Investment Rate of Return Assumptions

One Assumption for the Funding Valuation

The Legislative Commission on Pensions and Retirement spends considerable time every few years to review proposals and hear testimony regarding changing the actuarial assumption that is used to predict investment rate of return on pension fund assets. This assumption is used by the actuaries in preparing the annual funding valuation for each pension plan.

The Commission and the Legislature must address this issue because this assumption is in the statutes and, therefore, can be changed only through legislation. Currently, Minnesota Statutes, section 356.215, which sets forth requirements for performing actuarial valuations, requires that the actuarial valuations of the statewide plans and St. Paul Teachers must assume an annual rate of return on investments of 7.5%.

Another Assumption for the GASB Valuation

Minnesota's pension funds use an assumed rate of return on investments for another purpose and set this rate themselves, without having to refer to the statutes or seek a change in the rate through legislation. This other rate of return assumption is used in preparing the pension plans' financial statements, which are governed by Governmental Accounting Standards Board (GASB) Statements Nos. 67 and 68. This other rate of return assumption, sometimes referred to as the GASB rate or the discount rate, is set in consultation with the plan's actuary and is based on the same criteria used to evaluate the rate of return assumption in section 356.215. Under the actuaries' standards of practice (ASOPs), specifically ASOP No. 27, the funds' actuaries are required to review the reasonableness of the investment assumption used for valuations each year.

To recap, the actuaries retained by the pension funds prepare two separate actuarial valuations each year for each plan: one is for funding purposes, called the actuarial valuation report, and is forward-looking; the other is for financial accounting purposes, called the GASB financial statements, and is backward looking. In preparing both reports, the actuary must use assumptions that comply with the actuarial standards of practice. In addition, the financial statements must comply with the GASB Statements Nos. 67 and 68. Financial statements are prepared as of the end of the fiscal year. Actuarial valuations are prepared as of the first day of the fiscal year.

A detailed explanation of GASB's requirements for pension financial statements appears in a brochure published by PERA in 2015, shortly after GASB introduced new pension accounting standards: Understanding Accounting and Reporting Requirements Brochure.pdf.

As noted in the PERA brochure, a pension plan's GASB financial statements have real world impact on the financial statements of all employers that participate in the plan. The plan must annually calculate and report to each employer that employer's proportionate share of pension liabilities. Not all governmental employers issue plan financial statements, but the employers that do so must include pension plan assets and liabilities in their financial statements.

In contrast to the financial statements, the purposes of the actuarial valuation for funding purposes is to determine the actuarially determined contribution (ADC) (i.e., an amount that, if contributed consistently and combined with investment earnings, would be sufficient to pay promised benefits in full over the long-term) and to measure the plan's funding progress. Other states adjust the employer and employee contribution rates when needed to satisfy the ADC.

The GASB rate of return assumption each plan must use in its GASB financial statements is not defined in Minnesota statutes, so the board of each fund has the discretion to set the rate or to delegate setting the rate to its executive director.

GASB Rate and the Process for Setting the Rate

LCPR staff polled each of the pension funds about the GASB rate of return assumption and how it is set, and received the following responses:

<u>Minnesota State Retirement System (MSRS)</u>

Historically, the MSRS board of directors has approved the GASB rate if it deviated from the investment rate of return assumption in statute. For the June 30, 2021, valuation, the board chose a 6.5% assumption for GASB purposes.

<u>Public Employees Retirement Association (PERA)</u>

PERA's June 30, 2021, GASB reporting was based on a 6.5% discount rate for all the PERA plans. PERA's staff has authority to set the rate. In practice, this has been done collaboratively between the executive director and PERA's CFO after considering input from the actuary.

In 2016 staff proposed that PERA's board of directors approve staff's recommended rate for June 30, 2016 (7.5%). After discussion, the board declined approving the rate and continued to leave authority for the decision to staff. The decision was not because of a dispute of the rate, but rather the board preferring staff make the decision.

<u>Teachers Retirement Association (TRA)</u>

For the FY 2021 GASB valuation, TRA used a rate of return assumption of 7.0%; for the FY 2020 (year ending June 30, 2020) GASB valuation, the rate of return assumption was 7.5%.

Similar to PERA, TRA staff works with the actuary to set the GASB return assumption. The TRA board of trustees is made aware of the rate that is chosen but has not ever been asked to approve the assumption.

TRA noted that the only guidance for setting the assumption for GASB reports is contained in GASB Statement 67, paragraph 38, which states:

> *Selection of assumptions*
> *38. Unless otherwise specified by this Statement, the selection of all assumptions used in determining the total pension liability should be made in conformity with Actuarial Standards of Practice issued by the Actuarial Standards Board.*

St. Paul Teachers Retirement Fund Association (SPTRFA)

SPTRFA's GASB reporting uses the same rate of return assumption as the valuation (including FY 21). In the event circumstances led SPTRFA staff to conclude that a different rate was necessary, staff would work with the plan's actuary, GRS, to make a recommendation to the SPTRFA board of trustees.

Prepared by: Susan Lenczewski, Executive Director, LCPR
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