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DETERMINATION OF A DISCOUNT RATE

GASB STATEMENT NO. 68

EMPLOYER EDUCATIONAL VIDEO SERIES

KOREN HOLDEN, PROJECT MANAGER

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Discount Rate—
According to GASB

» Discount Rate for single and cost-sharing multiple employer plans

- Specific meaning under GASB Statement Nos. 67 & 68
- Is determined at the plan level
- Along with all other assumptions used by the plan, is required to be used by all employers of the plan

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Discount Rate—According to GASB

- The Discount Rate should be the single rate that reflects:
  - The long-term expected rate of return on pension plan investments that are expected to be used to finance the payment of benefits, to the extent that
    - The pension plan's fiduciary net position is projected to be sufficient to make projected benefit payments and
    - Pension plan assets are expected to be invested using a strategy to achieve that return, and
  - A yield or index rate for 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher, to the extent that the above conditions are not met

Determining the Discount Rate—What is the "Crossover Test?"

- Must perform a test to determine a crossover date, if any
- Projections of the pension plan's fiduciary net position are compared to the plan's projected benefit flows in each period (year) to determine if
  - Projected plan fiduciary net position is sufficient to pay projected benefit payments of the current membership, or
  - There is a point of crossover from projected plan fiduciary net position
    - Sufficient to cover projected benefit payments in each period --- to
    - Not sufficient to cover remaining projected benefit payments
- Crossover date does not necessarily mean that the plan runs out of money

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Determining the Discount Rate—
What Does the "Crossover Test" Tell Us?

- » If the plan fiduciary net position is projected to be sufficient for all future periods (and pension plan assets are expected to be invested using a strategy to achieve the long-term rate of return)
  - The long-term expected rate of return on investments can be used as the GASB Discount Rate
- » If the plan fiduciary net position is projected to be insufficient considering all future periods (a crossover date occurs)
  - A blended, single discount rate is calculated considering both
    - » The long-term expected rate of return and
    - » A 20-year municipal bond index rate

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Determining the Discount Rate—
Performing the "Crossover Test"

- Projected contributions
  - Should incorporate employee and employer contributions for
    - Current active employees
    - Future employees when total contributions are projected to exceed service costs for those employees
  - Should not include contributions
    - Intended to finance the service costs of future employees

Determining the Discount Rate— Performing the "Crossover Test"

- » Project benefit payments for all current active and inactive members and retirees
  - Including projected salary increases, service credit, automatic COLAs, and substantively ad-hoc COLAs, and
  - Considering any known benefit changes as of the measurement date
- » Project administrative expenses
- » Project the plan's fiduciary net position, including
  - projected contributions
  - projected benefit payments and
  - administrative expenses
- » Compare projected plan fiduciary net position to projected benefit payments
  - Determine "crossover date", if applicable

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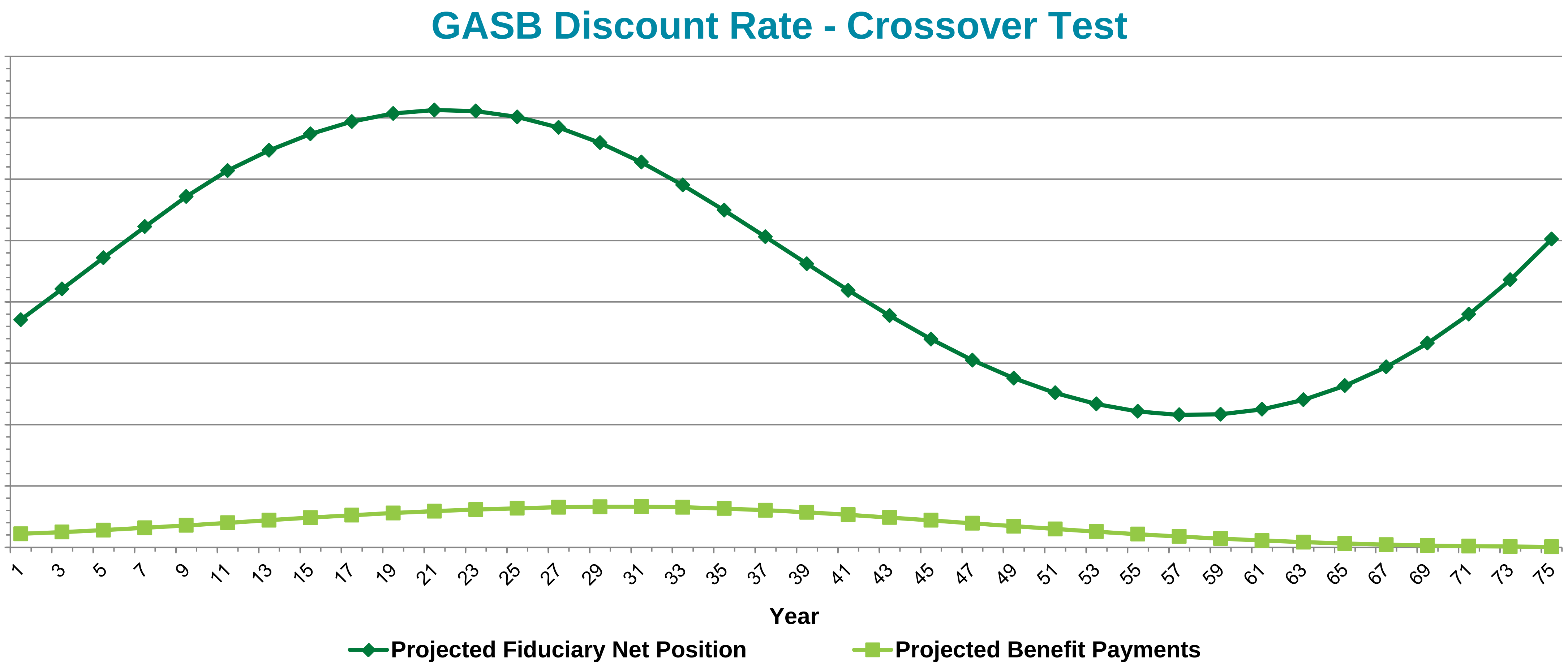
Determining the Discount Rate—
Illustrating the "Crossover Test"

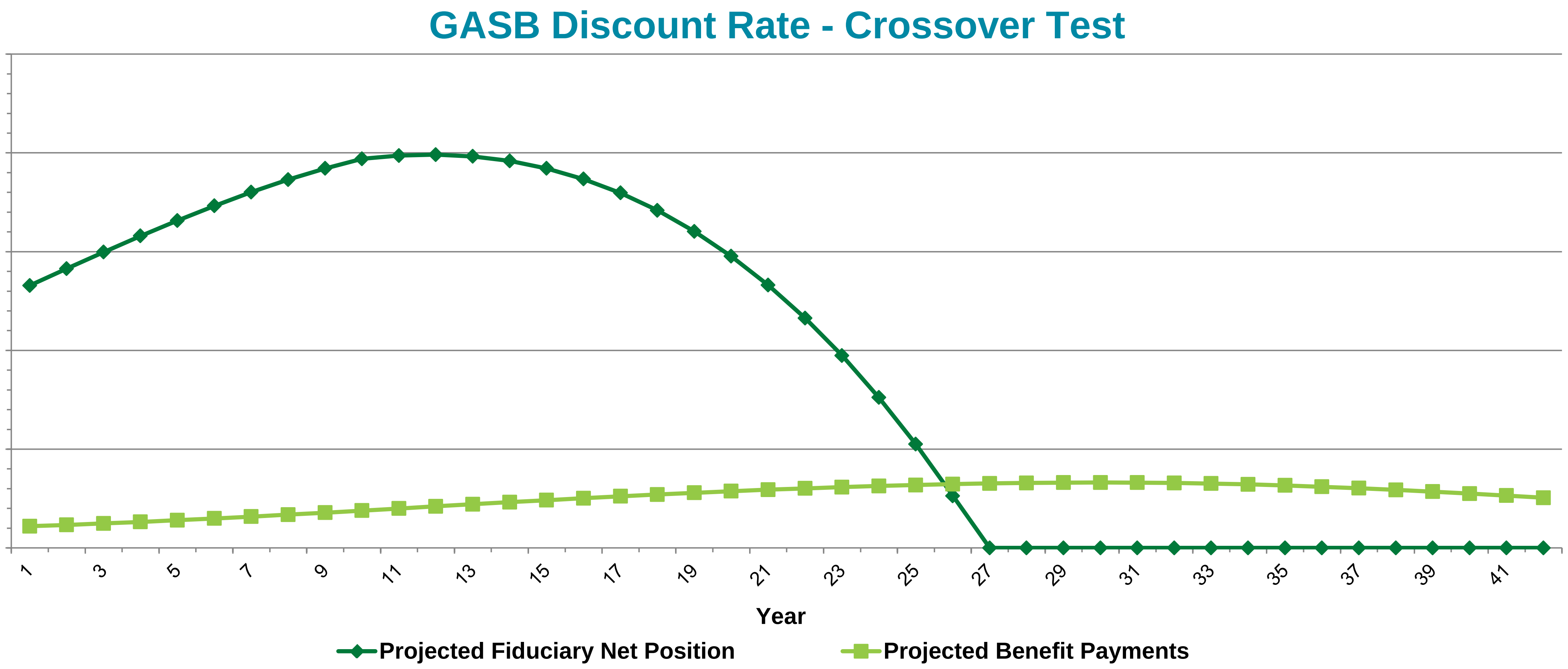


Note: This line graph depicts a hypothetical example and not any fund at Colorado PERA.

Determining the Discount Rate—
If Projected Net Position is Sufficient

- Determine if the amount of the plan's fiduciary net position is projected to be sufficient to pay benefit payments estimated to be made in each future period
  - If the plan's net position is projected to be sufficient to pay all projected benefits and pension plan assets up to that point are expected to be invested using a strategy to achieve the long-term rate of return
    - Process stops and long-term expected rate of return is determined to be the discount rate

Determining the Discount Rate—
Illustrating the "Crossover Test"



Note: This line graph depicts Illustration 1, of the *Guide to Implementation of GASB Statement 68* and not any fund at Colorado PERA.

Determining the Discount Rate—
If Projected Net Position is Insufficient

- Determine if the amount of the plan's fiduciary net position is projected to be sufficient to pay benefit payments estimated to be made in each future period
  - If the plan's net position is projected to be <u>insufficient</u> to pay all projected benefits
    - Determine "funded" and "unfunded" portions of projected benefit payments
      - Discount "funded" benefit payments at long-term expected rate of return
      - Discount "unfunded" portion at 20-year municipal bond rate
    - Solve for blended discount rate for which the total present value equals the sum of the present values related to the "funded" and "unfunded" portions of projected benefits

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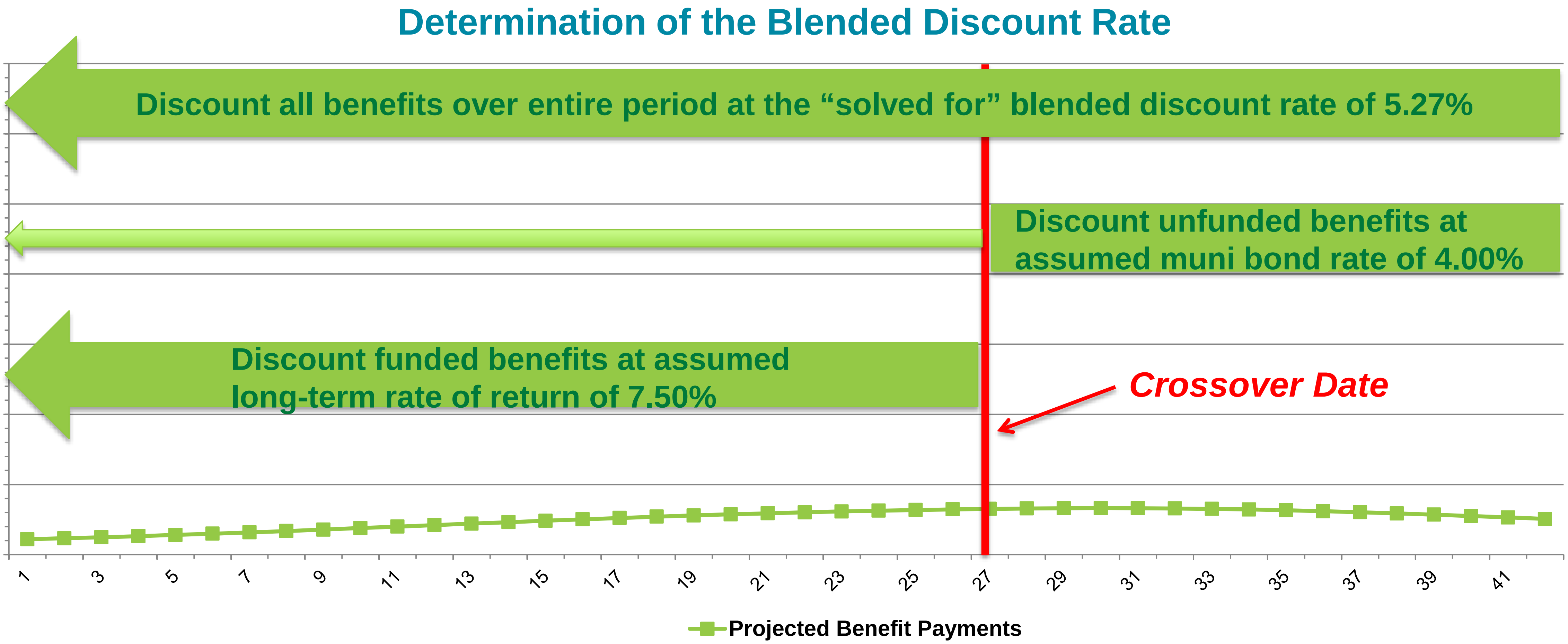
Determining the Discount Rate—
Illustrating the Blended Rate Calculation



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Additional Information

- Paragraphs 38-39, 40-42, and 44-45, in GASB Statement No. 67
- Paragraphs 61-62, 64-66, and 68-69, regarding Cost-Sharing Employers in GASB Statement No. 68
- Implementation Guide: Illustration 1, Calculation of the discount rate
- Colorado PERA's **GASB Reporting Standards** web page
- Please feel free to email Colorado PERA's GASB Work Group at **GASBMail@copera.org**

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