Response to Questions on the FY 2018 Budget

Request By: Supervisor Herrity

Question: What assumptions were used by Aon Hewitt/FCPS staff in their 2016 study that led to the conclusion that it would cost $70 million to end the ERFC program for employees?

Response: The following response was prepared by Fairfax County Public Schools (FCPS):

The study to determine the funding implications for closing the ERFC Plan to new hires was conducted by ERFC's actuary, Gabriel Roeder Smith & Company (GRS). When a plan is closed, it is necessary to evaluate the current funding policy and the major actuarial assumptions to determine if changes are warranted. A funding policy has three main components: an asset smoothing method, an actuarial cost method and an amortization policy.

Asset smoothing method. The present ERFC Plan asset smoothing method recognizes each year's investment gains or losses equally over a five-year period. If the ERFC Plan is closed, GRS does not recommend a change in the asset smoothing method.

Actuarial cost method. ERFC's current actuarial cost method is the individual entry age actuarial cost method. This method is required under the Governmental Accounting Standards Board (GASB) Statement 67. If the ERFC Plan is closed, GRS recommends switching to the aggregate cost method which is the method recommended by GASB and the Government Finance Officers Association (GFOA) in the event of plan closure. The aggregate cost method is well suited to a closed plan situation because it doesn't require assumptions about turnover, retirements, etc. for new entrants in the plan and, of course, there will be no new entrants if the ERFC Plan is closed to new hires.

Amortization policy. Generally accepted actuarial principles include the recommendation that the amortization of a plan's unfunded actuarial accrued liability should be accelerated if a plan is closed to new hires. For funding purposes, ERFC's unfunded accrued liability is currently being amortized over a closed 30-year period; the remaining amortization period in the December 31, 2015 valuation is 23 years. The liability is being amortized as a level percent of payroll.

Switching to the aggregate cost method changes the technique for amortizing the unfunded liability. The aggregate cost method funds the liability over the present value of future salary. This method produces a contribution rate that is theoretically a level percent of the declining closed plan payroll.

Assumed Rate of Return Assumption. ERFC's actuarial earnings rate assumption is 7.25 percent per year, net of investment expenses. If the ERFC plan is closed, (1) it may not be possible to develop a portfolio that earns 7.25 percent return throughout the life of the plan; and (2) at some point, the asset allocation will need to be changed and lower returns should be expected. In the closure study, GRS assumed that ERFC will earn 1 percent less than the current assumed 7.25 percent throughout the life of the closed plan.