The Pension/OPEB Funding Puzzle

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Pension Funding Basics

- Pension Funding is simply spreading the cost of benefits over time
- INTO the Fund: Contributions
- OUT of the Fund: Benefits, Expenses
Benefits

- Who?
- How much?
- Under what conditions?

Actuarial Assumptions

- Demographic Assumptions
  - When?
  - For How Long?...
  - Termination, Disability
  - RETIREMENT & MORTALITY
• Economic Assumptions
  ◦ What is tomorrow’s dollar worth today?...
  ◦ Inflation, Salaries
  ◦ INVESTMENT RETURN

Actuarial Assumptions

• How much should be spent each year?

• Paygo vs. pre-funding

• Cost methods can vary, but they all do the same thing

Actuarial Methods
### Actuarial Methods

#### Asset Smoothing

**Investment Return Averages**

<table>
<thead>
<tr>
<th>Year</th>
<th>Return</th>
<th>3-Year Avg</th>
<th>5-Year Avg</th>
<th>7-Year Avg</th>
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#### Asset Smoothing/Amortization

**Employer Contribution Rate (% Payroll)**

- **Softening the Blow through Actuarial Smoothing and Extended Amortization of the Unfunded Liability**
- **After the Crash**
The "Whole Pie"

- Contribution = Normal Cost + Amortization of UAAL

**Annual Cost**

**So What’s the Problem?**
Problem: Actuarial Gains and Losses

- Experience NEVER matches expectations
  - INVESTMENTS
  - Mortality, Retirement, etc.

Problem: Funding Adequacy

- ARC = $X
  - Actual contribution < $X

- Contribution Holidays
  - Contribution = $0
Problem: Benefit Increases

- "Free" Benefits
- Bargaining Issues
- Promise now, pay later

Benefit Decreases/New Tiers

- Very long phase in period
- Does not impact UAAL
- Possible bargaining/legal issues
## Pensions vs. OPEB

<table>
<thead>
<tr>
<th>Same</th>
<th>Different</th>
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</thead>
<tbody>
<tr>
<td>Demographic Assumptions</td>
<td>Medical Inflation</td>
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<tr>
<td>Project &amp; Discount</td>
<td>Predictability of Benefits</td>
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<tr>
<td>Basic Accounting Requirements</td>
<td>Historical Pre-funding</td>
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