Minnesota Rural Educators Association

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Today's topics

- Pension financial reporting under GASB Statement 68
- TRA funded status
- Experience study and sustainability
- The 2016 legislative session

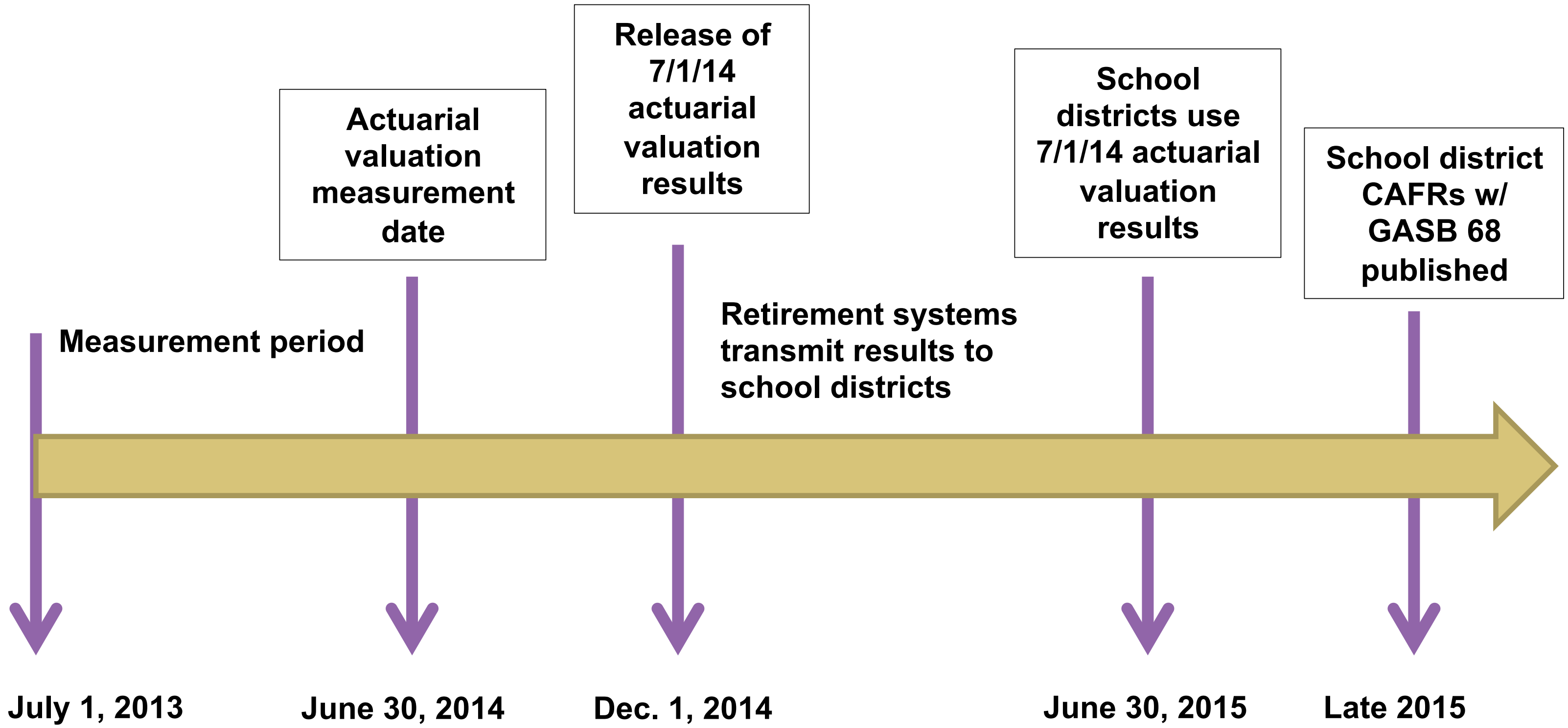
Government Accounting Standards Board (GASB)

- Seven-member board consisting of accounting professionals from academia and the public sector.
- GASB sets accounting pronouncements specifying standardized financial reporting for state, local and school districts.
- GAAP: Generally accepted accounting principles.
- Minnesota statute requires school district financial statements comply with GAAP (auditor's opinion).
  - Department of Education
  - Bond rating agencies

GASB 68 overview

- School districts report their proportionate share of collective net pension liability, deferred inflows and outflows of resources, and pension expense on government-wide financial statements.
  - District's proportionate share based on district's contributions at measurement date as a percentage of plan contributions from all employers.
- Pension expense calculated as change in net pension liability during the year, plus or minus amortization of deferred inflows and outflows.
  - Pension expense no longer based on contributions to the plan.
- Significantly more footnote disclosures.
  - Disclosures required for each plan.
  - PERA and TRA will provide footnote templates.
- Required supplementary information (RSI):
  - Ten-year schedule of district's proportionate share of the net pension liability (prospectively applied).
  - Ten-year schedule of district and non-employer contributions (if applicable).

GASB 67-68 timeline for school districts



- **Key point: There will be a one-year lag in school district reporting of GASB 68 results. School districts will use FY 2014 GASB 67/68 actuarial valuation results from PERA and TRA in their FY 2015 financial statements.**

Net pension liability (NPL)

- Measurement of the unfunded benefit payments TRA is expecting to pay in the future.
- Liabilities extend over 80 years – legislature's full funding goal is June 30, 2037.
- Each school district will report their employer proportionate share of NPL on their balance sheet.

Employer proportionate share (Based on employer contributions to TRA)

Minnetonka:		\$3.53 million
Total TRA employer		\$319.53 million
Proportionate share		1.10%
TRA net pension liability	=	\$4.61 billion
Minnetonka's share and amount to report	=	\$50.99 million

Pension expense on school district income statement

- No longer strictly based on employer contribution.
- Amounts based on calculations by TRA's actuary.
- Good investment years and actuarial experience at the TRA level will flow into lower expense for the school district (and vice-versa).

Role of external auditors for school district financial reporting

- More audit work likely needed to verify financial statement amounts and other disclosures.

- Office of the State Auditor is working for TRA on GASB 68 allocations. They will perform sample testing annually. Your school district will be visited on a regular rotation.

Key messages for boards and management

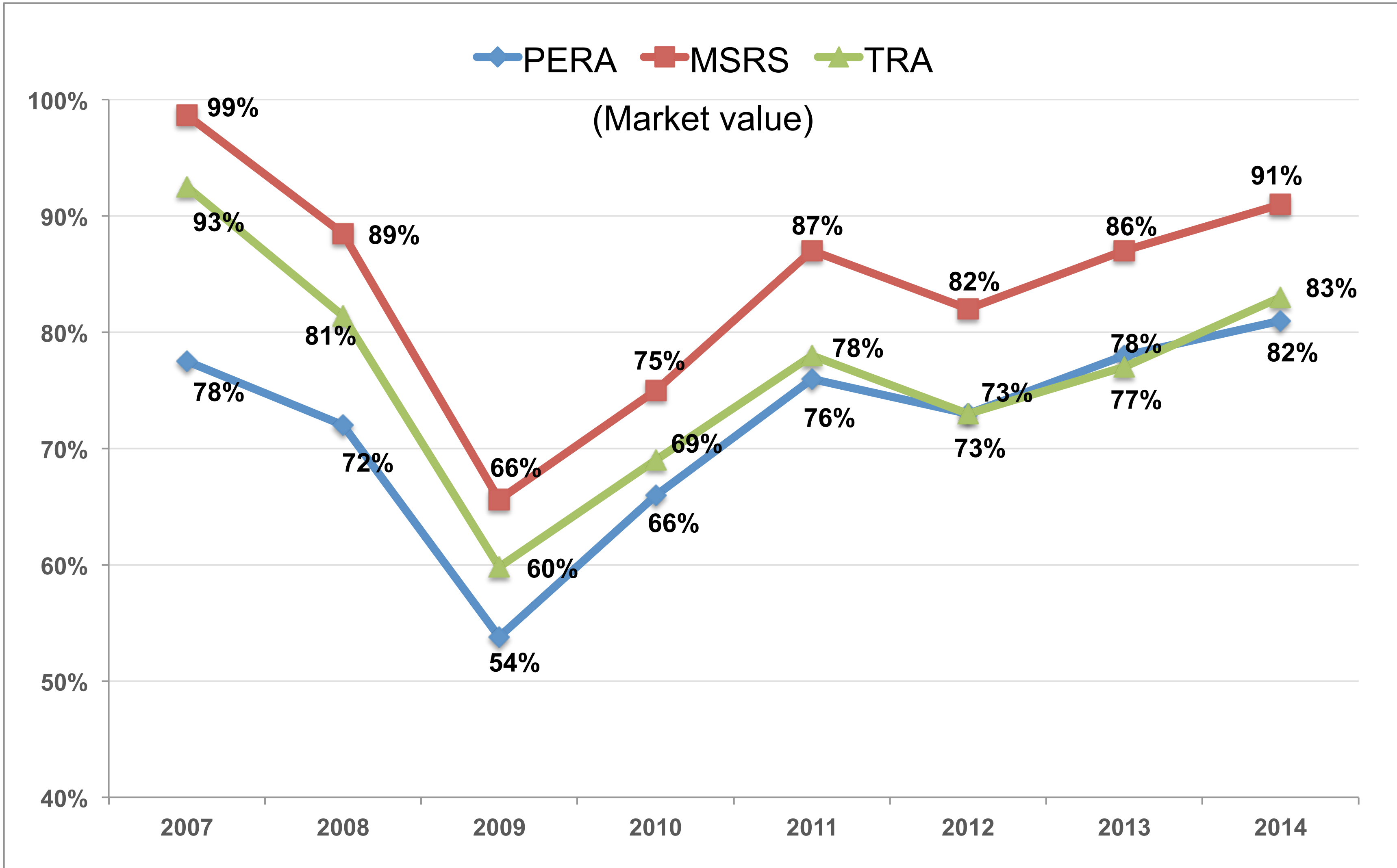
Retirement Systems of Minnesota handout: GASB for TRA and PERA Employers

- What is the GASB?
- What are the main GASB 68 requirements for me as an employer?
- How are the new pension liabilities and expenses determined?
- What is the difference between “accounting” liabilities and “funding” liabilities?
- Will the implementation of GASB 68 cause contribution rates to increase?
- Am I really liable for the net pension liability that will be on my books under GASB 68?
- Will this GASB affect our bond ratings?
- Why are some people concerned about the new accounting costs?

Key take-aways

- Your fiscal year 2015 financial statements will report a net pension liability and pension expense (first time).
- There is not much school districts can do to affect the GASB 68 results. The financial and actuarial condition of TRA dictate the amounts allocated to the school districts.
- TRA will continue to provide school districts the financial and actuarial results and disclosures schools districts need for their financial reports.
- The GASB 68 financial results do not determine employer contribution rates. TRA's actuary performs a second actuarial valuation report based on Minnesota statute. This other report calculates the contribution rate deficiency.

Post-2010: Funds rebound from market downturn

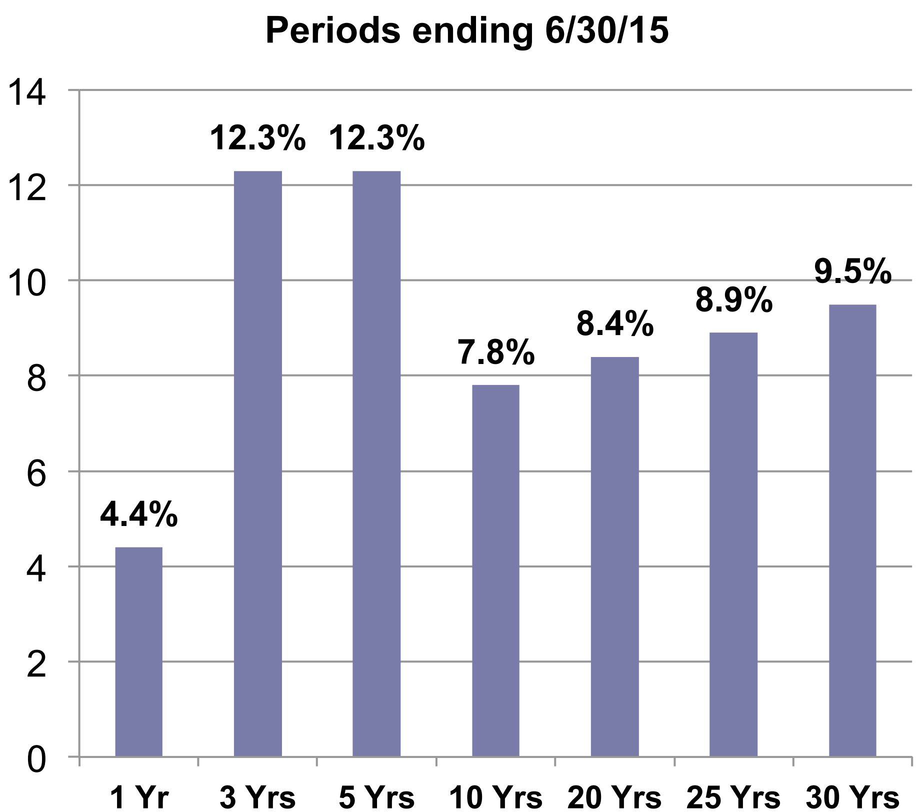


2015 Omnibus Retirement Bill

Interest/investment earnings assumption change – TRA exempted

- Investment assumption lowered to 8% for SPTRFA, PERA and MSRS.
- TRA Board stood firm that no TRA assumptions should be changed until completion of previously-scheduled **experience study** (due June 2015).
- TRA testified that if assumptions are changed, TRA would need time to work with its stakeholder groups to develop financial sustainability measures.
- Pressure to lower return assumption below 8 percent.

State Board of Investment returns



SBI ranks very high among other funds

	1 Yr	3 Yr	5 Yr	10 Yr
SBI rank vs. all private/public funds (1 = best, 100 = worst)	**21st**	**9th**	**6th**	**14th**

SBI returns exceed other public funds
Annualized returns
(for periods ending 6/30/2015)

	1 Yr	5 Yr	10 Yr	25 Yr
SBI	4.4%	12.3%	7.8%	8.9%
Public pension median	3.2%	10.4%	6.6%	8.4%

Investment returns critical to funding

Sources of MN public pension fund revenue, 1990-2014
(PERA, MSRS, TRA)

National public pension average:
(Source: National Association of State Retirement Administrators)

What is an ‘experience study’?

- Actuary conducts thorough review of all the underlying actuarial methods and assumptions used in TRA’s annual actuarial valuation to determine whether they continue to be **accurate and reasonable.**
- Looks at the system’s actual experience, and looks forward to **predict future experience,** especially economic assumptions such as inflation and investment returns.
- Helps assure that TRA’s annual valuations are accurately stating the system’s **long-term projected costs.**
- Two types of assumptions: ***economic*** and ***demographic***

Experience study findings: Economic assumptions

- **Inflation** expectations are lower and have been for some time. Social Security Administration's inflation assumptions are low. Study recommendation: Lower price inflation assumption from 3.0 percent to 2.75 percent.
- **Wage growth** has been stagnant due to lower inflation. The financial impact on TRA is negative – lower wage growth shrinks TRA's revenue base. Study recommendation: Lower general wage growth assumption (also used for payroll growth) from 3.75 percent to 3.5 percent.
- Expectation for long-term **investment returns** is lower. The financial impact on TRA is negative – lower return expectations increases liabilities. Study recommendation: Lower long-term investment return assumption from 8.5 percent* to 8 percent.

When combined, these changes will have a negative impact on TRA

*Select/Ultimate rate of 8.0% trending up to 8.5% over 5 year period, 2012-2017

Key findings:
Demographic assumptions

<u>Mortality – Life expectancy increases</u>

- Members and retirees are living much longer – on average an extra **2 years**.

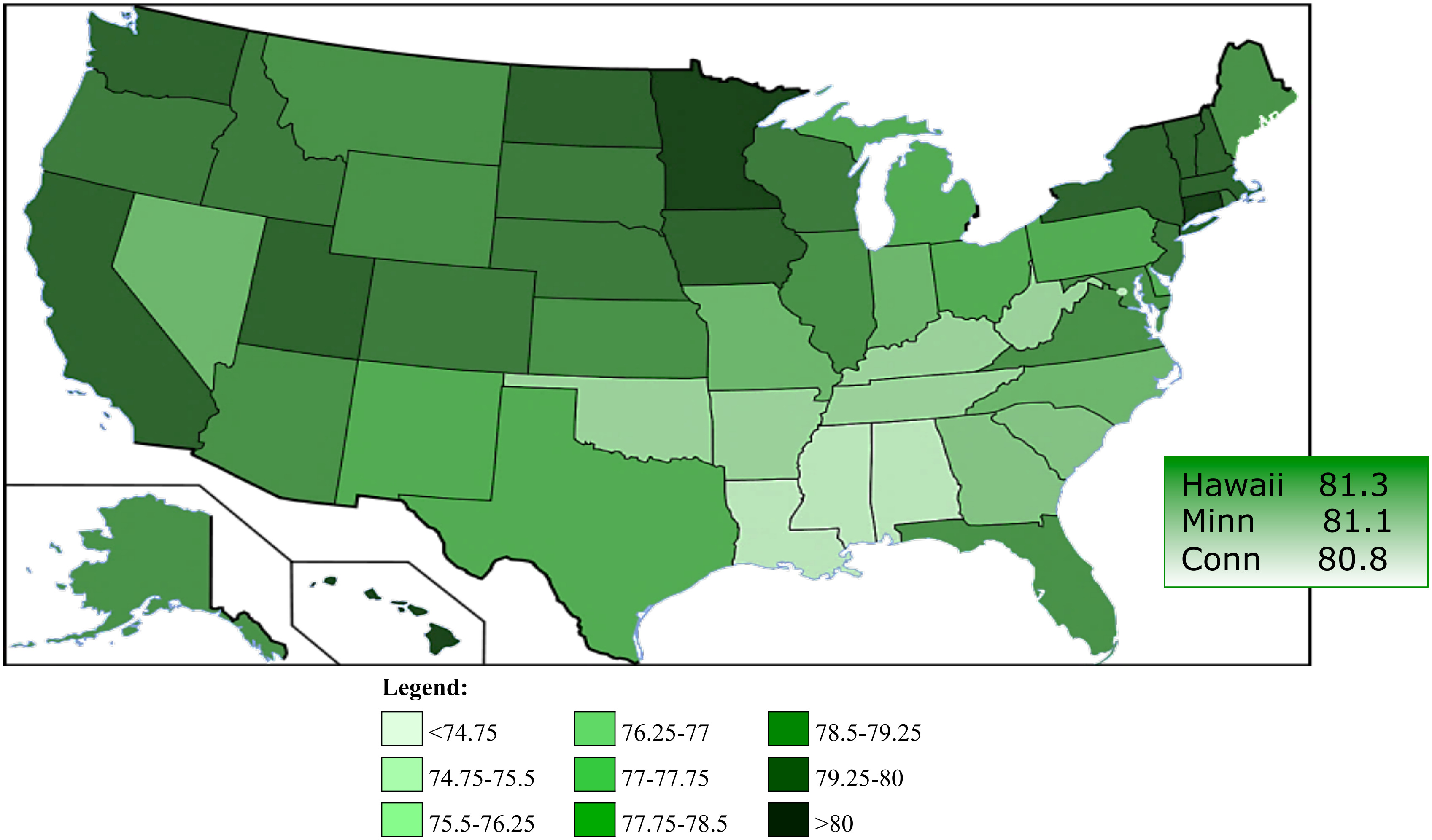
Why the big change?

  - TRA's active-member population is **75 percent female**; life expectancy is greater in the **Midwest** and among those more highly educated.
  - Average TRA life expectancy increased dramatically:
    - ✓ Age 65 female: was age 88.6, now age 90.3
    - ✓ Age 65 male: was 86 and now age 87.7.
    - ✓ TRA has 482 benefit recipients age 95+ and 87 are 100+.
  - Average retirement age for TRA members is 62.8. Benefits are now being paid for on average of 25 to 27.5 years – a much longer period than before.

- Lifetime payouts (with 2% COLA) projected to rise from **$855,000** (using old mortality tables) to **$928,000** (using updated mortality tables), an increase of approximately **10 percent**.

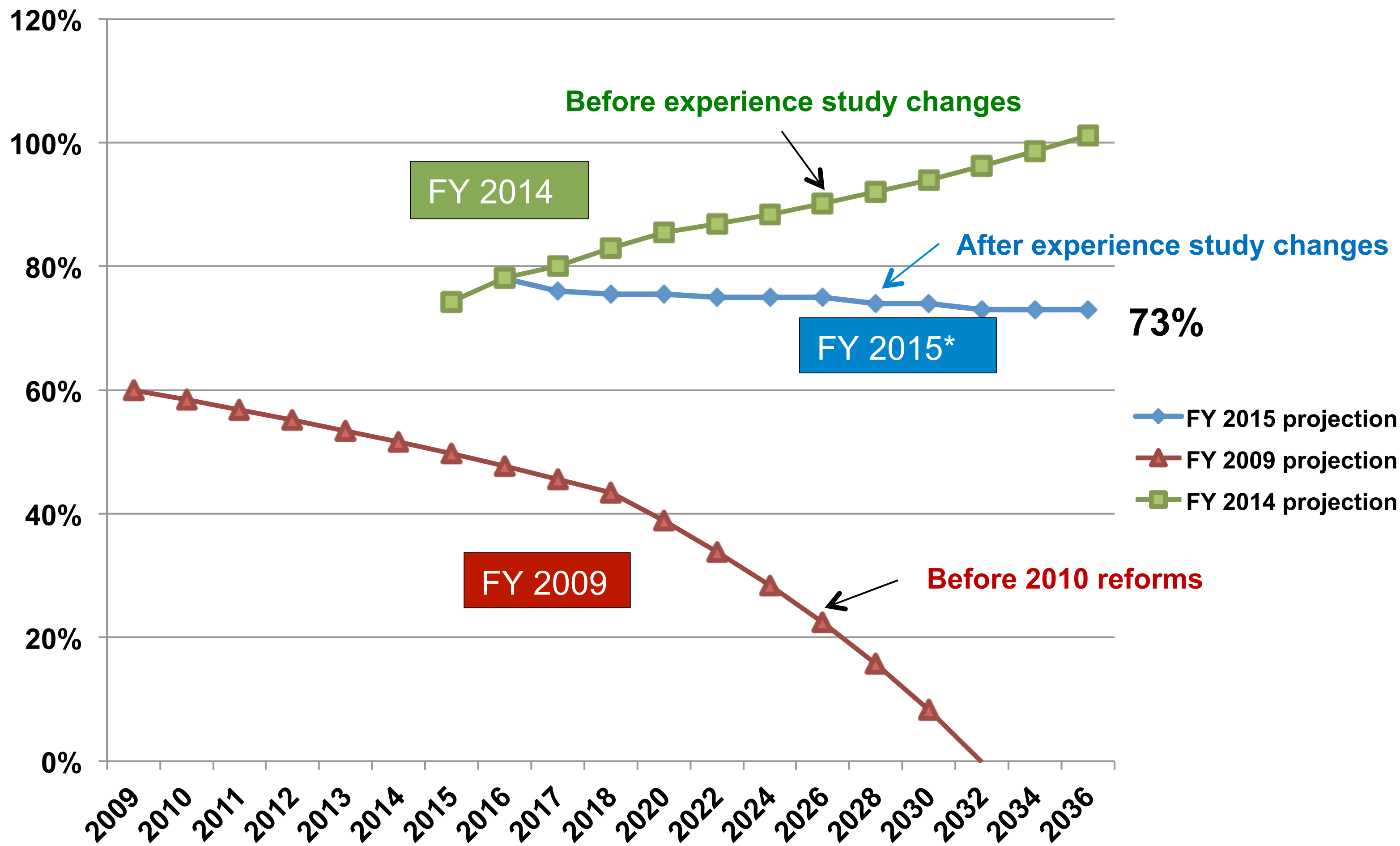
Note: MSRS and PERA are seeing similar impacts due to longevity

Geographic variations in life expectancy at birth



Source: American Human Development Report, from Cavanaugh Macdonald 8/19/15 presentation to TRA Board

Experience study – cost impact
TRA's projected funded ratio

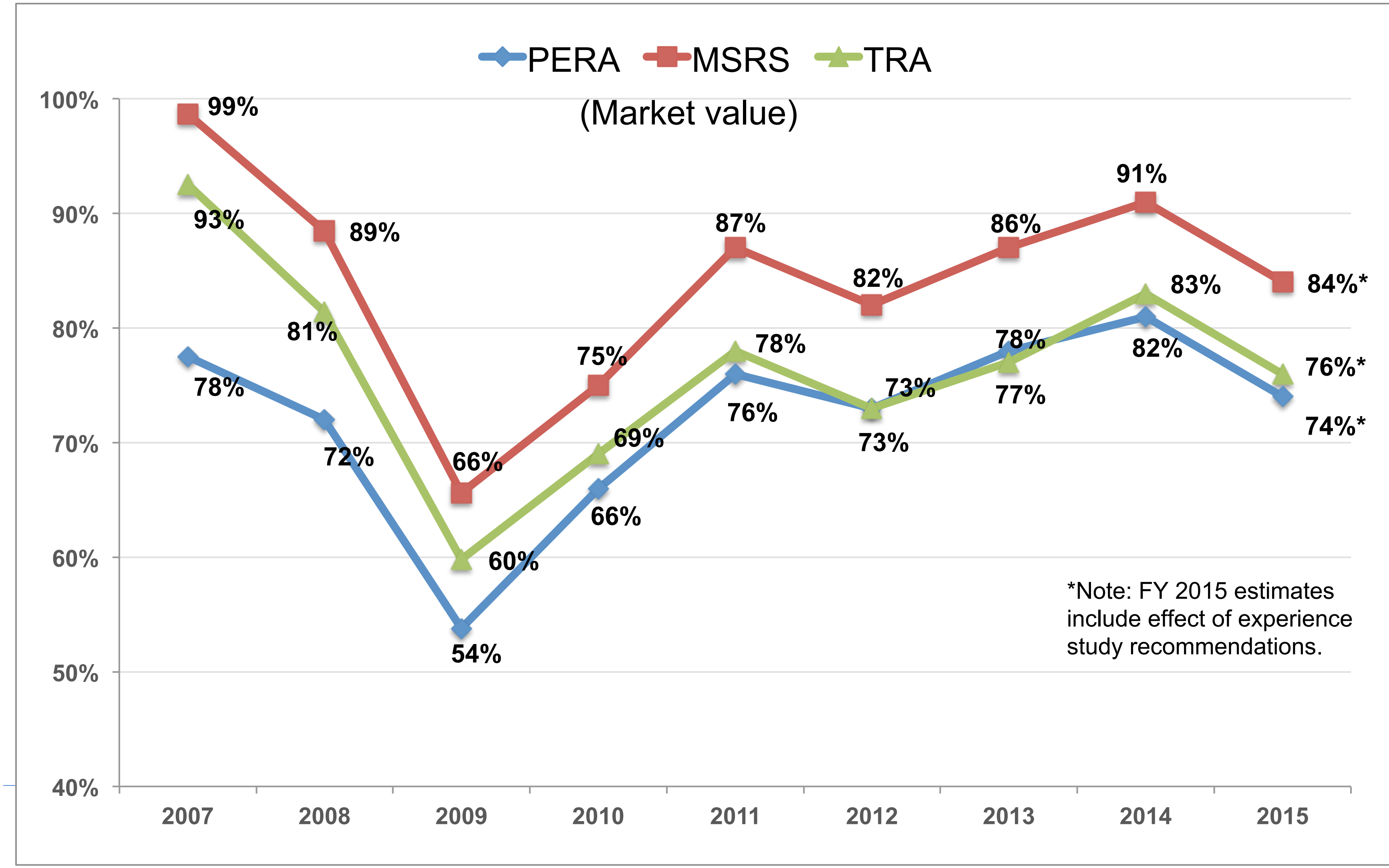


* 2015 projections include effect of investment return and mortality assumption changes

Experience study – cost impact on TRA

MARKET VALUE	7/1/14 valuation	7/1/15 valuation estimate (no assumption changes)	FY2015 estimate with all assumption changes (8% investment return, mortality, etc.)
Actuarial Accrued Liability	$24.5 billion	$24.9 billion	$26.6 billion
Market Value of Assets	$20.3 billion	$20.2 billion	$20.2 billion
Funded Ratio	82.7%	81.0%	75.9%
Total Required Contribution as % of Pay	15.75%	16.37%	19.87%
Employee plus Employer Contributions	15.68%	15.66%	15.66%
Sufficiency / (Deficiency) as % of pay	(0.07%)	(0.70%)	(4.21%)

Funding: Impact of assumption changes



TRA Board's sustainability goals + principles

Financial goals – develop proposal that will:

- address 4 percent to 5 percent of payroll deficiency
- put TRA on track to be 100 percent funded in 30 years

TRA Board guiding principles –

1. Shared sacrifice – all stakeholders - members, retirees, employers and state share in solution
2. Intergenerational equity – avoid creating or exacerbating imbalances among generations of members and retirees
3. Long-term financial sustainability – achieve full funding in 30 years in order to preserve DB pension for future generations
4. Maintain recruitment/retention value of TRA pension – experienced teachers benefit students and create high quality education system; need to avoid large cuts in basic pension that would reduce recruitment/retention value of pension

Sustainability options – revenue

Sustainability Options – ***Revenue***

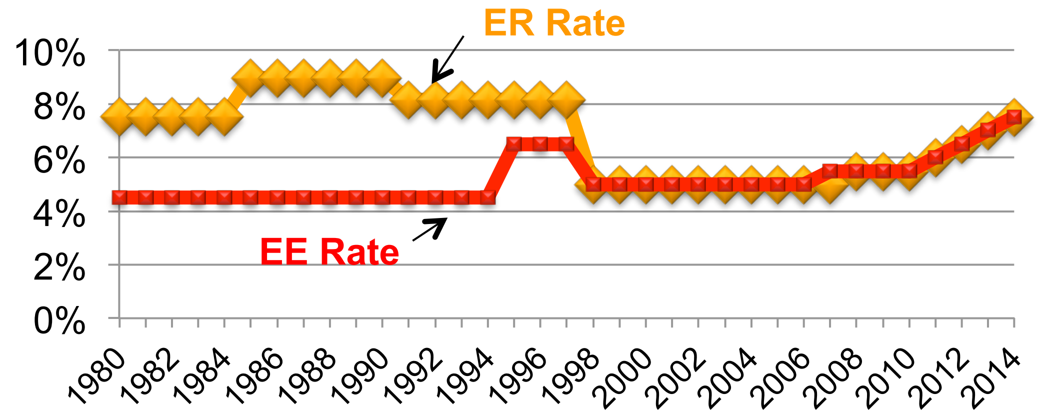
- Increase employer or employee contribution rate by 1 percent.
- Employer contribution increase could be offset by state aid or levy authority.
- 1 percent employer rate increase = $41 million annually.
- Adjust state aid for Minneapolis / Duluth = $9 million annually.

Revenue policy considerations:

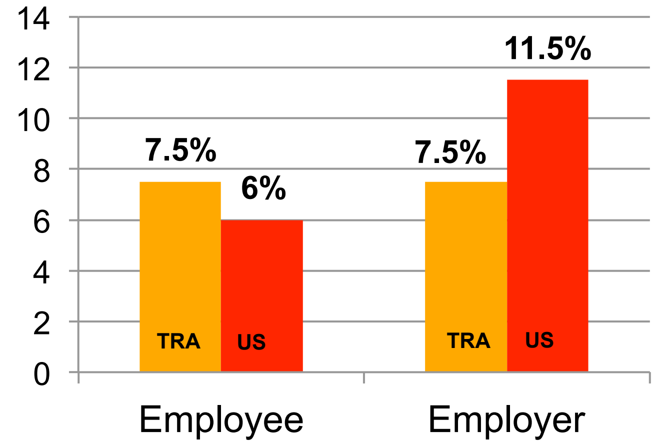
- 1 percent rate increase is significant contribution to long-term funded ratio.
- Sacrifice continues for both employers/employees due to 2010 rate increases to 7.5 percent.
- State has budget surplus, possible source for extra school aid.
- May not be productive to re-open debate regarding Duluth/Mpls aid.

Sustainability options - revenue

The employer contribution rate to TRA was higher in the past. …



… Today TRA has a higher employee rate and lower employer rate than the US average.



Sustainability options – COLAs

Sustainability Options – ***COLA CHANGES***

- Lower COLA to anywhere from 1 percent to 1.75 percent.
- 1- or 2-year COLA freeze.
- Lower COLA temporarily (for 5 year period).
- Combination of any of the above.

COLA policy considerations:

- Yield substantial savings both short and long term.
- Affects both current retirees and future retirees (current actives).
- Retirees sacrificed in 2010.
- Inflation is low now – Social Security unlikely to pay increase in 2016.
- COLA changes can offset longer lifespans. For example, lowering COLA to 1.5 percent roughly equalizes lifetime payouts. Lifetime payout with 2 percent COLA over 25 years (current longevity assumption) is roughly equal to lifetime payout with 1.5 percent COLA paid for 27 years (new longevity assumption).

Sustainability options – other benefits

Sustainability Options – ***OTHER BENEFIT CHANGES***

- Create Tier 3 (post-2017 hires) with lower employee contribution rate.
    - Increase normal retirement age from 66 to 67 (new hires).
    - Change from high-5 to high-10 salary for benefit calculation (new hires).
    - Lower formula multiplier from 1.9 percent to 1.7 percent for each prospective year of service.
    - Increase minimum retirement age from 55 to 60.

Benefit policy considerations:

- Lower savings in the short term and long term compared to COLA changes.
- Tier 3 structure for new hires would worsen intergenerational inequities and diminish recruitment/retention value of pensions.
- Actives continue to sacrifice with higher 7.5 percent contribution rate.

Sustainability options – miscellaneous

Sustainability Options – ***Miscellaneous***

- Return-to-work retiree reforms to address misuses.
- Extend amortization period for paying off unfunded liability from 2037 to 2046.

Policy considerations:

- Return to work reforms have minimal savings impact but address perceived misuse and headline risk.
- Extending amortization period relieves short-term cost pressure.

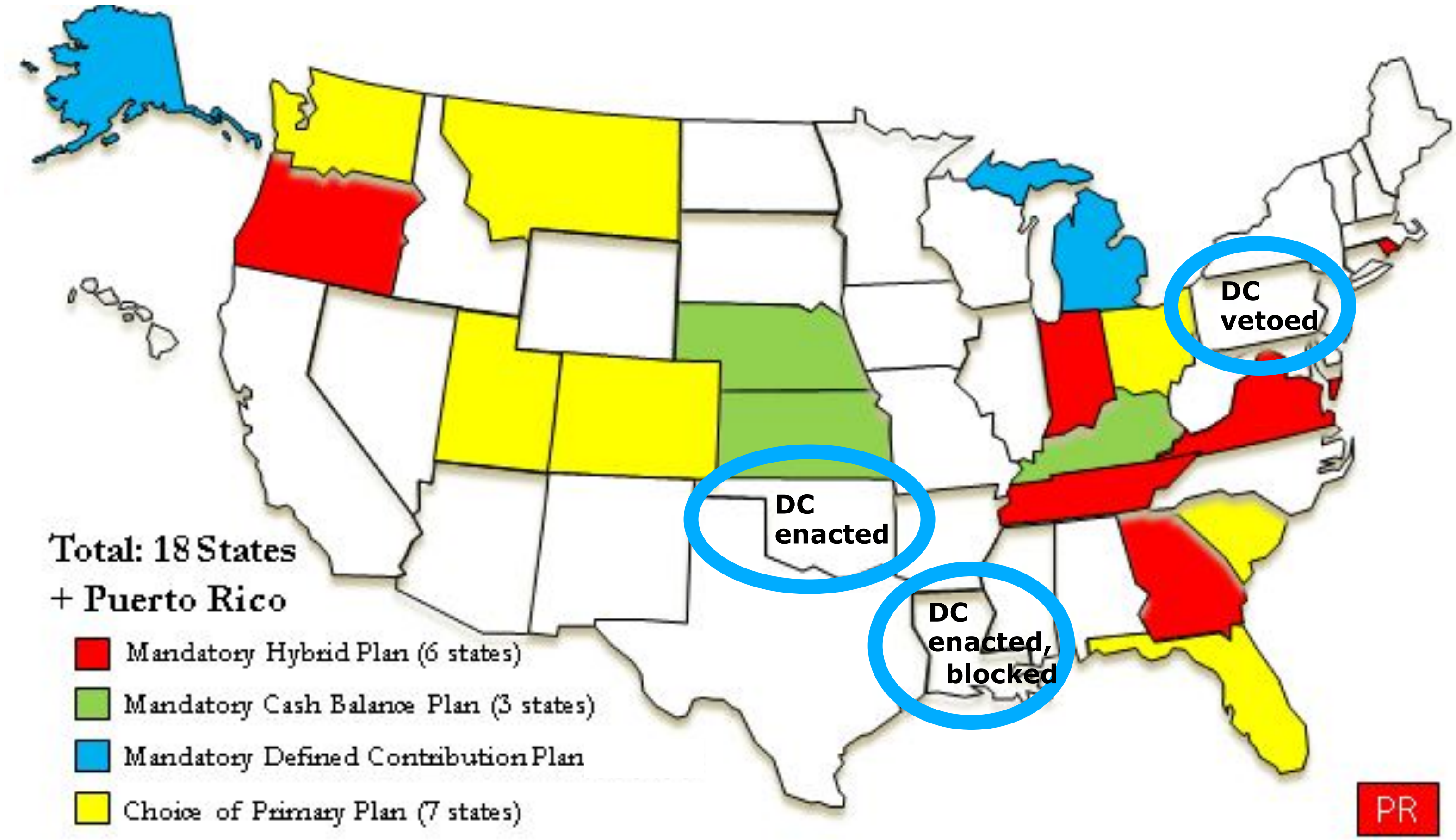
Sustainability Options – ***COMBINATION PACKAGE***	Impact as % of pay	Funded ratio by 2044
Combination: • 1% employER contribution increase* • 1-year COLA freeze, followed by 1.5% COLA • Extend amortization period to 30 years (2046)	4.50%	103%

*1% employEE rate increase yields only 85% of revenue that 1% employER increase yields due to leakage from refunds

Timetable for changes

- **2016 session –**
  - Legislature has authority to change investment return assumption. Could be pressure to lower below 8 percent.
  - LCPR will review TRA Board experience study recommendations for other assumptions (mortality, payroll/salary growth).
  - Legislature has authority over other sustainability measures, particularly any benefit changes.
  - TRA Board has some authority over contribution increases.
  - PERA/MSRS may seek changes due to longevity issue.
- **TRA Board wants feedback from stakeholders!**
  - Board will continue to work on options in September and finalize in November/December in time to work with policy makers.
  - Critical to have support of all stakeholders during legislative session.

Push to convert public DB to DC



Source: National Association of State Retirement Administrators

Avoid DC conversion – keep TRA sustainable!

MN unlike other states

- **Disciplined funding**. Problems are corrected as they occur, with positive effect on state's bond rating.
- **Proactive pension reforms**. 2010-2013 sustainability legislation was critical, cost savings: $1.75 billion (TRA), $6.44 billion (all Minnesota systems).
- **Modest benefits**. The average pension for Minnesota teachers is $2,300. Minnesota pension systems moved to a very high (age 66) normal retirement age over 24 years ago which has lowered costs.
- **Employees contribute half** the cost in Minnesota. Many other states have low – or no – employee contributions.
- **Employer contributions** in Minnesota are 2 percent of state and local government spending, compared to 3.7 percent in other states. (Census Bureau)

Resources

GASB

Visit the Employer tab on TRA's website (www.minnesotatra.org/employerinfo/gasb). You'll find:

- Links to GASB publications
- Links to AICPA audit guidance
- Toolkit of informational guides/articles
- Frequently asked questions
- News and developments on implementation

Questions about GASB? E-mail John Wicklund at jwicklund@minnesotatra.org.

TRA sustainability

We want to hear from you. Give us feedback about sustainability measures by e-mailing info@minnesotatra.org.