SAMPLE-TEMPLATE PENSION FUNDING POLICY STATEMENT FOR
The Pension Plan for Employees of the City of ABC, Florida
Adopted by the Retirement Board January 19, 2023

INTRODUCTION

The Pension Board (Board) for the Employee Pension Plan (Plan) of the City of ABC, Florida (Plan) has adopted this Funding Policy Statement to set forth policies, methods and procedures relating to the funding of the Plan. The City of ABC (City) is the Plan Sponsor. The Board recognizes its fiduciary duty to set prudent funding policies and actuarial assumptions that promote benefit security and other funding objectives. This Funding Policy Statement constitutes the Board's express intentions that the benefit obligations of the Plan be advance-funded in a systematic manner on a sound actuarial basis.

This Funding Policy Statement provides guidance to the Board and its Trustees, and to the Plan's retained Actuary (defined herein) in the discharge of their respective duties to the Plan. This Funding Policy Statement was developed with input from representatives of the City, as the City is primarily responsible for providing the funding for the Plan.

LEGAL COMPLIANCE

It is the Board's policy that the Plan and all funding-related calculations comply with applicable federal, state and local statutes and ordinances, including but not limited to, the Florida Protection of Public Employee Retirement Benefits Act contained in Chapter 112, Part VII of the Florida Statutes, and all administrative and regulatory requirements thereunder. Following are a few of the state statutes relevant to the duties of the Board and its Trustees with respect to funding (underlines added for emphasis):

§112.61, F.S. Legislative Intent (excerpts) –

- *"It is the intent of the Legislature in implementing the provisions of s. 14, Art. X of the State Constitution, relating to governmental retirement systems, that such retirement systems or plans be managed, administered, operated, and funded in such a manner as to <u>maximize the protection of public employee retirement benefits</u>."*
- *"Inherent in this intent is the recognition that the pension liabilities attributable to the benefits promised public employees be fairly, orderly, and <u>equitably funded by the current, as well as future, taxpayers</u>. Accordingly, except as herein provided, it is the intent of this act to <u>prohibit</u> the use of any procedure, methodology, or assumptions the effect of which is to <u>transfer to future taxpayers any portion of the costs which may reasonably have been expected to be paid by the current taxpayers.</u>"*

§112.656(1) –

- *"A fiduciary shall discharge his or her duties with respect to a plan <u>solely</u> in the interest of the participants and beneficiaries for the <u>exclusive purpose</u> of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan."*

§112.64(1) –

- *"Employee contributions shall be deposited in the retirement system or plan at least monthly. Employer contributions shall be deposited at least quarterly; . . ."*

ACTUARY'S RESPONSIBILITIES

On behalf of the Plan, the Board shall retain an independent "enrolled actuary" as defined by §112.625(3), F.S. (Actuary) for the determination of funding advice and calculations. The Actuary shall comply with the terms of this Funding Policy Statement in all matters specifically addressed herein. The Actuary shall comply with all relevant federal, state and local statutes and ordinances including, but not limited to, the requirement to provide the following statutory certification in each annual actuarial valuation report: "*A statement by the enrolled actuary that the report is complete and accurate and that in his or her opinion the techniques and assumptions used are reasonable and meet the requirements and intent of this act.*" §112.63(1)(g), F.S.

In addition to the state-mandated certifications, all actuarial valuation reports and actuarial impact statements prepared by the Actuary shall include the following certification:

> "*I hereby certify that the funding-related calculations presented herein comply with the current version of the Board's Funding Policy Statement and with all applicable requirements of federal, state and local rules relating to funding and asset valuation and all applicable actuarial standards of practice.*"

For those aspects of actuarial funding calculations that are not specifically addressed herein, the Actuary may use professional judgment, but shall comply with the Actuarial Standards of Practice (ASOPs) published by the Actuarial Standards Board, including sufficient disclosure thereof in the Actuary's respective actuarial communications.

FUNDING OBJECTIVES

The following Funding Objectives have been considered in detail by the Board and its Trustees in their adoption of specific Funding Policy Statement Elements, below. The Board shall consider balancing the following Funding Objectives in the development or amendment of the Funding Policy Statement Elements.

1. *Actuarial Benefit Security*: Future contributions and current plan assets should be sufficient to provide for all benefits expected to be paid to members and their beneficiaries when due. To secure that objective on a sound actuarial basis requires building up and maintaining a reserve backing the benefit promise as described in the ASOPs and other actuarial literature.

2. *Inter-period Equity*: Seek a reasonable and equitable allocation of the cost of benefits and the required funding between current and future taxpayers.

3. *Volatility Control*: Seek to manage and control future required contribution volatility to the extent reasonably possible, consistent with other Funding Objectives.

4. *Accountability and Transparency*: Support general public policy goals of the City and the Board for transparency and accountability.

5. *Avoidance of Agency Risk*: Avoid undue influence from outside non-fiduciary concerns that may undermine other Funding Objectives and the financial stability of the Plan.

FUNDING POLICY STATEMENT ELEMENTS

A. Actuarial Cost Method

The "Actuarial Cost Method" allocates (i) the actuarial present value of future Plan benefits and expenses to (ii) time periods, usually in the form of a normal cost and amortization of an actuarial accrued liability.

The portion for the total normal cost (a) representing funding of expected benefits for active employees shall be developed as a level percent of pensionable compensation using the Actuarial Cost Method commonly known in actuarial literature as the traditional individual entry age actuarial cost method and (b) representing funding of expected administrative expenses shall be developed as a one-year term cost with the dollar amount equal to the actual administrative expenses charged to the fund for the year prior to the valuation date. The total normal cost shall not include investment-related expenses, which are considered as offsets (net) against the gross expected return assumption.

[Note to reader: Other Actuarial Cost Methods used in Florida include the aggregate cost method and the frozen entry age cost method.]

[The cost of the Plan's current gain-sharing benefit provisions shall be advance-funded by recognizing an assumed single equivalent annual cost-of-living rate of increase in each actuarial valuation of Plan costs and liabilities. Refer to the Actuarial Assumptions Procedures below for how (and how often) to determine the assumed single equivalent rate. The modelling of future gain-sharing benefits shall take into account all relevant plan provisions for determining the gain-sharing benefits, including trigger points, thresholds, hurdle rates, experience accounts and caps, gain-sharing benefit pools, eligibility conditions for receipt, etc. Such modelling shall also take into account all relevant statutory and regulatory requirements, including the threshold identified in Ch. 112.62, F.S. as applicable.]

The Actuarial Cost Method, coupled with the specifications outlined in this Funding Policy Statement, shall form the Contribution Allocation Procedure that is used to develop the Actuarially Determined Contribution[1] required to be funded by the City (and other sources).

The expected employee contributions, regardless of how determined, shall be applied first to the total normal cost due (leaving the employer normal cost).

[Note for closed plans: Upon the first actuarial funding valuation when there are no active members covered, the portion of the normal cost representing funding of benefits shall be zero, leaving only administrative expenses as the sole component of normal cost. Any unfunded actuarial liability shall be treated as described in Section C below on Amortization Policy.]

Actual employer contributions made to the Plan's Trust Assets[2] may exceed the otherwise required Actuarially Determined Contribution. Such excess contributions shall be held in a notional Credit Balance Account (with interest credits) as described in Section B below on *Actuarial Value of Assets*. *[Note to reader: Other treatments for excess contributions are available.]*

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[1] The terms "Contribution Allocation Procedure" and "Actuarially Determined Contribution" are defined in ASOP No. 4.

[2] The "Plan's Trust Assets" are defined by reference to the Internal Revenue Code of 1986, as amended, relating to tax-exempt pension trusts (including section 401(a) and other sections therein and related Treasury Regulations) and in Governmental Accounting Standards Board (GASB) Statements of Governmental Accounting Standards (Statements) Nos. 67 and 68.

Contributions required to be paid during a given contribution year ending September 30, shall be determined by the actuarial valuation as of the second previous October 1 (adjusted for timing lag), in order to give City management the lead-time necessary for budgeting for a given contribution year.

B. ***Actuarial Value of Assets***

Only assets legally held as the Plan's Trust Assets are included in the AVA and FVA. For the purpose of smoothing assets, the "plan fiduciary net position" at the beginning and end of years should be reduced by the value of the Credit Balance and the DROP and share plan assets to obtain the net FVA, since the resulting AVA is intended to fund the core plan benefits, not the Credit Balance and the DROP and share plan assets.

The Actuarial Value of Assets (AVA) employed in actuarial valuations shall incorporate a methodology designed to smooth out the year-to-year fluctuations in the Fair Value of the Plan's Trust Assets as follows:

1. Except for special treatments for Credit Balances, DROP assets, share plan assets described below, the term "Fair Value of the Plan's Trust Assets" (FVA), as used in this Funding Policy Statement, shall have the same meaning as the "plan fiduciary net position," as such term is used in the GASB Statements Nos. 67 and 68.
2. In each current year: calculate the investment earnings excess or shortfall in relation to the actuarial assumed or expected earnings:
   a. The dollar amount of *actual* realized and unrealized investment earnings (net of investment-related expenses and net of earnings credited to the Credit Balance, and to the DROP and share plan assets) for the year on the net FVA minus
   b. The dollar amount of *expected* net investment earnings based on: the beginning net FVA, the actual non-investment cash flow and the expected rate of net investment earnings (net return assumption) used in the last actuarial valuation.
3. Twenty percent (20%) of such current year's difference shall be recognized in the current year's AVA and another 20% recognized in each subsequent year until fully recognized.
4. Mathematically, as of a given valuation date, the smoothed value of assets is the FVA adjusted by the unrecognized portion of actuarial investment gains (or losses) from the previous four years (as described above).

[Note to reader: Other asset smoothing methods may be employed; however, ensure that they satisfy ASOP No. 44 and satisfy the state statutes which, in turn, require compliance with the prior federal rules.]

The smoothed value of assets as described above as of any current valuation date shall be subject to upper and lower limits of 120% and 80% of the net FVA, respectively. The smoothed value of assets, as limited to the corridor of 80% to 120% around the net FVA is the Actuarial Value of Assets (AVA).

[Note to reader: Other variations and treatments of the Credit Balance and the DROP and share plan assets with respect smoothing procedures may be available for incorporation herein; but be certain the procedures follow sound actuarial funding principles.]

Any employer contributions in excess of the otherwise required Actuarially Determined Contribution accumulated (with interest credits based in either the assumed or actual investment returns as long as consistently applied) for funding contribution stabilization purposes in a notional Credit Balance account.

By action of the Board, amounts from the Credit Balance may be released as of the end of any Plan year in order to either:

1. Satisfy a Plan year's otherwise required Actuarially Determined Contribution, or
2. Reduce the unfunded actuarial liability by more than the amount scheduled under the computation of that Plan year's otherwise required Actuarially Determined Contribution or increase the Plan's surplus in the event the AVA exceeds the actuarial liability.

C. Amortization Policy

The "Amortization Policy" establishes the time period and method for adjusting contributions to (i) fund unfunded actuarial accrued liabilities, and (ii) to recognize any actuarial surplus.

The unfunded actuarial liability shall be calculated as:

- The actuarial liability calculated pursuant to the Actuarial Cost Method, as described above, minus
- The final AVA, as described above.

[Note to reader: Other Actuarial Cost Methods used in Florida may require a different definition of the UAL.]

For actuarial balance, any excess of the actuarial accrued liability over the AVA shall equal the net-sum of all outstanding amortization bases.

The current amortization bases that exist at the initial effective date of this Funding Policy shall remain on schedule, as set forth in the actuarial valuation report or actuarial impact statement most recently prepared prior to the effective date of this Funding Policy, as to the period remaining to amortize and as to the pattern of amortization.

All new amortization bases created on or after the effective date shall be funded according to the following parameters:

- For actuarial asset or liability gains (or losses): Level dollar payments over 15 years.
- For changes in actuarial assumptions: Level dollar payments over 20 years for lowering net return assumptions and over 15 years for all other changes in actuarial assumptions.
- For benefit changes: Level dollar payments over 15 years, except (a) over 5 years for early retirement windows and (b) over 10 years for benefits affecting only retirees.
- For changes in actuarial methods, software or asset smoothing methods: Level dollar payments over 15 years.

[Note to reader: Amortization periods can vary based on a balancing of the Funding Objectives; however, amortization periods longer than 20 years have been losing favor in the pension industry.]

If the valuation net return assumption changes in the future, then the outstanding balances of each then-existing amortization bases shall be re-amortized using the new net return assumption over the remaining periods under the same patterns.

As of any actuarial valuation date, upon the Actuary's recommendation and with the approval of the Board, some or all existing amortization bases (charges and credits) may be combined and have a single amortization payment. The Board may select a new amortization period for any such new single combined base, provided the period shall not exceed the payment-weighted average amortization period of each amortization base prior to the combination.

Actual contributions applied toward each amortization base shall be determined as follows: The total employer contribution in excess of the employer normal cost shall be allocated first to those outstanding amortization bases that are scheduled to expire during the contribution year. The residual excess shall be applied to each remaining outstanding amortization base scheduled to be paid off in future years in the same proportion that the total of such residual excess bears to the total expected amortization payments towards the remaining bases for such year; interest adjustments at the appropriate net return assumption shall be charged and credited to these components as necessary.

In the event that, as of any annual actuarial valuation date, the unfunded actuarial liability is zero or less (i.e., the AVA equals or exceeds the actuarial liability), no new amortization base is created and all previously existing amortization bases shall be set to zero.

The Actuarially Determined Contribution required from the City shall not be less than the total employer normal cost (for benefits and administrative expenses), as required by state statutes, *§*112.66(13), F.S.

D. <u>Actuarial Assumption Procedures</u>

The Board's express intention is to select unbiased assumptions and to adopt a disciplined process in order to fully satisfy Funding Objective #4 (*Accountability and Transparency*) and Objective #5 (*Avoid Agency Risk*), while retaining a degree of flexibility to the Board.

The mortality assumptions shall be based on a selection of mortality tables that complies with the parameters of *§*112.63(1)(f), F.S., with preference to the most recent mortality tables specified.

For other demographic actuarial assumptions, an actuarial experience study shall be performed no less frequently than every fifth year for the purpose of validating or updating other primary demographic actuarial assumptions. Such studies shall rely on actuarially credible historical experience of the plan using accepted actuarial techniques in compliance with actuarial standards of practice, with consideration of the effect of future emerging experience expected in the context of each such demographic assumption. Individual salary scale assumptions, as needed, shall be developed as part of the experience studies, using both historical and forward-looking considerations as above.

Economic actuarial assumptions, such as general inflation and net investment return, shall be forward-looking based on research and input from several authoritative forecasters. The horizon for such inflation and net return forecasts shall reflect a mid-term horizon and a long-term horizon consistent with the duration or expected benefit cash flow stream. The economic assumptions (including general inflation, net return, payroll growth, gain-sharing single equivalent rate, etc.) shall be reviewed in detail no less frequently than every third year, unless circumstances or forecasts suggest more frequent attention.

Regardless of the timetable for scheduled reviews of demographic or economic assumptions, every actuarial measurement of costs and liabilities should be based on assumptions that are reasonable and defensible for the purpose at hand.

Recommendations from the Plan's Actuary and/or Investment Consultant for a *general inflation assumption* to be used for actuarial funding valuations shall be based on research and input for forward-looking forecasts from several sources of authoritative economists (selected in an unbiased manner).

In order to ensure disciplined and unbiased assumption-setting procedures and to satisfy Funding Objectives 4 (*Accountability and Transparency*) and #5 (*Avoid Agency Risk*), the Board's selection of the valuation's net return assumption and the Actuary's recommendations and assessment of the reasonableness of the valuation's net return assumption shall be developed with recognition of:

- The mapping of the Plan's asset allocation targets to the surveyed investment firms' capital market assumption sets;
- The surveyed inflation expectations and expected investment-related expenses;
- The consensus average of the median (50^{th} percentile) expected compound returns over mid-term and long-term horizons derived from each capital market assumption set;
- The single equivalent rate between the mid-term and long-term consensus averages, based on the Plan's expected benefits and administrative expenses cash flow;
- A three-year average of prior single equivalent rates; and
- A reasonable range around the three-year average single equivalent rate.

All actuarial assumptions shall comply with the ASOPs.

Regardless of the timetable for scheduled reviews of economic and demographic assumptions, every actuarial measurement of costs and liabilities should be based on assumptions that are reasonable and defensible for the purpose at hand as of each annual valuation date.

The Actuary shall present the research and development of recommendations to the Board for the Board's selection of the actuarial valuation assumptions for future inflation and net investment return.

When adopting actuarial assumptions, the Actuary and Board should avoid undue influence from non-fiduciary concerns that may undermine other Funding Objectives and the financial stability of the Plan.

E. Enterprise Risk Management Process

The Board shall give due consideration to recommendations from the Actuary pursuant to guidance contained in the Actuarial Standard of Practice No. 51 ("*Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions*")**.**

The Board recognizes that future investment performance of the Plan's Trust Assets will vary from year to year, sometimes by narrow and wide margins, in spite of an actuarial assumption for annual actuarial valuations that the Plan's Trust Assets will earn a fixed rate of rate of return each and every year over the mid-term and long-term horizons.

This emerging variation in returns over time creates volatility in the two primary risk metrics:

1. The projected Actuarially Determined Contribution requirements over near-term, mid-term and long-term time horizons and

2. The Plan's projected funded status over near-term, mid-term and long-term time horizons, as measured in terms of either or all of (a) the unfunded actuarial liability for funding purposes, (b) the net pension liability for accounting purposes or (c) funded ratios for either funding or accounting purposes.

The amount of volatility risk inherent in the Plan's investment policy determines the vast majority of volatility expected in these two relevant risk metrics of pension funding.

The Board desires its Actuary to provide technical analyses and policy advice concerning the level of volatility in these two risk metrics.

The risk assessment process described below shall be undertaken no less frequently than once every five years. The frequency depends on (a) market conditions, (b) changes in mainstream expectations of professional forecasters of future inflation and future investment returns and (c) the Board's consideration of changes in the Plan's asset allocations to different asset classes and the implementation thereof.

Since the Plan Sponsor bears the investment risk for the Plan, the risk assessment process shall be conducted with appropriate participation by Plan Sponsor representative(s) from Human Resources and Finance. But the policies and procedures in this Funding Policy Statement are adopted for the Plan by the Board.

More risk in the portfolio generally means more volatility (i.e., less predictability) in the net returns and in these risk metrics of pension funding. However, more risk in the portfolio also generally means higher future net returns over time and lower Actuarially Determined Contributions over time. There is also a price to pay for taking more risk: the contributions are less predictable.

There is usually a long-term reward for taking more risk; but the downside is that the two risk metrics are more unpredictable and more volatile. Less risk in the portfolio generally means less volatility (i.e., more predictability) in the net returns and in these risk metrics of pension funding. However, less risk in the portfolio also generally means lower future net returns over time and higher expected Actuarially Determined Contributions over time. There is a price to pay for taking less risk: the returns are lower and the contributions are higher but more predictable.

In adopting an investment policy and actuarial assumptions, the Board strikes a balance between risk/reward trade-offs: (a) more risk and more reward and (b) less risk and less reward.

This is the Enterprise Risk Management Process:

Board members shall examine actuarial projections of these two risk metrics of pension funding so as to be more informed about the risk/reward trade-offs for the pension enterprise that are inherent in their decisions concerning the asset allocation (or risk profile) of the fund's portfolio and the net returns expected in the future.

Actuarial projections of these risk metrics presented to the Board for the near-term and longer-term horizons will illustrate the effects of alternate versions of the Plan's future net returns, as expected by the asset allocation using some or all of these methodologies:

- *A baseline future:* Graph the future risk metrics assuming the net return assumption is actually realized each year on the FVA of the fund;
- *Sensitivity testing*: Graph the future risk metrics assuming the current or recommended net return assumption and alternate actual net returns;
- *Stress testing:* Graph the future risk metrics assuming the same as the baseline future, above, but model the effects over time of one or more consecutive years of a relatively large market value loss in Plan assets; and/or
- *Stochastic simulations:* Use stochastic modelling techniques with generally accepted actuarial/finance distribution formulas to simulate and graph the effect of future net investment returns and the resultant risk metrics. .

When setting the Plan's asset allocation, the Board shall weigh the risk/reward trade-offs between (a) more risk/volatility with lower contributions and higher funded status and (b) less risk/volatility with higher contributions and lower funded status, as they relate to these two risk metrics.

ADOPTION AND AMENDMENT OF THE FUNDING POLICY STATEMENT

The Funding Policy Statement shall be adopted by formal action of the Board, voting under established procedures for other Board actions.

Unless deliberately and formally amended, this Funding Policy Statement shall be followed without exception, by the Board members and the retained Actuary.

The Board may amend this Funding Policy Statement (a) for good and sufficient reason and (b) with evidence of improvement over the existing Funding Policy Statement, based on an appropriate balance among the Funding Objectives described above. Amendment of the Funding Policy Statement shall be by formal action of the Board, voting under established procedures for any other Board action.

CERTIFICATION OF ADOPTION

The undersigned hereby certifies that the Board adopted this Funding Policy at its publicly-held meeting on January 19, 2023.

By: ______________________________ ________________

XXXXXXXXXX, Board Chair Date