



# DEFINED BENEFIT OPEB PLAN FUNDING POLICY

LAST AMENDED JANUARY 19, 2024



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# I. INTRODUCTION

The Colorado Public Employees' Retirement Association (PERA) maintains two pre-funded defined benefit retiree health care subsidy plans [i.e., Health Care Trust Fund and Denver Public Schools (DPS) Health Care Trust Fund], classified as other postemployment benefit (OPEB) plans. The primary benefit provided by both OPEB plans is an insurance premium subsidy to eligible PERA retirees and benefit recipients enrolled in PERACare. Each defined benefit OPEB plan is funded through PERA-affiliated employer contributions, a portion of purchased service contributions transferred at the time of retirement, and the investment earnings resulting from those contributions. The fixed contribution rate at which each division's employers contribute is determined by the Colorado General Assembly and defined within the statutes governing PERA.

The purposes of this funding policy are to state the overall funding goals and annual actuarial metrics and to guide the PERA Board of Trustees (Board) when considering whether to pursue or support proposed contribution and benefit legislation. The policy also includes a brief list of governance responsibilities regarding the commissioning, collection, and review of actuarial information, as described in the Board's *Governance Manual*.

PERA also maintains five pre-funded, hybrid defined benefit pension plans (i.e., State Division Trust Fund, School Division Trust Fund, Local Government Division Trust Fund, Judicial Division Trust Fund, and DPS Division Trust Fund). On March 20, 2015, the Board approved a separate pension funding policy with regard to these plans.

It is the intention of the Board that this funding policy be considered a working document, reviewed periodically and, as necessary, altered in the future through formal action of the Board. The final page of this document contains the review and revision/adoption history pertaining to the funding policy of the PERA defined benefit OPEB plans.

# II. BACKGROUND

In response to the unfavorable investment market of 2008, and in addition to the funding policy adopted in November 2007, the Board set the following guiding principles in 2009 in the development of a comprehensive package to maintain long-term sustainability of the pension plans:

- » Shared responsibility among members, retirees, and employers;
- » Intergenerational equity;
- » Preservation of the defined benefit plan;
- » Preservation of portability through the maintenance of existing benefit structures for the different divisions; and
- » Development of recommendations that would have little-to-no short-term impact on member behavior.

The combined funding policy regarding PERA's pension and OPEB plans, adopted by the Board in November 2007, was in force with regard to the OPEB plans through December 30, 2017. On January 19, 2018, the Board approved a separate OPEB funding policy with regard to these plans, which reflects the guiding principles listed above, as applicable. This OPEB funding policy is effective with the December 31, 2017, actuarial valuation, recognizes the adoption and implementation of the Governmental Accounting Standards Board (GASB) Statement No. 74, applicable to OPEB, and has been adopted and updated as indicated on the last page of the document.

This document is revised as of January 19, 2024, with the purpose of updating PERA law references and incorporating any necessary clean-up language.

# III. FUNDING GOALS

- » Preservation of the **defined benefit plan structure** of providing retirement health care premium subsidies and other benefits, as applicable to PERA retirees and benefit recipients.
- » Demonstration of **transparency and accountability** through the continued maintenance of a defined benefit OPEB plan funding policy for the stakeholders of PERA.
- » **Achievement of a combined OPEB plan actuarial funded ratio greater than or equal to 110%.** Once the 110% combined funded ratio is achieved, the Board will consider and/or support the following actions, as ordered, as long as the funded ratio, either combined or individual by fund, does not fall below 100% after consideration of the proposed change:
  - Examination and possible action of de-risking the OPEB plans, in parallel with the pension plans
  - Reduction in the portion of the base contribution rate(s), designated for funding the OPEB plans
  - Adoption of a benefit enhancement.

If the 110% combined funded ratio benchmark is attained through the assistance of certain funding arrangements where assets, outside of statutory contributions, are added to the plans, and results in additional tax-payer obligation, the payment method and duration of this debt should be considered prior to any supportive action taken regarding benefit enhancements.

- » Dedication to the balance between:
  - **Contribution rate stability**—keeping contributions relatively stable over time, and
  - **Intergenerational equity**—allocating costs over the employees’ period of active service.
- » Dedication to the systematic **reduction of the unfunded actuarial accrued liabilities** (UAAL).
- » Recognition that within a multiple-employer cost-sharing defined benefit plan, such as the PERA HCTF, there are **beneficial elements of pooled risk**, both in the accrual of plan liabilities, recognizing actuarial gains and loss for the fund in total, rather than by each employer; and in

the accumulation of plan assets through the engagement of an appropriate level of asset risk management.

# IV. ANNUAL ACTUARIAL METRICS

Below is a list of actuarial metrics to be assessed on an **annual basis as of the actuarial valuation date**. The Board recognizes that a single year’s results may not be indicative of long-term trends and projected results.

- » **Funded ratios**—Calculate and review by fund:
  - The actuarial funded ratio based on the actuarial value of plan assets divided by the defined benefit OPEB plan’s actuarial accrued liability (AAL), and
  - The market value funded ratio based on the market value of plan assets divided by the defined benefit OPEB plan’s AAL.
- » **Funding period**—To be determined for each fund with respect to the applicable contribution rates. A funding period is the amortization period required to pay off that fund’s UAAL considering the resources available. Funding periods for each fund will be determined in the annual actuarial valuation in relationship to both:
  - Statutory contribution rates, and
  - Actuarially determined contribution (ADC) rates.
- » **Contribution rate comparison**—
  - Calculate and review by fund.
- » **Actuarial Projections**—
  - Perform and review, by fund,
    - › Actuarial projections considering appropriate benefit provisions, salary and demographic data, actuarial assumptions, membership growth, and statutory contribution rates in order to determine the sustainability of each fund under their benefit provisions and statutory contribution rate structure.
    - › Projection modeling that allows for the testing of projection results under various economic and demographic stress conditions.

# V. FUNDING VALUATION ELEMENTS

Annually, the Board's actuary will perform an actuarial valuation for funding purposes, and calculate ADC rates against which to compare contribution rates mandated under State statute. The ADC will be the sum of a payment based on normal cost and a payment on the UAAL. The normal cost and the amount of payment on the UAAL are determined by the following three major components of a funding valuation:

- » **Actuarial Cost Method:** This component determines the attribution method upon which the cost/liability of the retirement benefits are allocated to a given period, defining the normal cost or annual accrual rate associated with the projected benefits.
  - The Entry Age Normal Cost Method (EAN), as is used for PERA's annual actuarial valuation purposes, is to be used for the determination of the normal cost rate and the actuarial accrued liability for purposes of calculating the ADC.
  - Under this method, normal cost is calculated using benefits based on projected service and salary at retirement and is allocated over an individual's career as a level percent of payroll. Because EAN normal cost rates are level for each participant, the normal cost pattern for the entire plan under EAN is more stable in the face of demographic shifts in the workforce. It is this normal cost stability that makes the EAN method the preferred funding method for the majority of public defined benefit pension plans.
- » **Asset Valuation Method:** This component dictates the method by which the asset value, used in the determination of the UAAL, is determined, which could be a market value or a smoothed actuarial value of trust assets.
  - Because investment markets are volatile and defined benefit OPEB plans typically have long investment horizons, application of an asset-smoothing technique can be an effective tool to manage contribution volatility and provide a more consistent measure of funding over time. Asset-smoothing methods reduce the effect of

short-term market volatility on contributions, while still tracking the overall movement of the market value of plan assets, by recognizing the effects of investment gains and losses over a period of years.

- The asset valuation method to be used shall be a four-year *smoothed* market value of assets. The difference between actual market value investment returns and the expected actuarial investment returns is recognized equally over a four-year period.
- » **Amortization Method:** This component prescribes, in terms of duration and pattern, the systematic manner in which the difference between the actuarial accrued liability and the actuarial value of assets is reduced.
  - Once established for any component of the UAAL, the amortization period for that component will be closed and will decrease by one year annually.
  - The amortization payment will be determined on a level percentage of pay basis.
  - The length of the amortization periods will be as follows:
    - › Existing UAAL on December 31, 2017–30 years.
    - › Any increase (or decrease) in the UAAL existing as of December 31, 2017–remaining period of the initial 30-year period from the date of the valuation.
      - Annual future actuarial experience gains and losses–30 years from the date of the valuation.
      - Future assumption changes–30 years from the date of the valuation.
    - › Future benefit enhancements/reductions–the number of years, as determined by the Board, to represent the anticipated duration of payment of the enhancement or, if a reduction, duration of the benefit to the plan. This determination will be based on the nature of the benefit change and the demographics of the membership group affected by the change, not to exceed 25 years from the date of the valuation.

- If any future annual actuarial valuation indicates a fund has a negative UAAL, the ADC shall be set equal to the Normal Cost until such time as the funded ratio equals or exceeds 120%. At that time, the ADC shall be equal to the Normal Cost less an amount equal to 15 year amortization of the portion of the negative UAAL above the 120% funded ratio.
- The target amortization period noted above regarding new UAAL will be applied for funding benchmark and RSI reporting purposes. Alternative ADCs will be determined by fund, by applying the layered amortization methodology as described above, using a 25-year closed period, a 20-year closed period, and a 15-year closed period, in lieu of the 30-year period, for amortization of new UAAL. These comparatives are to appear in the Annual Comprehensive Financial Report (ACFR) as a demonstration of the transparency and accountability funding goal delineated in Section III of this document.

In conjunction with the three major components discussed above, a number of actuarial assumptions are used to develop the annual actuarial metrics, as well as the ADC rates, and are described in detail in the annual actuarial valuation report. The actuarial assumptions are derived and proposed by the Board’s actuary and adopted by the PERA Board of Trustees in conformity with the *Actuarial Standards of Practice* issued by the Actuarial Standards Board. The assumptions represent the Board’s best estimate of anticipated experience under the benefit provisions of PERA and are intended to be long-term in nature. In the development of actuarial assumptions, the Board considers not only past experience but also trends, external economic forces, and future demographic and economic expectations.

- » **Actuarial Assumptions**—Actuarial assumptions are generally grouped into two major categories:
  - **Demographic assumptions**, which include rates of termination, retirement, disability, and mortality, and benefit utilization and coverage elections, etc., and
  - **Economic assumptions**, which include investment return, salary increase, payroll growth, inflation, and health care cost trend and morbidity, etc.

Actuarial assumptions do not impact the total cost of the plan (benefit payments and expenses), but rather the timing of prescribed contributions. To the extent that actuarial experience deviates from the assumptions, and actual contributions deviate from projected, experience gains and losses will occur. These gains (or losses) then serve to reduce (or increase) the projected future contributions necessary to achieve or sustain a certain actuarial standard. It is in this vein that the ADC rates may help indicate if the statutory contribution rates are adequate to meet the future cost requirements of the plan, although the ADC calculated in valuation results has limitations due to changing costs over time. Considering the extended period until the entire plan population has Medicare Part A coverage under the PERA Health Care Trust Fund, the results of the actuarial projections may provide a better indication of the adequacy of the statutorily prescribed OPEB contribution schedule.

## VI. GOVERNANCE POLICY/PROCESSES

As delineated in the **PERA Governance Manual**, below is a list of specific actuarial and/or funding-related studies, the frequency at which they should be commissioned/requested by the Board, and additional responsibilities relating to the studies:

- » **Actuarial Valuation** (perform annually)—The Board is responsible for reviewing PERA’s annual actuarial valuation report; and submitting a summary report to the Legislative Audit Committee and the Joint Budget Committee of the General Assembly, together with any recommendations concerning such liabilities that have accrued. In addition, the Board, in consultation with their retained actuary, will provide recommendations to the Colorado General Assembly regarding any necessary adjustments to the statutory employer contribution rates.
- » **Experience Analysis** (perform at least every five years, typically performed every four years)—The Board is responsible for ensuring that an experience analysis is performed as prescribed, for reviewing the results of that study, and for approving the actuarial assumptions and

methodologies to be used for all actuarial purposes relating to the defined benefit pension and OPEB plans.

- » **Actuarial Audit** (perform at least every five years, or the appointment of a new actuarial firm will satisfy requirement)—The Board is responsible for ensuring that an actuarial audit is performed as prescribed and for reviewing the results of that audit.
- » **Asset Liability Study** (perform at least every three to five years, or more frequently if necessary)—The Board is responsible for ensuring that a study of the relationship between the defined benefit trust assets and liabilities is performed as prescribed and for reviewing the results of that study.
- » Review of the **Defined Benefit Pension Plan Funding Policy and the Defined Benefit OPEB Plan Funding Policy** (perform every five years)—The Board is responsible for the periodic review of the funding policies applicable to the defined benefit pension and OPEB plans, as is deemed necessary.

## VII. GLOSSARY OF FUNDING POLICY TERMS

- » **Actuarial Accrued Liability (AAL):** The AAL is the value at a particular point in time of all past normal costs. This is the amount of assets the plan would have today if the current plan provisions, actuarial assumptions, and participant data had always been in effect, contributions equal to the normal cost had been made, and all actuarial assumptions had been met.
- » **Actuarial Cost Method:** The actuarial cost method allocates a portion of the total cost (present value of benefits) to each year of service, both past service and future service.
- » **Asset Values:**
  - **Actuarial Value of Assets (AVA):** The AVA is the market value of assets less the deferred investment gains or losses not yet recognized by the asset smoothing method.

- **Market Value of Assets (MVA):** The MVA is the fair value of assets of the plan as reported in the plan's audited financial statements.
- » **Entry Age Normal Actuarial Cost Method (EAN):** The EAN actuarial cost method is a funding method that calculates the normal cost as a level percentage of pay or level dollar amount over the working lifetime of the plan's members.
- » **Funded Ratio:** The funded ratio is the ratio of the plan assets to the plan's actuarial accrued liabilities.
  - **Actuarial Value Funded Ratio:** is the ratio of the AVA to the AAL.
  - **Market Value Funded Ratio:** is the ratio of the MVA to the AAL.
- » **Normal Cost:** The normal cost is the cost allocated under the actuarial cost method to each year of active member service.
- » **Present Value of Benefits (PVB) or total cost:** The PVB is the value at a particular point in time of all projected future benefit payments for current plan members.
- » **Surplus:** A surplus refers to the positive difference, if any, between the AVA and the AAL.
- » **Unfunded Actuarial Accrued Liability (UAAL):** The UAAL is the portion of the AAL that is not covered by the AVA as of the annual valuation date.
- » **Valuation Date:** The valuation date is the annual date upon which the trust assets and liabilities of the plan are valued and the annual actuarial valuation is performed. PERA's annual valuation date is December 31st.

Adopted: January 19, 2018

Amended: January 19, 2024