ranking against peers by benefits provided
- ✓ Dealing with the ratcheting phenomenon
- ✓ Just Say “No”



Top 5 Pension and OPEB Focus Areas

3. Benefits Policy (cost level goals)

- ✓ 30-year amortizations often, even for retro benefits
- ✓ Amortize over average future working lifetime
- ✓ Then if you cannot afford it, don't adopt it
- ✓ Would you sign a 20-year note to pay for a new car just because you could not afford the monthly payments on a 4-year note?



Top 5 Pension and OPEB Focus Areas

3. Benefits Policy (cost level goals)

- ✓ No benefit improvements until/unless
- ✓ Employer contribution is at or below X% of pay
- ✓ Plan's Funded Ratio is at or above Y%
- ✓ Cost sharing



Top 5 Pension and OPEB Focus Areas

3. Benefits Policy (cost level goals)

- ✓ No benefit improvements until/unless
- ✓ Employer contribution at or below X mills
- ✓ Employer Contribution at or below Y% of budget
- ✓ Cost sharing



Top 5 Pension and OPEB Focus Areas

3. Benefits Policy

- ✓ What if you are already violating reasonable objectives/limits?
- ✓ Desperate times require desperate measures (DT-DM)
- ✓ Collective bargaining (cooperative or adversarial)
- ✓ Bankruptcy (or the threat thereof)



Top 5 Pension and OPEB Focus Areas

3. Benefits Policy (DT-DM)

- ✓ Different benefits for new hires
- ✓ Second class citizens
- ✓ Roll-backs in future pension benefit accruals
- ✓ Higher retiree medical premiums



Top 5 Pension and OPEB Focus Areas

5. Investment Policy
4. Actuarial Assumptions and Methods
3. Benefits Policy
2. Elected Officials and Bargaining Team



Top 5 Pension and OPEB Focus Areas

2. Elected Officials and Bargaining Team

- ✓ Conflicts of interest, real and perceived
- ✓ Long term sustainability
- ✓ Open Group Actuarial Forecasts
- ✓ Taxpayers/Voters pay the bill
- ✓ Employer Contributions related to millage



Top 5 Pension and OPEB Focus Areas

5. Investment Policy
4. Actuarial Assumptions and Methods
3. Benefits Policy
2. Elected Officials and Bargaining Team
1. **Conservatism**



Top 5 Pension and OPEB Focus Areas

1. Conservatism

- ✓ One is seldom a hero when things go well, but often the scapegoat when things go wrong.
- ✓ It's easier to loosen-up as things go well, than to tighten and cut back when things go poorly.



Top 5 Pension and OPEB Focus Areas

1. Conservatism (continued)

- ✓ Conservative fiduciaries adopt conservative assumptions
- ✓ Conservative fiduciaries strike a reasonable balance between expected volatility and expected reward
- ✓ Conservative plan sponsors explore ways to cut overly generous Pension and OPEB programs
- ✓ Conservative plan sponsors advance-fund their OPEB liabilities



Top 5 Pension and OPEB Focus Areas

1. Conservatism (continued)

- ✓ Conservative plan sponsors contribute more than the bare minimum to the Pension or OPEB Trust and never take contribution holidays
- ✓ Conservative decision-makers require Open Group Actuarial Forecasts (deterministic and stochastic) of future risks before making benefit and subsidy improvements or investment policy changes, and before issuing OPEB bonds



Top 5 Pension and OPEB Focus Areas

5. Investment Policy
4. Actuarial Assumptions and Methods
3. Benefits Policy
2. Elected Officials and Bargaining Team
1. Conservatism



Sustainability Lessons to Learn from PPA

- ◆ Federal Pension Protection Act of 2006
 - ✓ Shorter amortization periods if funded ratio is $< 100\%$
 - ✓ New benefit improvements permitted only if funded ratio is over 80%
 - ✓ Benefit accruals cease if funded ratio is under 60%
 - ✓ And various other restrictions and requirements are triggered



Sustainability Lessons to Learn from MO

- ◆ In July, Missouri Governor signed into law pension restrictions based on funded ratio
 - ✓ If plan is less than 60% funded and delinquent in contributing the ARC for 5 consecutive years, plan has first lien, accelerated funding requirement, and State withholds funds
 - ✓ If plan is less than 80% funded, no benefit improvements
 - ✓ If plan is above 80%, benefit improvements permitted only if funded ratio after change is above 75%
 - ✓ UAAL for benefit improvements amortized over 20 years



Sustainability Lessons to Learn from GFOA

Develop a deliberative process to ensure sustainability.

1. Develop principles and priorities to guide decision-making that consider benefit design, funding approaches, and the needs of all stakeholders.
2. Carefully evaluate and design benefits which are sustainable.
3. Once a government has satisfied itself that its plan design is sustainable, it should intentionally select an appropriate funding approach.



Sustainability Lessons to Learn from GFOA

Develop a deliberative process to ensure sustainability.

4. If the government elects to establish an OPEB Trust, it should consider all aspects before implementation.
5. Governments should exercise considerable caution before issuing debt to fund their unfunded actuarial accrued liability.
6. Governments should consider how to most effectively communicate with and educate affected stakeholders on the impact of the decisions made.



DB Accounting Rules Might Change (Again)

- ◆ Pressure to adopt same accounting procedures for Pension and OPEB obligations as **private sector**
- ◆ Pressure to put total unfunded benefit liability right on the government-wide Statement of Net Assets (balance sheet)
- ◆ Pressure to value that liability using low interest rate
- ◆ Pressure to expense Pension and OPEB costs using only the Unit Credit Actuarial Cost Method, regardless of funding
- ◆ Pressure to converge with international accounting standards



DB Accounting Rules Might Change (Again)

- ◆ In the name of “Transparency”
- ◆ In the name of “Mark-to-Market” on everything imaginable
- ◆ This pressure makes it all the more critical to ensure the sustainability of govt Pension and OPEB plans.
- ◆ Take the necessary steps now, so that your Pension and OPEB plans are well-funded in case these accounting changes occur



Are Your Retirement Plans Sustainable?

1. Our decision-makers owe it to our taxpayers and investors to manage our Pension and OPEB benefits and plans responsibly.
2. We cannot continue to make new Pension and OPEB promises without a sustainable plan for financing them over a reasonable horizon. Adopt a Benefits Policy.
3. The alternatives and their consequences are seriously damaging to the financial well-being of governments and their employees and retirees, and their taxpayers.



Are Your Retirement Plans Sustainable?

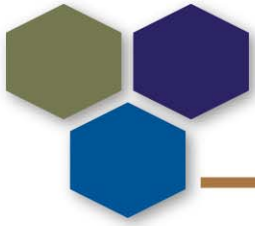
4. Once we make Pension and OPEB promises, it is very difficult to ever cut them back. So make them judiciously.
5. Limit your promise to what is sustainable; and take steps to ensure that your promise is sustainable.
6. Defined contribution (DC) plans would be better for those employers who cannot resist making repeated retroactive benefit and subsidy improvements. Although under DCs:
 - ✓ Their retirees would suffer and
 - ✓ It could put them at a competitive disadvantage



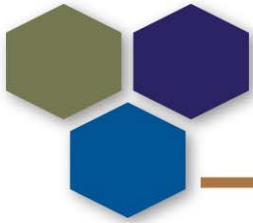
Are Your Retirement Plans Sustainable?

7. But if managed responsibly, by adults, defined benefit (DB) Pension and OPEB plans can ...
 - ✓ Pay the right amounts,
 - ✓ To the right persons,
 - ✓ At the right time and
 - ✓ For the right length of time

.....And be sustainable.



Questions and Answers?



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