McLean Citizens Association

MCA

The Voice of McLean for Over 100 Years

McLean Citizens Association Resolution
Amortization of ERFC's Unfunded Liabilities
February 02, 2022

Whereas, approximately 80% of Fairfax County Public Schools (FCPS) employees participate in three pension plans, each of which pays benefits for life: (i) the federal government's Social Security; (ii) the state-run Virginia Retirement System (VRS), plus (iii) the Education Employees' Supplementary Retirement System of Fairfax County (ERFC)[1]; and

Whereas, the MCA adopted a resolution on January 6, 2021, urging FCPS School Board members to identify ways for ERFC to become more financially sustainable, by hiring an independent new actuarial firm to perform a stress test and sensitivity analysis, similar to the annual VRS Stress Test and Sensitivity Analysis; and

Whereas, the purpose of this resolution is to suggest changes and commitments that will improve ERFC's financial sustainability; and

Whereas, ERFC's FY 2021 net investment return was 27%, which increased its reported GASB ratio of assets to liabilities (referred to as its Funded Ratio) from 73% as of June 30, 2020 to 88% as of June 30, 2021[2];

Whereas, ERFC's GASB Funded Ratio ranged from 73% to 77% during the years 2008 to 2020, and hasn't exceeded 90% since 2003[3]; and

Whereas, when pension plans pay extra cash contributions to reduce their unfunded liabilities over time, this is referred to as "amortization" of unfunded liabilities,[4] and choosing different amortization assumptions will affect both the speed with which the unfunded liabilities will be paid off and the required cash contributions each year[5]; and

Whereas, ERFC's unfunded legacy pension liabilities are being amortized over a closed 30 year period ending on June 30, 2040, except for unfunded liabilities resulting from benefit and/or

[1] The remaining 20% of FCPS employees participate in Social Security plus the Fairfax County Employees' Retirement System (FCERS), the costs of which were addressed in the MCA's November 4, 2020 resolution.

[2] ERFC FY 2021 Annual Comprehensive Financial Report (ACFR), p. 23-24, 33. The actuarial Funded Ratio would be lower than 88%, because actuarial guidelines "smooth" investment gains and losses over a 5-year period. As of December 30, 2020, for example, the Actuarial Funded Ratio was 76.6% and the GASB Funded Ratio was 82.1%.

[3] Actuarial Funded Ratios fluctuated between 74% and 78% between December 31, 2011 and December 31, 2020, as unfunded liabilities increased from $604 million to $849 million. ACFR, p. 68.

[4] Wade, Gardner & Rains-McNally, "Public pension plan funding policy: Effectiveness of amortization methods under deterministic projections," Milliman (June 1, 2021).

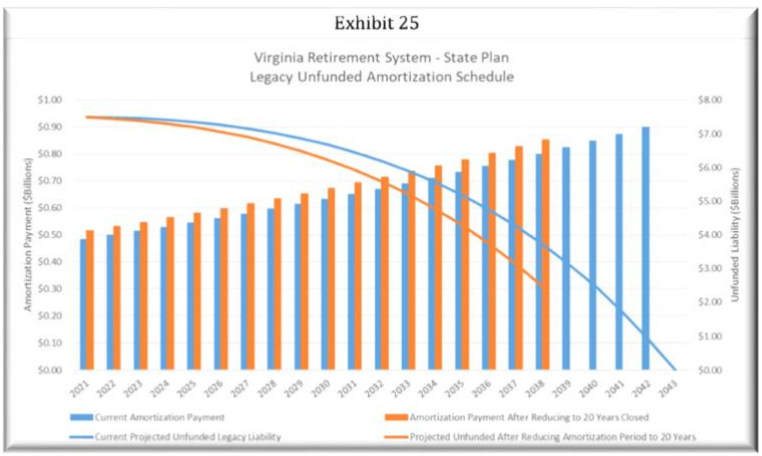
[5] Gardner, Rains-McNally & Wade, "Public pension plan funding policy: Effectiveness of amortization methods under projected investment scenarios," Milliman (January 10, 2022).

assumption changes reflected in Actuarial Valuations on or after December 31, 2019, which will be amortized over no more than 10 years[6]; and

Whereas, ERFC's amortization approach ties payments to an assumed 3.25% annual payroll increase, which results in smaller payments during the first half of the amortization period and higher payments at the end of the amortization period;[7] and

Whereas, all other pension plans in which Fairfax County or FCPS employees participate (including VRS) use the "level percentage of payroll" method to amortize their unfunded liabilities, which is allowed under GASB guidelines or requirements; and

Whereas, eliminating negative amortization substantially reduces interest payments;[8] and



Whereas, using a "level dollar" instead of a "level percentage of payroll" method to amortize unfunded liabilities reduces future employer contributions paid by taxpayers, while improving the financial stability of defined benefit pension plans,[9] and

Whereas, if ERFC had used a level-dollar method to amortize its unfunded liabilities, they would have decreased more rapidly during the 1st half of the amortization period;[10] and

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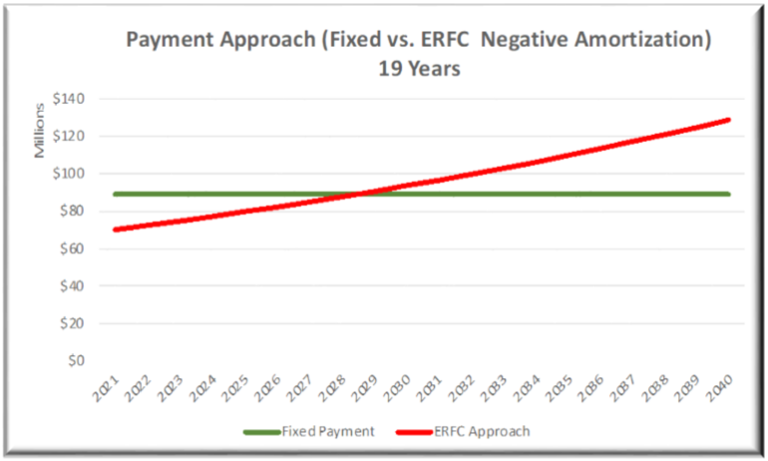
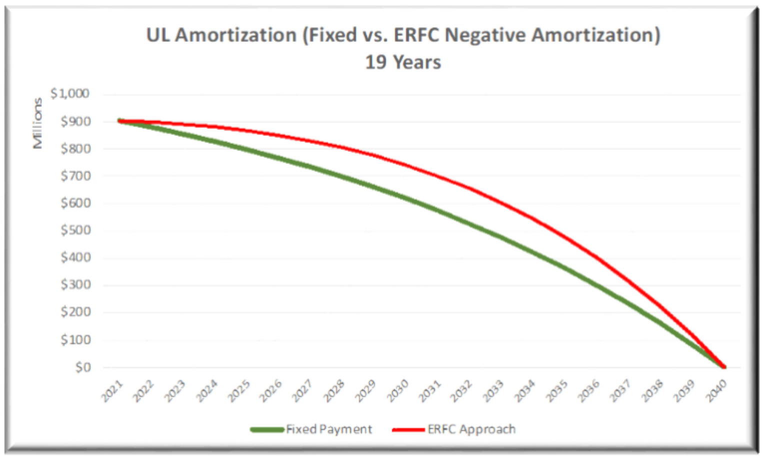
[6] ERFC Regulations, Section 16.03E; AON, ERFC Actuarial Valuation Report as of December 30, 2020, p. 3.
[7] ERFC Regulations, Section 16.03E.
[8] VRS Stress Test and Sensitivity Analysis, Report to the General Assembly of Virginia (Sept. 2021), Exhibit 25, p. 38.
[9] VRS Stress Test, pp. 36 - 40.
[10] Exhibits prepared by MCA, using data from ERFC's Annual Comprehensive Financial Report (ACFR) for FY 2021.





Whereas, the ERFC originally established a 30-year amortization period in 2011, and the use of a rising payroll assumption to amortize unfunded liabilities resulted in the failure to cover unfunded liability interest growth in the first several years of the amortization period; and

Whereas, if ERFC had chosen to use a fixed/level payment instead of a percentage of payroll approach to amortize its unfunded liabilities, ERFC's financial condition would be significantly better, as shown in the following two tables; and

2011 through 2020 Actual vs. Theoretical results of a 30 year fixed/level amortization approach							
Actual Amortization Payments	Theoretical 30 Year fixed Payments	Additional Payments in Fixed/level	Calculated increase in 2020 funded Liability	Applying additional funding to the 2021 27% investment return	2021 Actual Unfunded Liability	Theoretical 2021 Unfunded Liability	Theoretical Funding Ratio
$336,000,000	$449,000,000	$113,000,000	$158,000,000	$200,660,000	$438,000,000	$237,340,000	93.5%

2011 through 2020 Actual vs. Theoretical results of a 15 year fixed/level amortization approach							
Actual Amortization Payments	Theoretical 15 Year fixed Payments	Additional Payments in Fixed/level	Calculated increase in 2020 funded Liability	Applying additional funding to the 2021 27% investment return	2021 Actual Unfunded Liability	Theoretical 2021 Unfunded Liability	Theoretical Funding Ratio
$336,000,000	$585,000,000	$249,000,000	$341,000,000	$433,070,000	$438,000,000	$4,930,000	99.9%

Whereas, employer plus employee contributions to ERFC, as a percentage of covered employees' salaries, were less than 6% in 2002, 8.04% in 2011, 9.44% in 2020,[11] and the School Board voted to increase this rate to 9.7% for FY 2022 and FY 2023[12]; and

Whereas, the VRS Stress Test and Sensitivity Analysis suggests several strategies to accelerate the elimination of unfunded pension liabilities, including use of a shorter amortization period with a level dollar payment, which would avoid the negative amortization arising from the percentage of payroll method used by ERFC;[13] and

Whereas, inflation during 2021 was 7%, the highest inflation rate since 1982[14], but ERFC assumes a general inflation rate of 2.75%[15]; and

Whereas, higher inflation could result in lower investment returns, growth in unfunded pension liabilities, and related increases to employer contribution rates[16]; and

Now therefore, be it resolved that the McLean Citizens Association stresses that the ERFC now has a rare opportunity to improve its financial sustainability; and

Be it further resolved the McLean Citizens Association urges ERFC Trustees to establish and commit to a plan that:

- Continues amortizing legacy unfunded liabilities until they are eliminated by or before 2041,
- Uses a level fixed payment amortization approach instead of negative amortization through rising payroll assumptions, and
- Amortizes new unfunded liabilities over periods of no more than 10 years; and

Be it further resolved that MCA urges the School Board to commission a study of the possible impacts of inflation on the long-term financial health of ERFC, and to develop and communicate in public documents how ERFC will mitigate adverse consequences from inflation.

Approved by the MCA Board of Directors
February 2, 2022

McLean Citizens Association, P.O. Box 273, McLean, Virginia 22101

cc: Elaine Tholen, Dranesville District School Board Member

[11] ERFC Annual Comprehensive Financial Report for FY 2021, p. 82.
[12] AON, ERFC Actuarial Valuation Report, p. 5.
[13] VRS Stress Test and Sensitivity Analysis, p. 36.
[14] News Release USDL-22-0018, Bureau of Labor Statistics, U.S. Department of Labor,
[15] AON, ERFC Actuarial Valuation as of Dec. 30, 2020, p. 38.
[16] VRS Stress Test and Sensitivity Analysis, pp. 14-22.

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