McLean Citizens Association Resolution
Assumed Investment Return and Discount Rate for Education Employees' Supplementary Retirement System of Fairfax County (ERFC)

February 2, 2022

Whereas, Fairfax County (County) employees participate in one of three County-run pension plans that pay benefits for life: (i) Employees Retirement System (ERS)[1]; (ii) Police Officers Retirement System (PORS); or (iii) Uniformed Retirement System (URS); and

Whereas, employees of Fairfax County Public Schools (FCPS) all participate in the federal government's Social Security, and are eligible for one of two additional pension plan regimes:

- approximately 80% of FCPS employees also participate in the state-run Virginia Retirement System Teacher Plan (VRS Teachers), plus the Education Employees' Supplementary Retirement System of Fairfax County (ERFC); and
- approximately 20% of FCPS employees also participate in the County-run ERS; and

Whereas, FY 2021 investment returns were exceptionally high compared to past returns:

- VRS Teachers earned 27.5%,
- ERS earned 26.8%,
- PORS earned 31.2%,
- URS earned 25.3%,
- ERFC earned 26.8%; and

Whereas, as of June 30, 2021, ERFC's assets were invested in domestic equity (25%), domestic fixed income (20%), Multi-Asset Class Solutions (9%), international equity (9%), private equity (7%), hedge funds (6%), emerging market equity (6%), global equity (5%), real estate (5%), emerging market debt (3%), and private debt (1%)[2]; and

Whereas, ERFC has committed to substantially increase its percentage of total assets invested in private equity, private debt, real estate, and infrastructure[3]; and

Whereas, the MCA adopted a resolution on January 6, 2021 urging the FCPS School Board to conduct a "sensitivity and stress test" for ERFC, and also noted that:

- in 2019, VRS began using a 6.75% assumed return to calculate its pension liabilities,
- ERFC had been using a 7.25% assumed return since 2015; and

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[1] County employees who participate in ERS also participate in the federal government's Social Security system.
[2] ERFC Annual Comprehensive Financial Report for FY 2021, p. 48.
[3] Meketa Investment Group, ERFC 2022 Private Markets Commitment Pacing & Board Action Item (Jan. 28, 2022).

Whereas, an independent actuarial auditor advised ERFC in 2018 to consider reducing its assumed investment return, since there was only a 37.5% chance of achieving this goal and the 7.25% expectation was "at the high end of reasonability,"[4] and

Whereas, in 2021, the boards of ERS, PORS and URS each voted to reduce their pension plans' respective assumed net investment returns and discount rates from 7.25% to 6.75%; and

Whereas, as of 2022, of the five pension plans in which County or FCPS employees participate, only ERFC still assumes 7.25% net investment returns and uses a 7.25% discount rate in estimating its pension liabilities; and

Whereas, a higher discount rate substantially reduces estimated pension liabilities and a lower discount rate substantially increases estimated pension liabilities:

- using 6.25% instead of 7.25% would increase ERFC's estimated pension liabilities as of June 30, 2021 from $438 million to $900 million[5],
- using 8.25% instead of 7.25% would decrease ERFC's estimated pension liabilities as of June 30, 2021 from $438 million to $38 million[6]; and

Whereas, ERFC was fully funded (with zero unfunded pension liabilities) as of 2000[7] and reported unfunded pension liabilities of $438 million as of June 30, 2021; and

Whereas, the primary reason ERFC's unfunded pension liabilities increased more than projected since 2000 was that ERFC's actual net investment returns were less than ERFC assumed;[8] and

Whereas, adopting a lower assumed rate of investment return would allow ERFC to reduce its exposure to higher-risk investments; and

Whereas, if inflation rates continue to exceed ERFC's assumed inflation rate of 3.25%, ERFC could be faced with higher pension liabilities and cash flow requirements, especially if higher inflation is coupled with a flat or depressed economy overall (i.e., stagflation);[9] and

Whereas, ERFC's ability to cover its accrued liabilities under the short-term solvency test for services already rendered by active FCPS employees increased from 18% as of December 31, 2019 to 27% as of December 31, 2020, a level last achieved in 2008;[10] and

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[4] Cheiron, Independent Actuarial Review of the ERFC Actuarial Valuation (March 2018), pp. 39-41.
[5] ERFC Annual Comprehensive Financial Report for FY 2021, p. 25.
[6] Ibid.
[7] Gabriel, Roeder, Smith & Co., ERFC Annual Actuarial Valuation (Dec. 31, 2014), p. B5.
[8] ERFC Annual Comprehensive Financial Report for FY 2021, p. 76
[9] Cf. VRS Stress Test and Sensitivity Analysis, Report to the General Assembly of Virginia, Sept. 2021, p. 16.
[10] ERFC Annual Comprehensive Financial Report for FY 2021, p. 75.

Whereas, the lower the interest rate used to compute the present value of its estimated future payments, the more likely that ERFC will achieve the investment returns needed to avoid potentially large and unsustainable increases in pension plan contributions; and

Whereas, as noted in the Stress Test and Sensitivity Analysis for VRS, "[f]ollowing robust market returns in FY 2021, future outperformance in the near term may be materially lower than both historic norms as well as projected returns over longer time frames."[11]

Now therefore, be it resolved that the McLean Citizens Association commends the Boards of Trustees for ERS, PORS and URS for voting to reduce their assumed investment returns from 7.25% to 6.75%; and

Be it further resolved that ERFC has a rare opportunity in 2022 to improve its financial sustainability without requiring a significant additional increase in the employer contribution rate, if ERFC reduces its assumed investment return to 6.75%, given the exceptional investment returns that it and other pension plans realized in FY 2021; and

Be it further resolved that the McLean Citizens Association urges:

- the ERFC Board of Trustees to vote to lower ERFC's assumed rate of net investment return and its discount rate from 7.25% to 6.75%, and
- the School Board to advocate for ERFC to reduce its assumed rate of net investment return and its discount rate from 7.25% to 6.75%.

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
Karl Frisch, Providence District School Board Member
FCPS School Board Members
Scott Brabrand, FCPS Superintendent
Leigh Burden, FCPS CFO
John Foust, Dranesville District Supervisor
Dalia Palchik, Providence District Supervisor
Fairfax County Board of Supervisors
Bryan Hill, Fairfax County Executive
Christina Jackson, Fairfax County Chief Financial Officer

[11] VRS Stress Test and Sensitivity Analysis, Report to the General Assembly of Virginia, Sept. 2021, p. 4.