

REGIONAL WATER AUTHORITY POLICIES AND PROCEDURES MANUAL

Policy Type : Fiscal Management
Policy Title : Defined Benefit Pension Plan Funding Policy
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DEFINED BENEFIT PENSION PLAN FUNDING POLICY

RWA provides defined pension benefits for plan participants that meet the vesting criteria as established by CalPERS and the California Public Employee's Pension Reform Act (PEPRA)¹. The fundamental financial objective of an employee defined benefit pension plan policy is to fund the long-term costs of benefits promised to the plan participants. In a defined benefit plan, an employer has promised a benefit and must make contributions to the plan in order to meet the promised benefit². In order to assure the pension benefits will remain sustainable, RWA should accumulate adequate resources for future benefit payments in a systematic and disciplined manner during the active service life of the benefitting employees. The objective of Policy 500.15 is to accelerate additional payments towards the unfunded pension liability over a period of four years so as to achieve a 100% funded ratio³

The funding policy should follow these general policy objectives:

- 1) Create a funding discipline to ensure legally obligated benefits can be paid
- 2) Use actuarially determined contributions to fund the plan
- 3) Maintain intergeneration equity by ensuring the membership at a given time pays the full cost of employee benefits earned as services are provided
- 4) Make pensions costs a consistent percentage of payroll
- 5) Require clear reporting to show how and when pension plans will be fully funded

¹ Any current or future changes to the pension laws will dictate available benefits to employees or retirees.

² The required contributions are typically variable in nature due to variable market performance and changing assumptions.

³ The funded ratio is defined as the accrued liability compared to the market value of assets as of the measurement date. If the market value of assets equal the accrued liability, then the funded ratio is 100%.

On an annual basis, CalPERS provides a valuation report incorporating the above objectives in determining the required annual funding contributions that are split into two components: the normal cost rate expressed as a percentage of payroll and the additional annual lump sum payment. The normal cost represents pension benefits earned during that year associated with active employees. The additional annual lump sum payment is designed to help pay down unfunded accrued liabilities (“unfunded liability”) of employers related to past employee service.⁴

As part of the annual budget process, RWA Executive Committee (“EC”) will determine what additional amounts should be contributed towards the pension plan above the annual required contribution as determined by CalPERS latest available valuation report. Staff will provide the most recent unfunded pension liability amount to the EC by January 1 for budgetary purposes. The budget will continue to be subject to full board approval on an annual basis.

RWA’s Miscellaneous Pension Plan 2% at 55

RWA participates in the pooled Miscellaneous Pension 2% at 55 plan through CalPERS. Since 2003, CalPERS has pooled or grouped employer plans with less than 100 employees. Therefore, RWA’s pension plan market value of assets is allocated to RWA based upon RWA’s share of actuarial accrued liability (“AAL”) in relation to the pooled plan. The AAL represents the calculated obligation for past service for current, transferred and retired employees as of the valuation year. The difference between the accrued liability and the market value of assets represents the unfunded liability and the amount RWA still needs to contribute to fund the AAL.

Currently CalPERS amortizes the remaining unfunded liability over a set number of years, typically 30 years⁵, with a ramp up phase for the first five years. Each annual valuation can create a new unfunded liability generated for that year’s variances that is reflected separately in the reporting, and is in addition to the previous years calculated liability⁶. In order to meet a 100 percent funded ratio, RWA needs to make additional contributions above and beyond the annual required pension payment. Considering that RWA membership is voluntary, pension costs for employee services should be adequately and timely funded by the RWA members as they receive these services to meet the goal of intergenerational equity. The unfunded liability represents pension costs associated with past service of employees that have been received by RWA members and these past services have

⁴ This lump sum payment is not tied to a percentage of payroll. Starting with the June 30, 2013 valuation report, CalPERS added the lump sum payment as a way to pay down the growing unfunded liability resulting from changes due to PEPRRA, assumption changes, and asset market performance.

⁵ “Fresh start” unfunded liabilities can have shorter amortization periods. Fresh starts can occur when CalPERS make significant assumption changes or when additional large payments are made by the employer over and above the required contributions.

⁶ Each year’s calculation of the additional unfunded liability is separately listed to arrive at a cumulative total unfunded liability. See page 12 of the June 30, 2015 Annual Valuation Report.

contributed to the current influence and success of RWA as a regional water advocate.

Funding Limits

CalPERS' current funding limit allows employers to fund up to the present value of projected benefits. The present value of projected benefits is the total dollars needed as of the valuation date to fund all benefits **earned in the past or expected to be earned in the future** for current members (active, separated or retired employees). Alternatively, the actuarially accrued liability represents the total dollars needed as of the valuation date to fund all benefits **earned through the valuation date for current** members (active, separated, or retired employees). RWA's objective is to fund 100% of the actuarially accrued liability.

Accounting Policy versus Funding Policy

Accounting for pension contributions and liabilities using Governmental Accounting Standards Board Statement ("GASB") No. 68 *Accounting and Financial Reporting for Pensions-An Amendment to GASB Statement No. 27* ("GASB 68") is independent and different than this funding policy⁷. GASB 68 has explicit rules on how to calculate the liability of the pension plan. It uses shorter time frames (up to five years) to amortize differences caused by market performance and actuarial assumptions. Additionally, the GASB 68 calculated liability can be up to two years lag from the valuation date⁸.

Funding Strategy

Annually, RWA receives an estimate of its unfunded actuarially accrued liability (UAAL) from CalPERS. This information will be communicated to the EC by January 1. Each year, RWA will develop a budget for the upcoming fiscal year and three or more additional years that provides for paying the full amount of the UAAL over the course of no more than four years based upon the lasted available CalPERS report at January 1 when the budget is being prepared.⁹ These payments are in addition to the ongoing normal cost and lump sum payment funding requirements of the plan.

⁷ From time to time, GASB revisits and modifies existing GASB policies, including GASB 68. For example GASB No. 82, *Pension Issues*, clarifies some application of GASB 68. Current GASB accounting policy is separate from the funding requirements. Funding requirements are established by the pension plan documents. Funding policy is established by the RWA Board.

⁸ For example, for the June 30, 2016 financial statements, the calculated GASB 68 liability was based upon the June 30, 2014 CalPERS valuation report with some roll forward procedures applied.

⁹ The budget process typically begins in January of the fiscal year and adopted by May in preparation of the following fiscal year. To the extent a more current annual valuation report becomes available prior to budget adoption, this new information may or may not be incorporated into the budget, depending upon the timing of the new data compared to the timing of EC meetings and board approval of the budget.