PERSI

Public Employee Retirement System of Idaho

FUNDING GUIDELINES

2022

Section III. Governance Matters Related to PERSI Plans, Programs and Services

21. Base Plan Funding Guidelines

The PERSI Board annually makes decisions related to the funding of the defined benefit plan ("Base Plan") benefits. Benefits for the Base Plan are set by the Idaho Legislature and outlined in law (Idaho Code, Title 59, Chapter 13). Funding to pay the benefits, including any cost of living adjustments ("COLAs"), is supported by the following three sources: a) earnings from the Base Plan investment portfolio, b) contributions from employers, including State and affiliated political subdivisions and other governmental entities, and c) contributions from employees as members of PERSI.

The purpose of these guidelines ("Guidelines") is to:

- outline the Board's significant funding responsibilities provided by law,
- identify the actuarial studies that inform the Board's funding decisions,
- define the Board's framework to assess Base Plan sustainability,
- delineate the competing priorities the Board balances and the principles it embraces in evaluating funding decisions and promoting Base Plan sustainability, and
- explain the process the Board undertakes to evaluate and make annual funding decisions.

These Guidelines provide a statement of intent and general approach to assist the Board in its decision-making. They are not intended to bind the Board to specific actions. Where appropriate, these Guidelines incorporate paraphrased excerpts of applicable PERSI law and administrative rules. These Guidelines supersede any prior funding guidelines adopted by the Board. Should any conflict between the provisions of these Guidelines and applicable law and administrative rules arise, the prevailing law and rules govern. For capitalized terms that are not defined within the body of the Guidelines, a glossary of capitalized terms is provided (Appendix C, Funding Policy Glossary of Terms).

Board Funding Responsibilities

The Board must carry out its responsibilities with respect to the Base Plan solely in the interest of the members and their beneficiaries, for the exclusive purpose of providing benefits to the members and beneficiaries, defraying reasonable expenses of administering the system, and in accordance with the provisions of the Idaho Code governing PERSI.[42]

By law, the Board must perform certain responsibilities to arrange for the cost of Base Plan benefits to be funded in an equitable and sustainable manner. The Board has also adopted and adheres to actuarial standards of practice and best practices in public pension fund management. Board funding responsibilities are either required by law or adhered to by

[42] Idaho Code § 59-1301, et seq.

practice. Some responsibilities are performed annually. Others are performed periodically as appropriate. The responsibilities, along with their source and timing, include the following:

- Periodically retain an independent external consulting actuary selected by the Board ("Board Actuary") and compel certain actuarial measurements and studies (Idaho Code § 59-1305(4)).
- Set and periodically update, as appropriate, the actuarial methods and assumptions used in measuring Base Plan liabilities (actuarial standards of practice).
- Annually establish the Normal Cost Rate and Amortization Payment Rate (Idaho Code § 59-1322(1)).
- Annually determine the Employer Contribution Rate (Idaho Code § 59-1322(1)).
- Annually certify to the state controller the necessary adjustments in the Employee Contribution Rate (Idaho Code §§ 59-1333;1334), which is based on a percentage of the Employer Contribution Rate.
- Annually determine the amount of any COLAs (Idaho Code § 59-1355).
- Annually determine whether, and in what proportion, if any, extraordinary gains will be allocated (Idaho Code § 59-1309).
- Periodically retain an independent external actuary to audit and confirm the actuarial funding results produced by the Board Actuary (best practice).
- Periodically review and update funding Guidelines (best practice).

Actuarial Studies Used by the Board

The Board routinely assesses the health and sustainability of the Base Plan and determines its funding needs by commissioning the following legally required and best practice actuarial studies:

- **Actuarial Valuation** – Performed annually by the Board Actuary, the Actuarial Valuation provides a measurement of the liabilities of the Base Plan and calculates the contributions required, the funded status, and the Amortization Period (Idaho Code § 59-1305(4)).
- **Experience Study** – Performed by the Board Actuary at least every four years, compares the actuarial assumptions in light of actual Base Plan experience. Recommends changes, as necessary, to the Board on the economic and demographic assumptions, and the actuarial tables used by PERSI (Idaho Code § 59-1305(4)).
- **Asset/Liability Study** – The Asset/Liability Study is performed by the Board Actuary, in consultation with the investment consultant selected by the Board ("Board Investment Consultant"), every three to five years to evaluate the risk and return requirements of the Base Plan investment portfolio in relation to the Base Plan's liabilities (best practice).
- **Actuarial Audit** – At least once every five years, the Board selects an independent actuary other than the Board Actuary to monitor the quality of actuarial services performed by the Board Actuary on behalf of PERSI. The audit reviews the Board's

current actuarial methods and assumptions for reasonableness, and audits and confirms the actuarial funding results produced by the Board Actuary (best practice).

- **Scenario Modeling** – Scenario Modeling is performed as needed by the Board Actuary to assess the impact associated with the Board's funding decisions. Scenario Modeling evaluates the effects of a specified set of circumstances and conduct simulations to ascertain overall risk in the long term. It allows the Board to assess both the impact of a hypothetical scenario and the rough likelihood of that scenario occurring as it considers its funding decisions (best practice).

Base Plan Sustainability Framework

The Base Plan is statutorily designed to address the risk of inadequate funding. If, in the most recent actuarial valuation, the Base Plan Amortization Period exceeds 25 years, the law[43] compels the Board to act so that the Amortization Period is within 25 years. For this reason, the Base Plan has a low risk of insolvency.

However, the Base Plan Funding Ratio continuously fluctuates. It is important to understand the relationship between the impact of a single proposed funding decision made by the Board and possible future outcomes. The Board considers the impact of any proposed funding decisions over a longer-term horizon using forward-looking Scenario Modeling for Base Plan sustainability developed by the Board Actuary. The framework considers the following elements in relation to any proposed funding decision:

- whether a proposed funding decision might result in the need to enact a future Contribution Rate increase,
- the time horizon over which the enactment of a future Contribution Rate increase may be needed, and
- the Board's tolerance for requiring enactment of a future Contribution Rate increase after adopting any proposed funding decision.

The framework assists the Board in exercising its discretion to determine whether the Base Plan is sustainably funded ("Sustainably Funded").

Board Priorities and Principles in Evaluating Funding Decisions

In considering any single funding decision, the Board balances the following competing priorities inherent in managing the Base Plan to maintain its sustainability.

- Align actuarial assumptions,
- Maintain predictable rates of contribution,
- Address the purchasing power of retiree benefits, and
- Consider the allocation of extraordinary gains.

[43] Idaho Code § 59-1322.

A description of the Board's principles relative to each of the competing priorities follows. The principles under each priority are listed in no particular order of importance.

A. Align Actuarial Assumptions

i. The membership population of the Base Plan has unique actuarial characteristics, patterns, and trends that will be taken into consideration by the Board when adjusting demographic actuarial assumptions.
ii. The Board will adopt actuarial assumptions that are within the actuarial range of reasonableness.
iii. To support the continued sustainability of the Base Plan, it is a principle of the Board to seek, over time, to adopt more conservative actuarial assumptions to gradually reduce market volatility risk and improve Contribution Rate stability.

B. Maintain Predictable Rates of Contribution

i. Contribution Rate increases will be considered only to accommodate significant change in circumstances where the Funding Ratio drops below the Contribution Rate Increase Trigger, as required by applicable law, or as may be needed to accommodate legislative change.
ii. Contribution Rate decreases will be considered only if the Base Plan is deemed to be Sustainably Funded under the proposed changes.
iii. Contribution Rate reductions for a set period of time may be used in circumstances where a Contribution Rate decrease is not appropriate.
iv. The Board also considers the frequency, timing, and amount of historical Contribution Rate adjustments, and any anticipated Contribution Rate adjustments.

C. Address the Purchasing Power of Retiree Benefits

i. Past Discretionary and/or Retro-COLA decisions will not set future expectations, nor be a measure by which the Board considers future Discretionary and/or Retro-COLAs.
ii. The actuarial characteristics of the Base Plan, coupled with an anticipated low-return market environment, will make it increasingly challenging to grant future discretionary COLAs.
iii. The Board considers Discretionary COLAs and/or Retro COLAs when the following conditions exist:
    1. The adjustment can be offset by investment returns in excess of the Board's actuarial assumptions,
    2. The Base Plan is deemed to be Sustainably Funded after incorporating COLAs under consideration.

D. Consider the Allocation of Extraordinary Gains ("Gainsharing")

i. A Gainsharing event will not be initiated by the Board unless at the close of the fiscal year there is an excess in the amount of the Base Plan's assets over the sum of the actuarial accrued liability plus an amount to absorb a One Standard Deviation market event without increasing Contribution Rates[44].

ii. The Board prefers Gainsharing as a mechanism to address actuarially determined periods of prolonged overfunding as opposed to potential long-term benefit enhancements enacted by the plan sponsor.

Board Process in Evaluating Funding Decisions

The Board evaluates and makes decisions on the following funding topics: actuarial assumptions, Contribution Rates, COLAs, and should conditions permit, Gainsharing.

A description of the Board's process for each topic follows:

A. Actuarial Assumptions (Actuarial Standards of Practice)

The Board evaluates actuarial assumptions at least every four years through an Experience Study. It receives recommendations from its Board Actuary on how actual Base Plan experience has differed from the actuarial assumptions previously established by the Board. The Board Actuary recommends, as necessary, changes to economic assumptions, including the long-term investment rate of return, price inflation, and wage inflation assumptions as well as changes to demographic assumptions including disability, retirement, and mortality assumptions. Should the Board determine that adjustment is warranted, the Board adopts the changes to be effective with a specific Actuarial Valuation or Actuarial Valuations.

B. Contribution Rates (Idaho Code § 59-1322)

The Board typically makes annual Contribution Rate decisions based on the Actuarial Valuation no later than its October meeting. It determines the Normal Cost Rate and the Amortization Payment Rate that make up the Contribution Rate and compare it to the current Contribution Rate. Then, the Board considers a range of options, including maintaining current Contribution Rates, deferring Contribution Rate adjustments, or making temporary or permanent adjustments. If the Board determines that an adjustment is warranted, the Contribution Rate becomes effective no later than January 1 of the second year following the year of the most recent Actuarial Valuation. The Contribution Rate remains effective until next determined by the Board.

The Board may establish a Grace Period, not to exceed one year, in connection with Contribution Rate adjustments only if it has already not done so more than once in the preceding four years.

C. COLAs (Idaho Code § 59-1355)

[44] Idaho Code § 59-1309(2).

The law provides for an adjustment based on the Consumer Price Index for All Urban Consumers (“CPI-U”) from the index month of the previous year (“Calculation Period”). If there is an increase in the CPI-U, all or a portion of this increase may result in a percentage increase to a PERSI retirement benefit. The Board must make annual COLA decisions no later than its December Board meeting. The Board’s decisions, subject to the provisions of Sections 3 and 4c(iii) of these Guidelines, address the following legally provided COLA benefits:

i. *Mandatory COLA.* The Board is required to award a COLA of one percent if the CPI-U, for the year, is at one percent (1%) or greater for any applicable year. If the CPI-U is less than one percent (1%), the statute provides for a mandatory COLA ranging from negative six percent (-6%) to one percent (1%) depending on the change in the CPI-U over the Calculation Period.
ii. *Discretionary COLA.* If the CPI-U is greater than one percent (1%), the Board is permitted to recommend a total COLA of the annual CPI-U that is greater than one percent (1%) but less than six percent (6%).
iii. *Retroactive-COLA (“Retro-COLA”).* A Retro-COLA exists when there is a lag between the cumulative historical CPI-U and the cumulative historical COLAs awarded. The Board may consider recommending a Retro-COLA to make up past differences for any previous year or years between the actual CPI-U for that year or years and the COLA awarded.

The Mandatory COLA is not subject to review by the Legislature. The Discretionary COLA and Retro-COLA recommendations must be sent to the Legislature prior to the start of the Legislative Session. If the Legislature takes no action within forty-five days to reject or amend the Board's COLA decision, it becomes effective March 1 of each year.

Not all retirees are eligible to receive the same amount of COLA; individual calculations are based on each retiree’s date of last contribution. Retirees in their first year of retirement receive a proration of the COLA awarded based on the number of months they have been retired. Retro-COLAs will be awarded based on the date of a retiree’s last contribution and in accordance with a first-in, first-out principle.