City of St. Joseph Employees Retirement System
Actuarial Funding Policy

Introduction

The purpose of this Actuarial Funding Policy is to record the funding objectives and policy set by the Board of Trustees (Board) for the City of St. Joseph Employees Retirement System (Retirement System). The Board establishes this Actuarial Funding Policy to help ensure the systematic funding of future benefit payments for members of the Retirement System.

In 2012, the Governmental Accounting Standards Board (GASB) approved two new financial reporting standards. GASB Statement No. 67, "Financial Reporting for Pension Plans" replaces the requirements of Statement No. 25. GASB Statement No. 68 "Accounting and Financial Reporting for Pensions" replaces the requirements of Statements No. 27 and No. 50. Prior to the changes, the Annual Required Contribution (ARC) rate was used as a basis for funding decisions. The GASB statements separate accounting cost (expense) from funding cost (contributions), necessitating the creation of this funding policy.

Funding Policy Objectives

1. Maintain adequate assets so that current plan assets plus future contributions and investment earnings should be sufficient to fund all benefits expected to be paid to members and their beneficiaries.
2. Maintain stability of employer contribution rates, consistent with other funding objectives.
3. Maintain public policy goals of accountability and transparency. Each policy element is clear in intent and effect, and each should allow an assessment of whether, how and when the funding requirements of the plan will be met.
4. Monitor material risks to assist in any risk management strategies the Board deems appropriate.
5. Promote intergenerational equity. Each generation of members and employers should incur the cost of benefits for the employees who provide services to them, rather than deferring those costs to future members and employers.
6. Provide a reasonable margin for adverse experience to help offset risks. Should the funded ratio of the plan exceed 120%, the board shall evaluate reducing the actuarial rate of return to facilitate reducing the risk associated with the asset allocation of the investment portfolio.
7. Review the plan's investment return assumption in conjunction with a periodic asset liability study and in consideration of the Board's risk profile.
8. Continue prudent management of the Unfunded Actuarial Accrued Liabilities (UAAL).

Legal Requirements

1. Annual Actuarial Valuation: Section 20h(4) of Act 314 [MCL 38.1140h(4)] requires the Retirement System to have an actuarial valuation performed annually. See Appendix I
2. Supplemental Actuarial Analysis: Section 20h(5) of Act 314 [MCL 38.1140h(5) requires that a supplemental actuarial analysis shall be provided to the Retirement System before adoption of pension benefit changes. See Appendix I
3. Annual Employer Contribution: Section 20(m) of Act 314 [MCL 38.1140m] requires the Board to annually certify the annual required contribution to be made by the City of St. Joseph. See Appendix II
4. Summary Annual Report: Section 20(h)(6) of Act 314 [MCL 38.1140h(6) requires the Retirement System to make the summary annual report created under section 13 available to the plan participants and beneficiaries and the citizens of the City of St. Joseph. See Appendix I

Elements of Actuarial Funding Policy

1. Actuarial Cost Method

a. The Individual Entry Age Normal actuarial cost method of valuation shall be used in determining Actuarial Accrued Liability (AAL) and Normal Cost with the following characteristics:

   i. The annual normal costs for each individual active member, payable from the date of employment to the date of retirement, are sufficient to accumulate the value of the member's benefit at the time of retirement; and

   ii. Each annual normal cost is a constant percentage of the member's year by year projected covered pay.

b. Differences in the past between assumed and actual experience ("actuarial gains and losses") shall be factored into the AAL.

c. The Normal Cost shall be determined on an individual basis for each active member.

2. Asset Smoothing Method

The investment gains and losses of each valuation period, resulting from the difference between actual investment return and assumed investment return, shall be recognized annually in level amounts over 5 years in calculating the Funding Value of Assets.

3. Amortization Method

a. The Level Percent Closed amortization method shall be used to systematically pay off the UAAL over a closed amortization period of no greater than 20 years.

b. Unfunded liabilities associated with pension benefit changes or assumption changes shall be funded over a period determined by the Board in consultation with the actuary. See Appendix I – MCL 38.1140h(5).

c. Unfunded liabilities arising from benefit changes provided to retirees or in conjunction with early retirement incentive programs offered by the employer shall be separately funded over a period determined by the Board in consultation with its actuary.

d. In the event that the Retirement System's assets exceed its liabilities, all amortization schedules other than those related to benefit changes for retirees or early retirement incentive programs offered by the employer shall be considered completed , and employer contributions will be set based upon the Normal Cost and the completion of any remaining amortizations due to benefit changes for retirees or early retirement incentive programs offered by the employer, without regard to the overfunding status of the Retirement System.

4. Assumptions

a. The economic and demographic actuarial assumptions utilized to determine the contribution requirements and benefit values of the Retirement System shall be determined by the Board in consultation with its actuary, subject to the following limitations:

i. The assumed rate of investment return shall not exceed 7% compounded annually.

5. Funding Target

a. The targeted funded ratio of the Retirement System shall be 100%.

b. A funding plan shall be developed by the Board in consultation with its actuary if the funded ratio falls below or is projected to fall below 75%, which may include additional funding requirements.

c. The actual employer contribution rate shall be not less than the amount shown in the following table. The Employer Normal Cost is the Total Normal Cost minus the Member Contributions. The Actuary Calculated Employer Contribution Rate is the Employer Normal Cost plus or minus the net Amortization Amounts.

Funded Ratio – Market Value Basis	Minimum Actual Employer Contribution Rate
75% to 100%	Greater of: Actuary Calculated Employer Contribution Rate or 80% of Employer Normal Cost
100% to 120%	Greater of: Actuary Calculated Employer Contribution Rate or 75% of Employer Normal Cost
120% to 150%	Greater of: Actuary Calculated Employer Contribution Rate or 50% of Employer Normal Cost
Greater than 150%	Greater of: Actuary Calculated Employer Contribution Rate or 25% of Employer Normal Cost

d. This required minimum contribution shall be applied to each employee group and not the combined funded ratio of the plan.

e. At no time shall an employee group take a contribution holiday.

6. Contributions

a. Employer and employee contributions shall be paid to the pension fund no less than on a monthly basis.

7. Risk Management

a. Assumption Changes

i. The actuarial assumptions used shall be those last adopted by the Board based on the most recent experience study and upon the advice and recommendation of the Board's actuary. The Board's actuary shall conduct an experience study at least once every five years. The results of the study shall be the basis for the actuarial assumption changes recommended to the Board.

ii. The actuarial assumptions can be updated during the five-year period if significant plan design changes or other significant events occur, as advised by the actuary.

b. Amortization Method

i. The amortization method, Level Percent Closed, will ensure full payment of the UAAL over a finite, systematically decreasing period not to exceed 20 years. [Statute allows 30 years]

c. Risk Measures

i. The following risk measures will be annually determined to provide quantifiable measurements of risk and their movement over time.

(i) Funded ratio (assets / liability):

(ii) Unfunded Actuarial Accrued Liabilities (UAAL)

The years required to pay down the unfunded liabilities of the Retirement System based upon the current funding schedule;

(iii) UAAL / Total Payroll

Measures the risk associated with contribution decreases relative impact on the ability to fund the UAAL. A decrease in this measure indicates a decrease in contribution risk.

(iv) Total Assets / Total Payroll; and

(v) AAL / Total Payroll.

Review and Amendment

1. **Periodic Review**.
    a. This Actuarial Funding Policy shall be reviewed no less frequently that once every five years in conjunction with the required experience study performed by the Board's actuary, and may be reviewed at any time in the Board's discretion.
2. **Amendment.**
    a. The Board, in consultation with its Actuary and Legal Counsel, may amend this Actuarial Funding Policy at any time as deemed necessary to address changes in the makeup, benefit structure and/or funding status of the Retirement System.

Glossary

1. **Actuarial Accrued Liability (AAL**): The difference between (i) the actuarial present value of future plan benefits, and (ii) the actuarial present value of future normal cost. Sometimes referred to as "accrued liability" or "past service liability".
2. **Actuarial Assumptions**: Estimates of future plan experience with respect to rates of mortality, disability, turnover, retirement, rates of investment income and salary increases. Decrement assumptions (rates of mortality, disability, turnover and retirement) are generally based on past experience, often modified for projected changes in conditions. Economic assumptions (salary increases and investment income) consist of an underlying rate in an inflation-free environment plus a provision for a long-term average rate of inflation.
3. **Actuarial Cost Method**: A mathematical budgeting procedure for allocating the dollar amount of the "actuarial present value of future plan benefits" between the actuarial present value of future normal cost and the actuarial accrued liability. Sometimes referred to as the "actuarial funding method".
4. **Actuarial Gain (Loss):** A measure of the difference between actuarial experience and that expected based upon a set of actuarial assumptions during the period between two actuarial valuation dates, in accordance with the actuarial cost method being used. For example, if during a given year the assets earn more than the investment return assumption, the amount of earnings above the assumption will cause an unexpected reduction in UAAL, of "actuarial gain" as of the next valuation. These include contribution gains and losses that result from actual contributions made being greater or less than the level determined under the policy.
5. **Actuary**: A person who is trained in the applications of probability and compound interest to problems in business and finance that involve the payment of money in the future, contingent upon the occurrence of future events. Most actuaries in the United States are Members of the American Academy of Actuaries (MAAA). The Society of Actuaries (SOA) is an international research, education and membership organization for actuaries in the life and health insurance, employee benefits, and pension fields. The SOA administers a series of examinations leading initially to Associateship and the designation ASA and ultimately to Fellowship with the designation FSA.
6. **Amortization**: Paying off an interest-bearing liability by means of periodic payments of interest and principal, as opposed to paying it off with a lump sum payment.
7. **Employer Normal Cost**: The total Normal Cost less the Member Contributions.

8. **Entry Age Normal Actuarial Cost Method:** A funding method that calculates the Normal Cost as a level percentage of pay over the working lifetime of the plan's members.
9. **Experience Study**: An actuarial investigation of demographic and economic experiences of the system during the period studied. The investigation is made for the purpose of updating the actuarial assumptions used in valuing the actuarial liabilities.
10. **Funding Value of Assets**: The value of current plan assets recognized for valuation purposes. Generally based on a phased-in recognition of all or a portion of market related investment return. Sometimes referred to as Actuarial Value of Assets.
11. **Market Value of Assets**: The fair market value of plan assets as reported in the plan's audited financial statements.
12. **Normal Cost (NC):** The annual cost assigned, under the actuarial funding method, to current and subsequent plan years. Sometimes referred to as the "current service cost". Any payment toward the unfunded actuarial accrued liability is not part of the normal cost.
13. **Unfunded Actuarial Accrued Liability (UAAL):** The positive difference, if any, between the actuarial accrued liability and valuation assets. Sometimes referred to as "unfunded accrued liability".

Appendix

1. Section 20(h) of Act 314 [MCL 38.1140h(4)]
2. Section 20(m) of Act 314 [MCL 38.1140m]