Response to Questions on the FY 2018 Budget

Request By: Supervisor Herrity

Question: As a follow up to the previous question regarding assumptions used in the FCPS ERFC study, please provide the cost to close the ERFC for new hires with the following assumptions:

- The same discount rate (7.25%) as was used to determine the cost of maintaining ERFC.
- The same amortization period as was used to determine the cost of maintaining ERFC.
- The same entry age actuarial cost method as was used to determine the cost of maintaining ERFC.
- The same asset smoothing method as was used to determine the cost of maintaining ERFC.

A. In short, please recalculate the cost to close the ERFC for new hires using identical assumptions that were used to determine the cost of maintaining ERFC in its existing form.

B. Additionally, please provide documentation to justify changing from "individual entry age actuarial cost method" to the "aggregate cost method."

C. The previous response indicates that both GFOA and GASB recommend this change in methodology. Please provide documentation to that effect.

Response: ***Please note this response is a follow up to the response to Question #19, included in Package #4 dated March 21, 2017.***

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

A. If ERFC is closed to new hires and nothing about the actuarial cost method or assumptions change, there would not be any apparent closure cost. The FY 2018 contributions would be very close to the levels indicated in the December 31, 2015 actuarial report. <u>However, the fact that there is no *apparent* closure cost does not mean that there is no *actual* closure cost.</u> An actual closure cost is likely to occur because the 7.25 percent return cannot be expected to be realized indefinitely in a closed plan. Once the asset pool begins to decline and benefit payout is high with respect to the assets, the allocation to more conservative assets will need to be increased. External auditors would also question retaining the 7.25 percent return assumption since the forward-looking return projections for the asset structure do not substantiate it. This point is also discussed in the GFOA article, "Core Elements of a Funding Policy": http://gfoa.org/core-elements-funding-policy. The article says that "For closed plans with no remaining active members, special attention needs to be given to the mix of investments (given the shorter time horizon)".

B. The same GFOA article explains that "When a plan is closed to new participants, the aggregate actuarial cost method – level percentage of pay normal cost – is especially well suited for funding." This is perhaps because the aggregate cost method is designed to complete plan funding over the future working lifetimes of the active members. The sound financial practice of changing the cost methodology is also addressed in an article included in the July 2014 issue of Periscope. A second actuarial firm, Milliman, states that a plan that has implemented a "soft" freeze (meaning future new hires do not enter the plan) may wish to calculate their annual funding amount using the aggregate cost method, so that the present value of the benefit is fully funded when the last member terminates employment. Additionally, the Conference of Consulting Actuaries also provided guidance on funding policies for closed plans in its white paper entitled: "Actuarial Funding Policies and Practices for Public Pension Plans." https://www.ccactuaries.org/Portals/0/pdf/CCA_PPC_White_Paper_on_Public_Pension_Funding_Policy.pdf. The actuaries noted that "plans that are closed to new entrants may require additional analyses and forecasts to determine whether the policy parameters herein provide for adequate funding." The implication is that a funding policy that is suitable for an open plan may not be suitable for the same plan if it is closed.

C. GASB never specifically required a change to the aggregate cost method for a closed plan. However, GASB Statement Nos. 25 and 27 required the annual required contribution to reflect the fact that closed plan covered payroll would no longer be expected to increase at the wage inflation assumption. This typically led to a change in amortization method from a level percent of payroll method to a level dollar method and resulted in an increase in the plan's Annual Required Contribution, over what it would have been if the plan remained open. The new GASB standards effectively separated **funding** from **financial reporting,** so that they no longer address the issue. At a minimum, then, both GFOA now, and GASB (prior to GASB 67) have recommended funding policy changes in the direction of increasing contributions to the plan.