PUBLIC EMPLOYEES
RETIREMENT ASSOCIATION

Date: December 12, 2024
To: PERA Board of Trustees
From: Doug Anderson, ASA, MAAA, Executive Director
Amy Strenge, Policy Coordinator
Subject: Amortization Work Group Recommendation

The 2024 Omnibus Pension Bill established the Amortization Work Group. The Amortization Work Group is led by the Executive Director of the LCPR and consists of Executive Directors and a second staff person from PERA, MSRS, and TRA; and the Executive Director from the St. Paul Teachers Retirement Fund Association.

The purpose of the Amortization Work Group is to recommend legislation amending Minnesota Statutes, section 356.215, subdivision 11, to conform to current actuarial best practices for amortizing liabilities.

An **Amortization Method** defines the amounts and timing of payments needed to pay for costs of unfunded actuarial accrued liabilities (UAAL). **Unfunded Actuarial Accrued Liabilities** (UAAL) are the unfunded portion of liabilities attributable to benefits provided for a member's past service. The UAAL may increase or decrease as a result of benefit increases or decreases, assumption changes, investment gains and losses, and other economic or demographic gains and losses.

The amortization method defines how much and how long current and future active members and taxpayers will pay for the liabilities attributable to the portion of current member's past service not yet funded. Achievement of intergenerational equity depends on good amortization methodology.

The current statutory methodology is not consistent with actuarial best practices because it does not reduce the unfunded liability in a reasonable time, is subject to tail volatility, and lacks transparency.

The Amortization Work Group relied primarily on a Conference of Consulting Actuaries Whitepaper titled "Actuarial Funding Policies and Practices for Public Pension Plans" as a consolidated source of best practices for amortization methods. The work group also heard from the retained actuaries for funds (GRS and Cav Mac) as well as from the LCPR's actuary, VIA Consulting.

After several meetings, the Amortization Work Group reached consensus to recommend a "layered amortization" approach. Currently all sources of an UAAL are combined during the annual valuation process and the single amount is amortized over the plan's amortization period, which currently is defined by the Legislature as the Amortization Target Date (2048).

Under the "layered amortization" approach all sources of the UAAL would be individually tracked and amortized over different periods that are more appropriate for cost attribution. The following chart shows the sources of the UAAL, the CCA Whitepaper's model practices, and the Amortization Work Group's recommendation.

Source of Unfunded Actuarial Accrued Liability (UAAL)	Model Practices*	Amortization Work Group Recommendation
"Legacy" UAAL	No Recommendation	Retain current Statutory Amortization Target Date (2048)
Experience Gain or Loss	15 to 20 years	15 years
Assumption or Method Changes	15 to 25 years	20 years
Active Benefit Changes	Active demographics, or up to 15 years as an approximation	15 years
Long-term Inactive Benefit Changes	Inactive demographics, or 10 years as an approximation	15 years
Short-term Inactive Benefit Changes	5 years or less	Match the period that benefit applies
Contributions more or less than Actuarially Determined Contribution	No Recommendation	15 years

Staff will review the recommendation at the Board meeting and show the expected impact of the proposed change.

Staff Recommendation

Staff recommends that the PERA Board authorize staff to pursue legislation using layered amortization methodology and timeframes recommended by the work group.

Amortization Work Group Update

Doug Anderson, ASA, MAAA, Executive Director| December 2024

- **Creation**

  "The executive director of the Legislative Commission on Pensions and Retirement (commission executive director) must convene a work group for the purpose of recommending legislation amending Minnesota Statutes, section 356.215, subdivision 11, that will update the statute to conform to current actuarial best practices for amortizing liabilities."

- **Composition**

  Executive Directors and a second staff person from PERA, MSRS, and TRA; and the Executive Director from the St. Paul Teachers Retirement Fund Association.

- **Why**

  Statutory methodology does not reduce the liability in a reasonable time; is subject to tail volatility, and lacks transparency. The approach does not conform to actuarial best practices.

Amortization Method

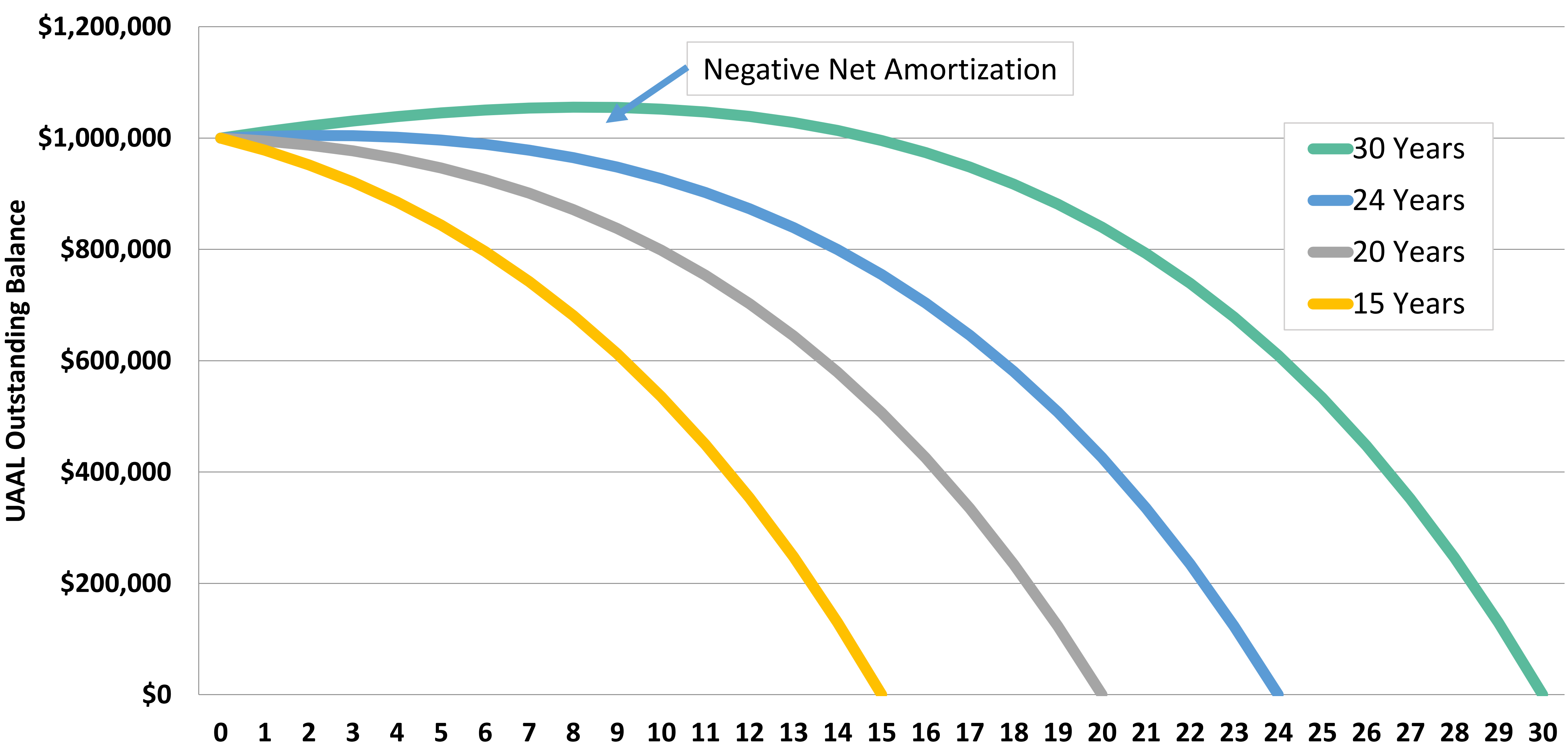
Defines the amounts and timing of payments needed to pay for costs of unfunded actuarial accrued liabilities (UAAL).

Unfunded Actuarial Accrued Liabilities (UAAL)

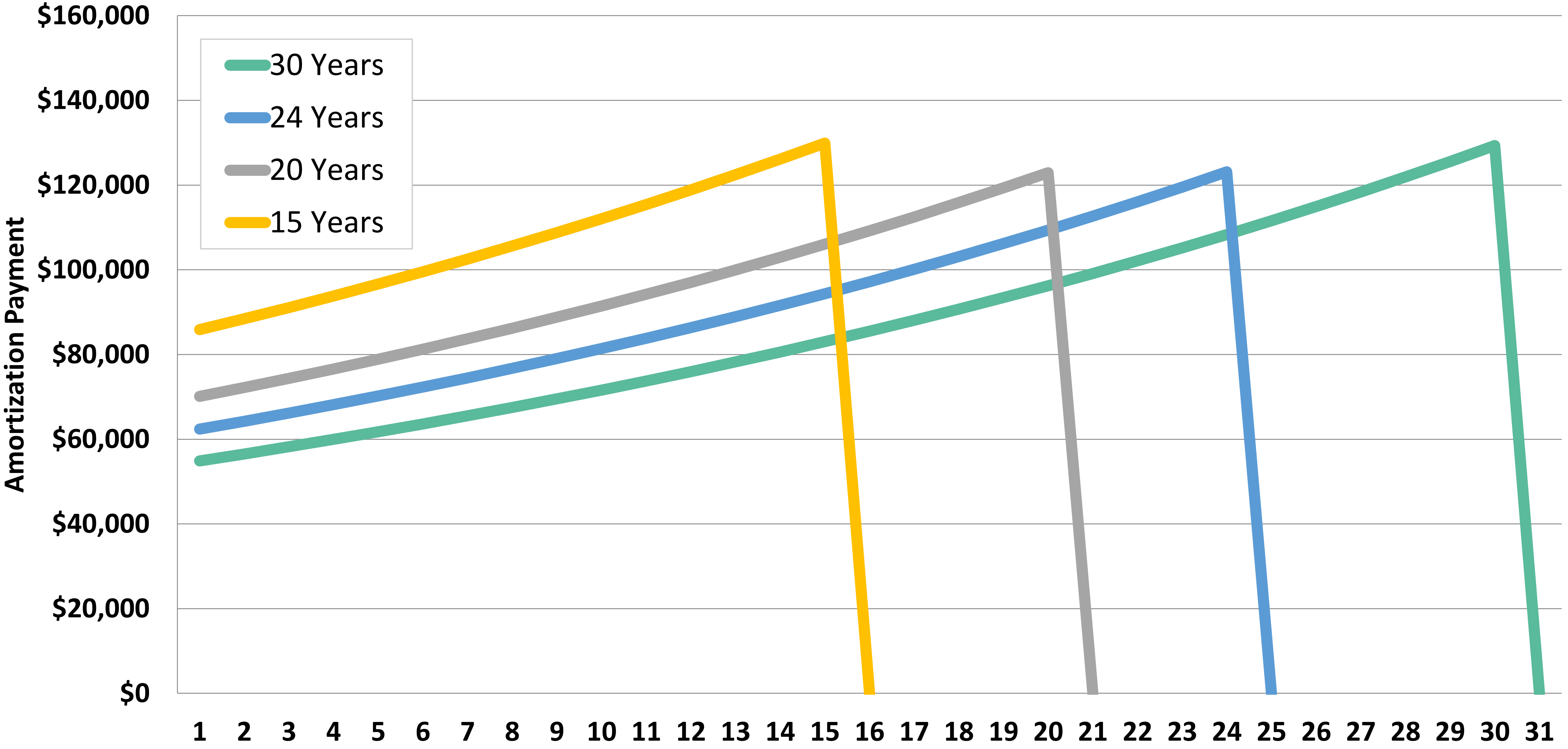
The <u>unfunded</u> portion of liabilities attributable to benefits provided for member's <u>past</u> service. The UAAL may increase or decrease as a result of benefit increases or decreases, assumption changes, investment gains and losses, and other economic or demographic gains and losses.

The amortization method defines how much and how long current and future active members and taxpayers will pay for the liabilities attributable to current member's past service that has not yet been funded. Achievement of intergenerational equity depends on good amortization methodology.

UAAL Amortization Using Various Periods



Amortization Payments Using Various Periods



Actuarial General Policy Objectives

- **Contribution Sufficiency**

  Contributions must be sufficient to fund *at least* the value of benefits accrued.

- **Demographic Matching**

  Each generation of taxpayers pays for the benefits of the employees who provided services to them.

- **Volatility Management**

  Strive for contribution stability but *not at the detriment* of other policy objectives.

- **Transparency and Accountability**

  The intent and impact of each funding policy element is known to all stakeholders.

- **Sound Governance**

  Policy decisions are made in the best interest of the plan members.

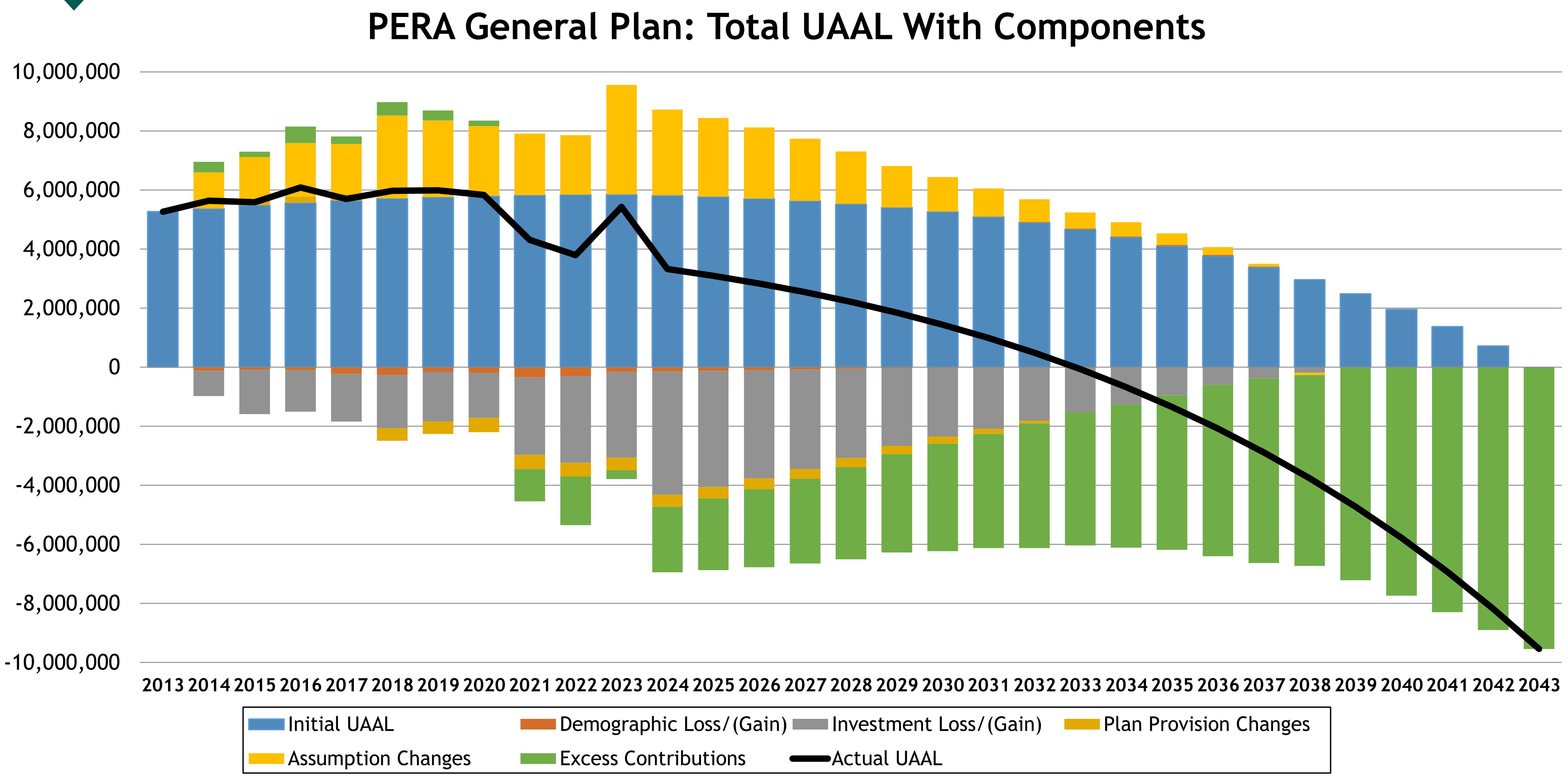
From the Conference of Consulting Actuaries Whitepaper titled "Actuarial Funding Policies and Practices for Public Pension Plans"

Amortization Method Concepts

- Balance **demographic matching** and **volatility management**
- Consider source of UAAL change
- Consider level and duration of negative amortization
- Sum of outstanding balances should equal UAAL
- Support **transparency and accountability**

From the Conference of Consulting Actuaries Whitepaper titled “Actuarial Funding Policies and Practices for Public Pension Plans”

An Example – UAAL by Components



Amortization Methods Objectives

- Each amortization payment should either:
  - Fully amortize the amortization base within a reasonable time period, or
  - Reduce the outstanding balance by a reasonable amount each year.

- The sum of all UAAL amortization payments should either:
  - Fully amortize the UAAL within a reasonable time period, or
  - Reduce the UAAL by a reasonable amount within a sufficiently short period

From the Conference of Consulting Actuaries Whitepaper titled “Actuarial Funding Policies and Practices for Public Pension Plans”

Amortization Work Group Recommendation

Source of Unfunded Actuarial Accrued Liability (UAAL)	Model Practices*	Amortization Work Group Recommendation
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Amortization Methodology Comparison

Current Method – Amortization of UAAL by 2048				
Sources of UAAL	**Outstanding Balance**	**Period**	**FY25 Amortization $ Amount**	**FY25 Amortization % of Pay**
Combined	$4,503,957,000	24 years	$291,476,000	3.45%

AWG Recommendation – If Applied Initially Effective July 1, 2024				
Sources of UAAL	**Outstanding Balance**	**Period**	**FY25 Amortization $ Amount**	**FY25 Amortization % of Pay**
Legacy UAAL	$5,130,189,000	24 years	$331,994,000	3.93%
Investment (Gain)	(411,731,000)	15 years	($36,677,000)	(0.43%)
Demographic Loss	288,744,000	15 years	25,721,000	0.30%
Assumption Changes	(503,245,000)	20 years	($36,596,000)	(0.43%)
Total	**$4,503,957,000**		**$284,442,000**	**3.37%**