Municipal Employees' Retirement System

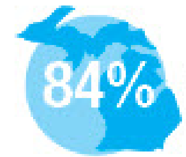
Michigan Association of Counties & Michigan County Medical Care Facilities Council

2016 Legislative Conference

Municipal Employees' Retirement System
1134 Municipal Way, Lansing, MI 48917
800.767.MERS (6377)

MERS of Michigan

- The Municipal Employees' Retirement System (MERS) of Michigan is an nonprofit organization that is independent from the State of Michigan
- We provide retirement services to more than 800 municipal members across Michigan
- Proudly serving more than 100,000 participants
- We manage nearly 2,000 retirement and employee benefit plans with a combined value of over $9 billion
- We are a multiple-employer plan — assets are pooled for investment purposes but separate trusts are maintained for each individual municipality



of Michigan municipalities participate in MERS programs

participants

in combined total assets

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Governance

Three Employee Members:
Non-officers of a participating municipality, elected by members

Two Expert Members:
With experience in retirement system or investment management, appointed by the Board

Three Officer Members:
Officers of a participating municipality, elected by membership

MERS Retirement Board
is responsible for administration of the system with fiduciary responsibility for the investment of assets and oversight.

One Retiree Member:
Retiree of the system, appointed by the Board

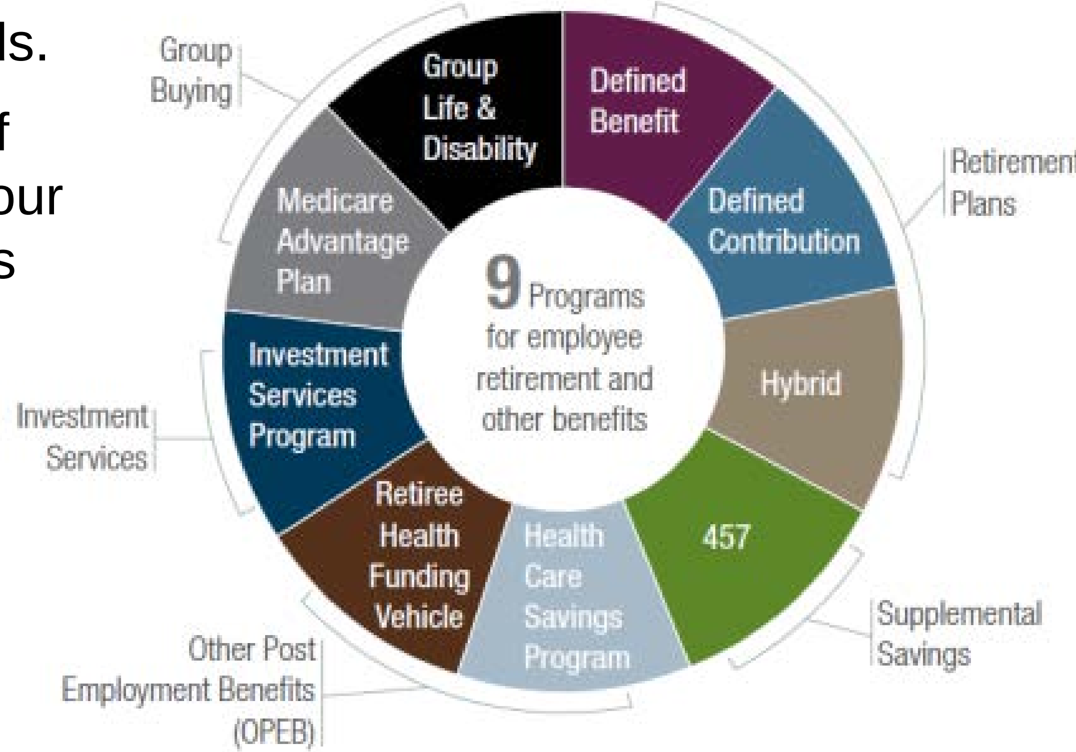
- MERS is governed by an elected board that operates without compensation
- Our board is committed to accountability and transparency, holding the line on costs, and operating in the best interest of our members
- The MERS Retirement Board serves as the fiduciary of the funds and has oversight responsibilities for the System

A Program For Every Need

Customized Plans

We recognize that every member has unique needs.

We offer a broad range of customizable plans to fit our members' budgets, needs and goals.



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Agenda

- Defined Benefit Funding
- 2015 Experience Study and National Trends
- Unfunded Accrued Liability
  - What is UAL?
  - Why UAL Occurs
  - Strategies to Manage UAL
- Implementing Recent Accounting Changes
- Other Post Employment Benefits
  - What is OPEB?
  - New Accounting Reporting Requirements
  - Proactive OPEB Solutions

DEFINED BENEFIT

The fundamentals of pension funding

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How Defined Benefit Works

Final Average Compensation X Service Credit X Benefit Multiplier = $ Annual Benefit

The benefit formula is comprised of three components:

- Final Average Compensation (FAC) is average of highest consecutive wages
- Service Credit is earned for each month of work that meets the employer’s requirements
- Benefit Multiplier is a specific percentage adopted by the employer ranging from 1.0% to 2.5%

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Meet Jane

Final Average Compensation
$45,000

Service Credit of 25 years

2.0% Benefit Multiplier

Annual Straight Life benefit*
$22,500

Monthly Straight Life benefit*
$1,875

*Maximum benefit at retirement with no benefit to beneficiary

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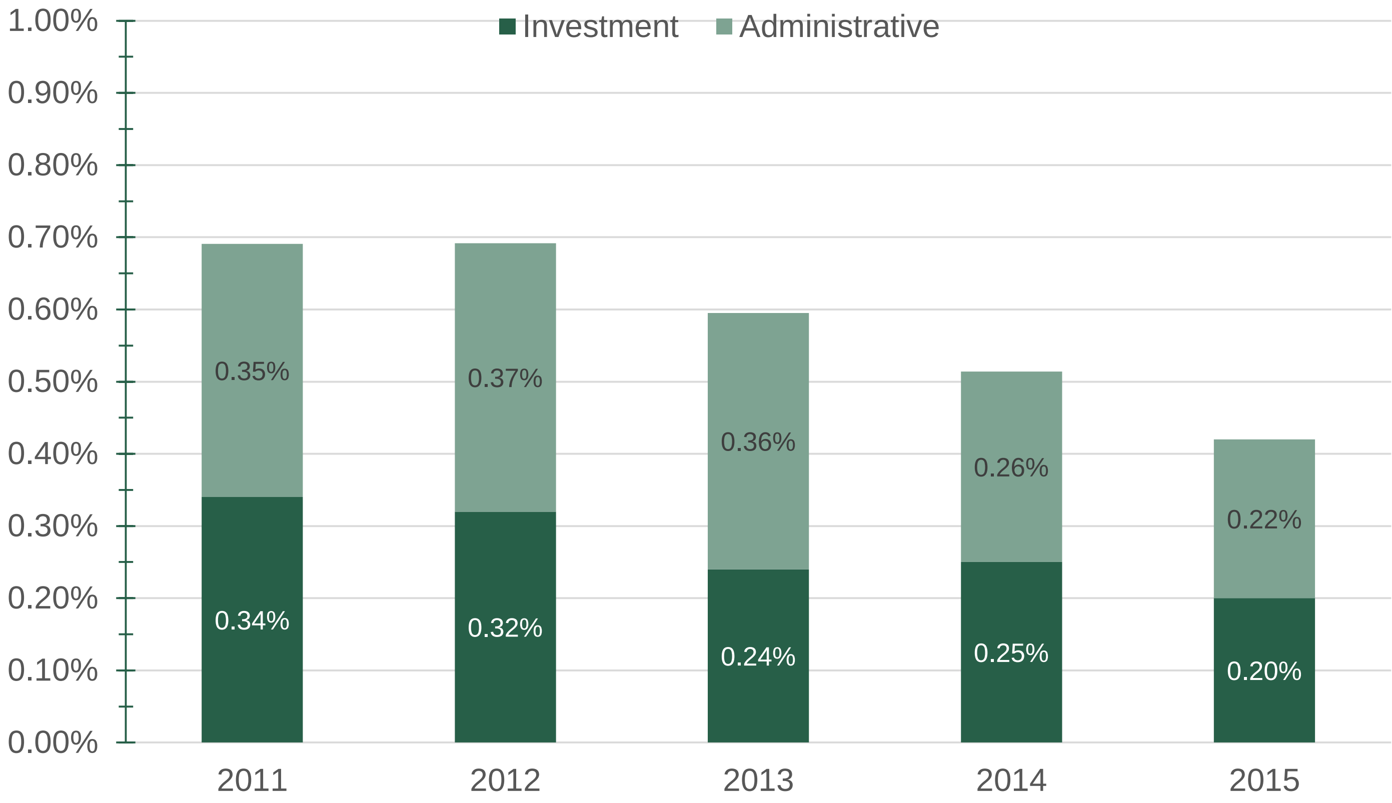
Defined Benefit Plan Costs

- The cost of the Defined Benefit Plan is determined annually and provided in the Annual Actuarial Valuation
  - DB Plan costs vary by each municipality and depend on the **benefit plan design** and other plan specific details
  - The ultimate cost will not be known until the last retiree/beneficiary stops drawing
- There are also MERS administrative and investment costs, which are charged to your plan as basis points and are found on your quarterly statements
- MERS administrative & investment costs have decreased over the last 5 years by 39%

MERS Defined Benefit Cost Reduction History

5-Year History



How Defined Benefit Plans are Funded

- Defined benefit plans may be funded by three sources: employer contributions, employee contributions and earnings on investments
- Each year in your **Annual Actuarial Valuation** we provide the required contributions, funding level and unfunded liability of your plan
- In a defined benefit plan contributions vary from one Annual Actuarial Valuation to the next as a result of the following:
  - Changes in benefit provisions
  - Changes in actuarial assumptions and methods
  - Experience of the plan (investment experience and demographic experience); this is the difference between actual experience of the plan and the actuarial assumptions
- Actuarial valuations do not affect the ultimate cost of the plan; benefit payments (current and future) determine the cost of the plan
- Assumptions are for the long term; plan experience will not match the actuarial assumptions in any given year (except by coincidence)

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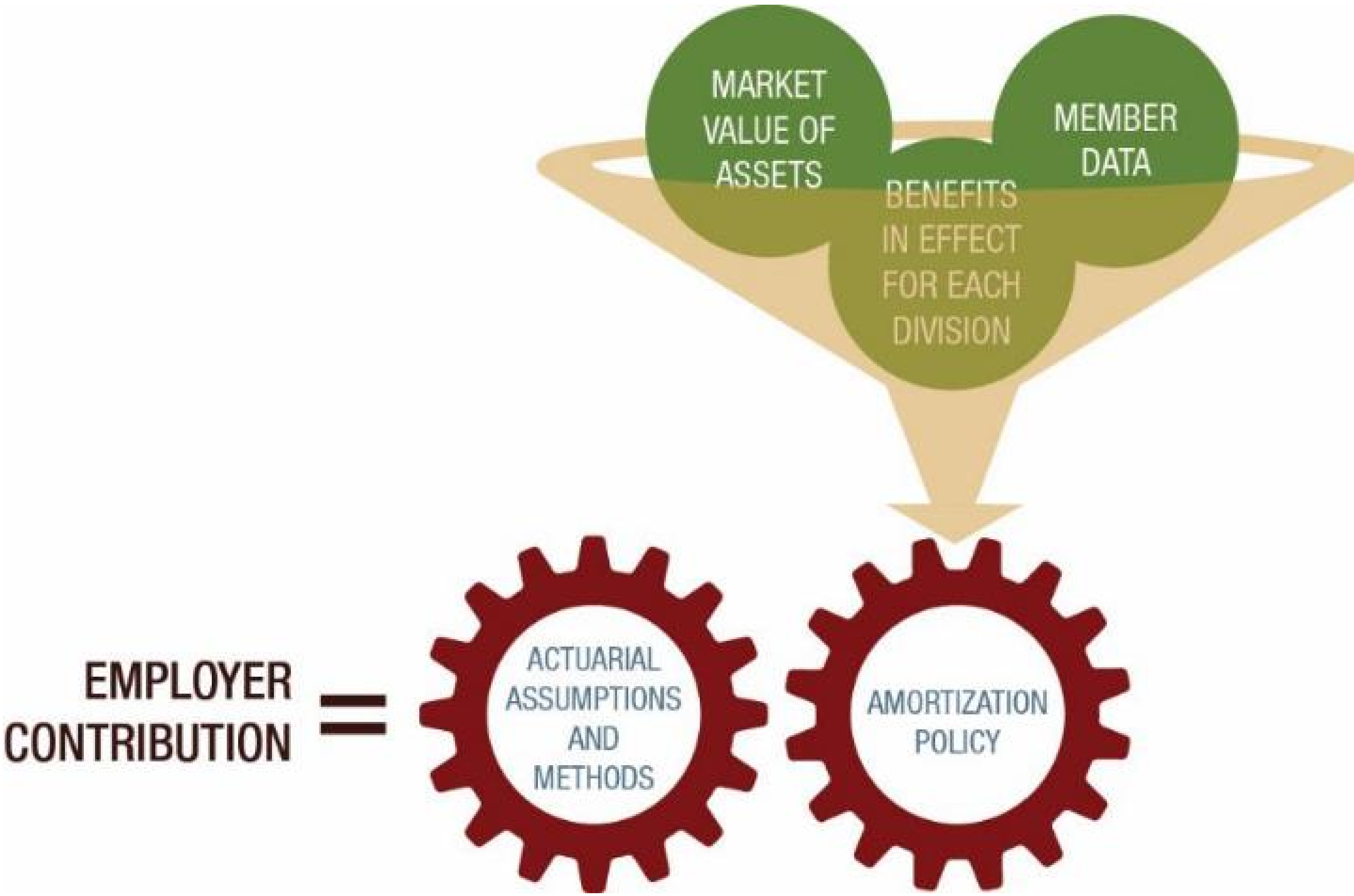
How is the Employer Contribution Calculated?



Actuarial Assumptions and Methods established by the Retirement Board

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Employer Contribution

Employer contribution rate is made of up two parts:

1. **Employer Normal Cost**– Present value of benefits allocated to the current plan year less any employee contribution
2. **Amortization Payment of Unfunded Accrued Liability**– Payment to reduce any shortfall between liability for past service and assets

Employer Normal Cost + Amortization Payment of the Unfunded Actuarial Accrued Liability = Employer Contribution

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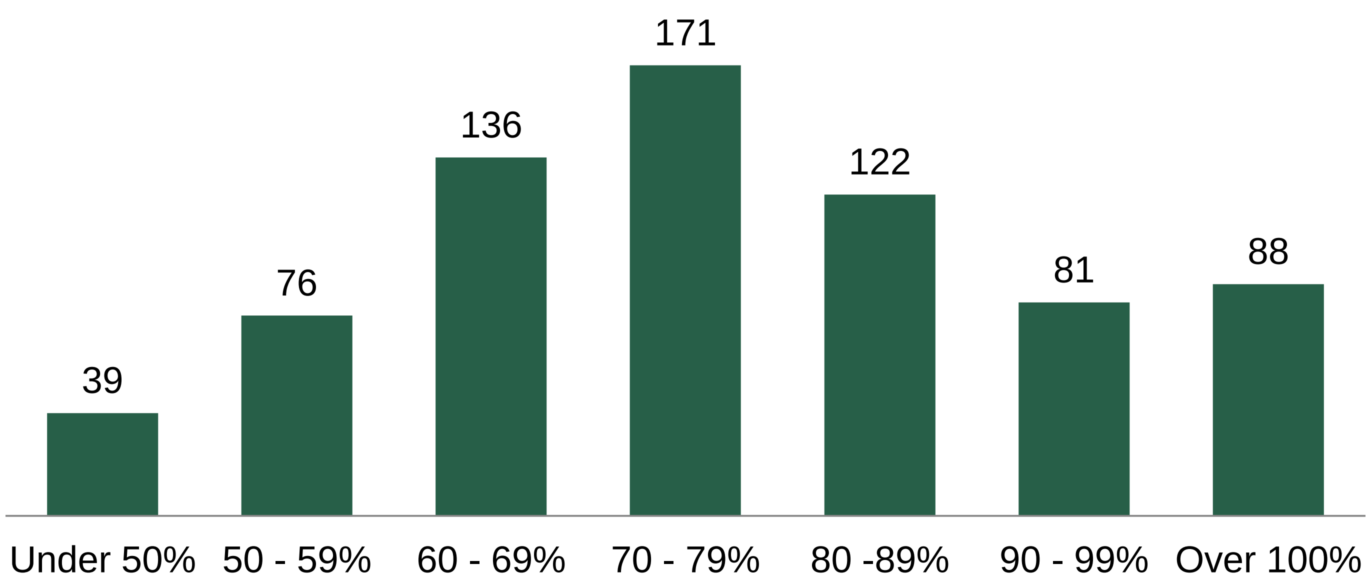
Distribution of Funded Percentage

Our Defined Benefit Plan is a multiple-employer plan

- Assets are pooled for investment purposes only
- Separate trusts are maintained for each individual employer
- We do not borrow from one municipality's account to cover another municipality's obligation



As of 12/31/14

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EXPERIENCE STUDY

Data driven assumptions help our members maintain plan stability

MERS Governance and Oversight

- MERS' Fiduciary Duty
  - Experience Study
- Funding Policy
- Fiscal Responsibility Policy
- Investment Policy and Oversight

Experience Study

- Part of MERS' fiduciary responsibility
- Conducted with our actuarial firm every five years
- Compares actual experience of the plan with the current assumptions to determine if changes are necessary

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Experience Study Goals & Priorities

- Adequacy
  - Ensuring each plan's assets are sufficient to provide for the benefits that are expected to be paid and that each plan is making reasonable progress to achieve full funding
- Intergenerational Equity and Transparency
  - Each generation should incur the cost of benefits for the employees who provide service in that generation, rather than deferring those costs to future employees. In addition, a funding policy should be easily understood.
- Contribution Stability
  - Contribution volatility should be balanced with the commitment to ensure plans are properly funded.

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Experience Study – Key Changes

- Funding Policy Changes
  - Amortization Policy
  - 5 year smoothing
- Economic Assumptions
  - Investment Return Assumption– moved from 8% to 7.75%
- Mortality Tables
  - Updated rates to reflect longer life expectancies
- Overall, changes will result in higher contributions for all groups

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Amortization Policy

- Since 2005, MERS has been gradually reducing the amortization period
- MERS will continue to reduce the amortization by one year, every year, until the UAL is completely paid off
- Beginning in 2023, future liability gains/losses will be spread over a 15-year fixed period for open divisions

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National Trends

- Other Systems are implementing similar changes
- Largest public practice actuarial firms advising clients to make these changes

TMRS Texas Municipal Retirement System

IMRF

Office of Retirement Services ORS

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Recent Trends

Downward trend assumptions about long-term expected rates of return

- Public Fund Survey
  - 126 plans measured
  - More than half have reduced their investment return assumptions since FY 2008
  - Median return assumption is now 7.75, down from 8.0
- According to NASRA, average plan returns assumption as of 12/31/2014 was 7.69% (down from 8% as of 2008)
- Pension & Investments: "Public pension funds taking a new look at return assumptions" (August 2015)

GFOA – Best Practices

- Use fixed (closed) amortization periods
- Balance equitable allocation of cost among generations with volatility management
- Never exceed 25 years; 15-20 years
- Use a layered approach for the various components to be amortized

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Experience Study Key Takeaways

- Letter will be sent to all affected municipalities with estimated impact
- Actual impact first disclosed in 2015 AAV delivered by June 2016
- First contribution impact seen with fiscal year beginning in 2017
- Overall, contributions are expected to increase
- Legacy unfunded liability now has a definite pay off date
- Impact on contributions can be paid in full or phased in over 5-year period

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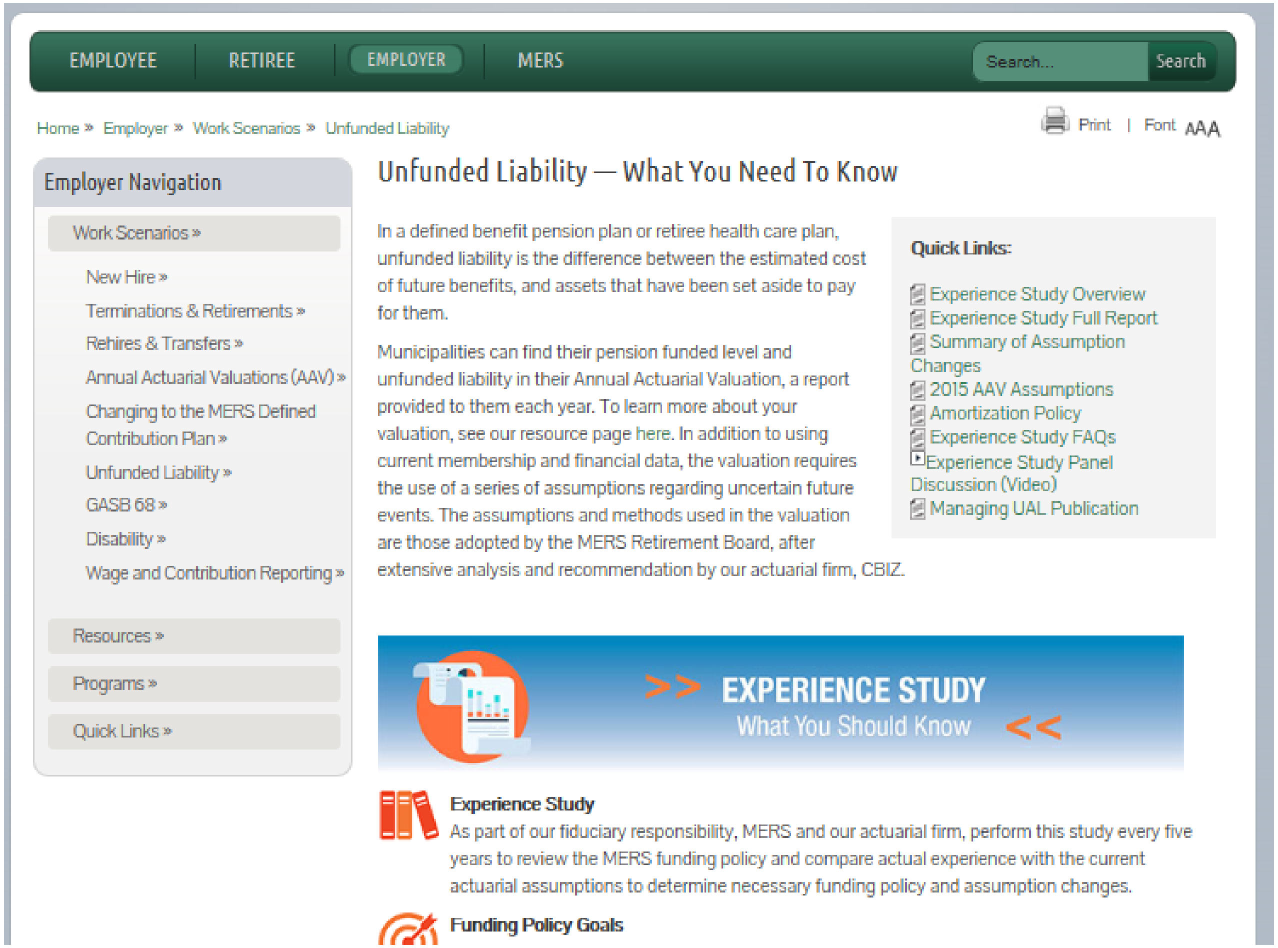
Additional Resources

Visit www.mersofmich.com



REDUCING UAL

Strategies to reduce Unfunded Accrued Liability

What is Unfunded Liability?

Unfunded liability is the difference between a plan's estimated pension benefits and assets that have been set aside to pay for them

- The dollar value of the benefits is actuarially determined each year for pension
- Assets are held in a trust and are professionally managed over the years
- Unfunded liability is paid off over a period of years

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Why Unfunded Liabilities Occur

- Actual experience different than assumed (liabilities and assets)
  - Market performance
  - Demographic experience
  - Rates of retirement
- Benefit enhancements adopted and not entirely funded
  - Early retirement windows
  - Increased benefit multiplier
  - COLA
- Higher than projected Final Average Compensation
- Granting prior service for benefits without funding

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Strategies to Manage UAL

Strategy	Description	Trend 2011	2012	2013	2014	2015	Impact
Cost Sharing for Existing Employees	• Employees contribute to help fund the overall cost of the plan	176	149	280	143	[VALUE]	• Reduces the employer cost, but does **not** affect total cost or the plan's unfunded liability
Lower Benefit to New Hires	• New hires receive a lower tier of Defined Benefit provisions	63	49	53	43	52	• Existing employees are not affected • Reduces the liability for new hires
Bridged Benefits for Existing Employees	• Benefits are offered in parts to existing employees • Multiplier is then lowered on a going-forward basis	14	17	19	29	16	• Leaves earned benefits unchanged • Reduces the liability for new hires and existing employees
Hybrid for New Hires	• New hires receive a Hybrid Plan	31	67	31	43	21	• Existing employees are not affected • Reduces liability for new hires
Defined Contribution for New Hires	• New hires receive a defined Contribution Plan	21	20	45	30	37	• Existing employees are not affected • Eliminates liability for new hires
Bonding	• Municipalities may bond for all or a portion of their unfunded accrued liabilities—pension or OPEB				4	1	• Proceeds of the bond are deposited and potentially will fully fund the UAL • No guarantee that future unfunded liabilities may not occur
Voluntary Contributions	• Additional payments made into plan toward unfunded liability		180	211	210	259	• Reduces existing liability • Extra dollars are invested and recognize market returns

IMPLEMENTING RECENT ACCOUNTING CHANGES

Helping our members navigate new pension liability reporting requirements

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Overview of GASB 68 (Pension)

- GASB 68 substantially changed accounting and financial reporting of public employee pensions
  - Employers will now record the Net Pension Liability on the full accrual statements
  - Much more detailed footnotes
- The most notable change is the separation of accounting calculations from funding calculations

TOTAL pension liability − Plan Net Position = **NET** pension liability

Summary of the Changes

	Pre-GASB 68 (Statements 27 & 50)	Post-GASB 68
Balance Sheet (Government Wide Financial Statement)	Long-term liability was recorded in the footnotes of the financial statements	A new calculation of long-term liability, called Net Pension Liability, will be on the balance sheet and the footnotes will be more extensive
Income Statement (Government Wide)	Pension expense equaled the annual required contribution	Pension expense will now be calculated based on accrual accounting, thus it will not equal the annual required contribution
Deferred Outflows and Inflows		New requirement
Required Contributions	The annual actuarial valuation process calculates the required contributions	Same process

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OPEB LIABILITIES

New reporting requirements are coming

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County Legacy Costs

- In total, counties owe approximately $3 billion in unfunded OPEB liabilities (compared to $2.1 billion in pension)
  - All counties offer a pension benefit
  - 65% offer retiree healthcare
- On average, counties are 21% funded for OPEB
  - For counties below 200,000 the average is much lower
  - Pension is on average 80% funded

What is OPEB?

Other Post Employment Benefits (OPEB) are benefits other than pension benefits that employers provide to their retirees

- Health Care Benefits
- Prescription Drug Coverage
- Dental and Vision
- Life Insurance
- Disability
- Long-term Care

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Calculating OPEB Liabilities

Like pensions, OPEB liabilities are calculated based on:

- Specific plan provisions
- Employee and retiree demographics
- Actuarial assumptions, including interest rates

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New Accounting Standard – GASB 75

- Similar to the pension standards (GASB 68)
- Update to GASB 45 standards
  - Standards around OPEB valuations and footnote requirements
- Liabilities will now be reported on the government wide financial statements as a “Net OPEB Liability”
- Changes in the net OPEB liability will generally be recognized in expense

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Basic OPEB Formula

Employers will now record the NET OPEB liability on the full accrual statements

TOTAL OPEB liability − OPEB Plan Net Position = **NET** OPEB liability

*These amounts will be measured as of the "**measurement date**"*

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OPEB Strategies

Strategy	Impact	Considerations
Eliminate retiree health insurance for new hires	Lowers/reduces future liability	Promise of healthcare in retirement is not a benefit that is protected by the Michigan Constitution
Implement Defined Contribution style health care (like MERS HCSP)	Reduction of future liability	May reduce or eliminate current liability; this provides a tax advantage investment program for employees to save for these future costs. Tactics: 1. New hires only 2. Mandatory conversion of existing employees and/or retirees to a DC style plan. May choose to “jump start” contribution based on a formula (months of service, value of benefit accrued, etc.) 3. Allow employees the option to “opt out” of retiree health care coverage by offering an incentive. May choose to jump start contributions based on a formula (years of service, accrued benefit value, etc.)

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OPEB Strategies - Continued

Strategy	Impact	Considerations
Establish a qualified medical trust for OPEB expenses (MERS Retiree Health Funding Vehicle)	Assets in a qualified trust can be used to offset OPEB liability	Investment earnings and growth over time can provide additional advantages
Change the provisions of retiree health care coverage	Reduction of future liability, depending on changes made	Change coverage and benefit levels reduces the total liability of the plan. Tactics: 1. Implement changes to insurance coverage levels 2. Increase co payments 3. Modify eligibility requirements for coverage 4. Increase employee contributions
Issue a bond for OPEB liabilities	Partial or full reduction of OPEB liability	Retiree health insurance coverage must not be available to new hires. This can be combined with Strategy 1-3 to help reduce future unfunded liabilities and take advantage of investment earnings and growth over time to reduce the potential of increased healthcare costs.

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OPEB Strategies - Continued

Strategy	Impact	Considerations
Discontinue retiree health coverage for existing employees	Reduction of current liability	Promise of healthcare in retirement is not a benefit that is protected by the Michigan Constitution. This can be combined to give employees a tax advantaged investment program to save for these future costs.
Discontinue retiree health insurance for existing retirees	High reduction of current liability	Retiree healthcare is not a benefit that is protected by the Michigan Constitution. This can be combined to give retirees money in a tax advantaged investment program to cover some of the health care costs.

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MERS Regional Teams Map

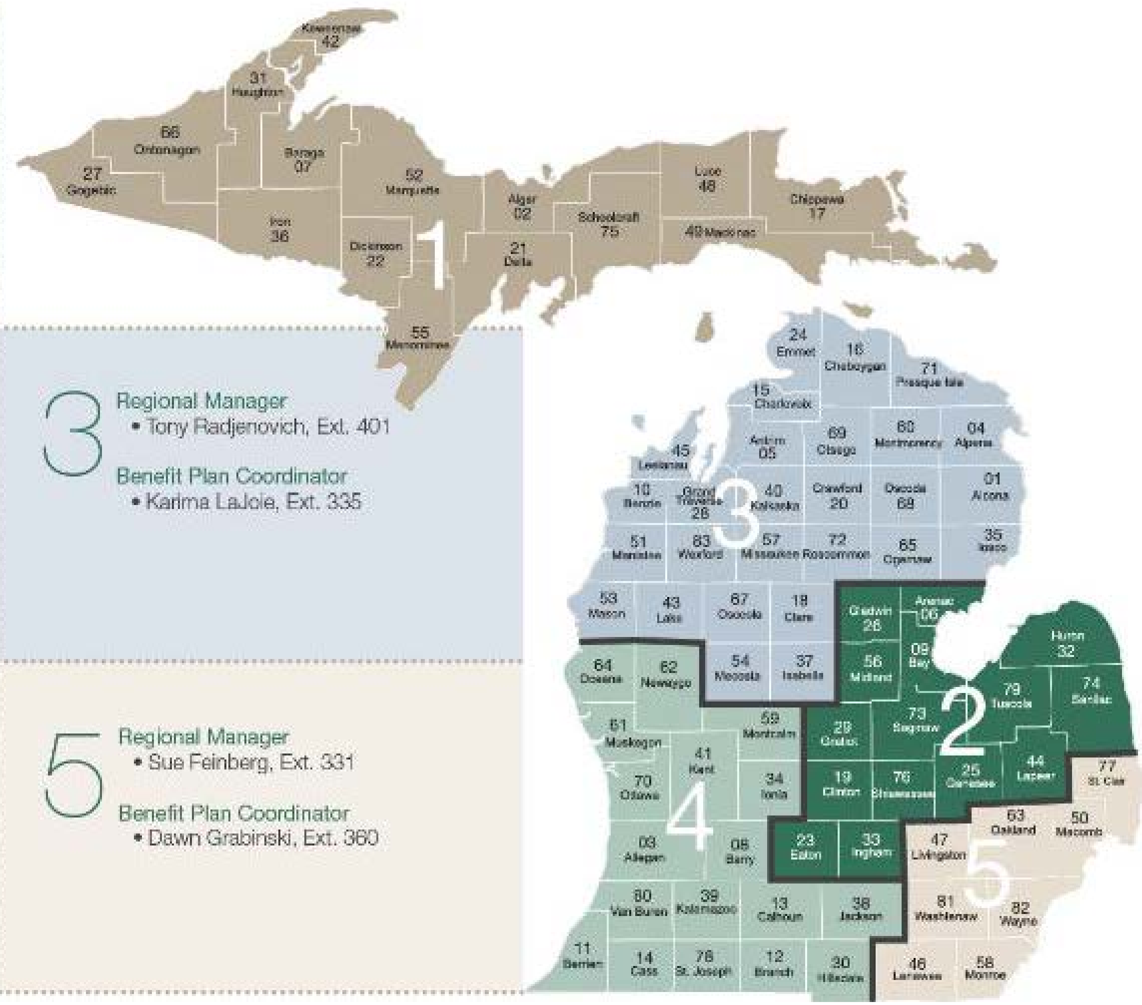
1
Regional Manager
• Terra Langham, Ext. 402
Benefit Plan Coordinator
• Karima LaJoie, Ext. 335

2
Regional Manager
• Marne Carlson, Ext. 213
Benefit Plan Coordinator
• Jamie LaFavor, Ext. 250

3
Regional Manager
• Tony Radjenovich, Ext. 401
Benefit Plan Coordinator
• Karima LaJoie, Ext. 335

4
Regional Manager
• Michael Overley, Ext. 281
Benefit Plan Coordinator
• Karima LaJoie, Ext. 335

5
Regional Manager
• Sue Feinberg, Ext. 331
Benefit Plan Coordinator
• Dawn Grabinski, Ext. 360



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