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Other Postemployment Benefits (OPEB) Funding Policy Statement

CITY OF ROCHESTER HILLS, MICHIGAN

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LAUTERBACH & AMEN, LLP

TABLE OF CONTENTS

PURPOSE OF THE FUNDING POLICY STATEMENT

General Purpose

This Funding Policy Statement sets forth the procedures that the Board of Trustees for the City of Rochester Hills, Michigan have adopted to make funding contributions to the City of Rochester Hills Other Postemployment Benefits Trust. The policy identifies goals and objectives of the City. The policy sets out the decision-making process for handling various aspects of OPEB funding, and defines the ongoing items to be reviewed in assessing the ongoing effectiveness of this policy.

Goals and Objectives

The key goals and objectives considered in the preparation of the funding policy are noted below:

→ Make sure that benefits are secure for fund participants now and in the long-term.

→ Develop recommendations that are more cost-effective in the long-term.

→ Provide year-to-year contribution stability/budgeting for the City.

→ Address any transition items needed at the policy implementation.

Operation of the Policy

It is the intention of the City to review the policy on an annual basis. The intention is to review the effectiveness of the policy and determine if it continues to meet the goals and objectives as set forth.

The City retains the right to amend the policy, as necessary, to keep the policy in line with the goals and objectives.

PRINCIPLE ELEMENTS OF AN ACTUARIAL FUNDING POLICY

Principle Elements of an Actuarial Funding Policy

The balance of this document will outline the parameters for determining an Actuarially Determined Contribution (ADC). The ADC will provide a roadmap to 100% funding for the City to review on an annual basis as future funding is considered.

The key components of the ADC are noted below:

→ Selection of Actuarial Cost Method

→ Amortization Policy for Handling Unfunded Accrued Liability

→ Selection of Asset Smoothing Method

The Actuarial Cost Method

General Purpose

The intent of any Actuarial Cost Method is to set aside the appropriate number of dollars during an employee's working career so that the OPEB Plan has the dollars necessary to make payments at retirement. The Actuarial Cost Method will set the pattern by which contributions are made to the plan during the working career of the employee and provide two key measures for reporting:

- → Normal Cost – The amount of money to contribute for each active employee for the upcoming year of service.
- → Accrued Liability – The amount of money that is expected to be in the OPEB Plan already, based on all past service already worked by members of the Plan.

Recommended Selection

The Entry Age Normal (EAN) Cost Method (Level Dollar) is the current recommended method to measure the Normal Cost and Accrued Liability for the Plan.

The EAN Method is a cost-based actuarial method which focuses on budgeting annual costs during the working career of an employee. The Normal Cost level is set with the expectation that it will not increase during an employee's working career.

UNFUNDED ACCRUED LIABILITY

General Purpose

The Actuarial Cost Method will provide a method for setting the annual contribution pattern for current year services, as well as setting the expected level of assets needed to be on budget for past services rendered by employees. When the OPEB Plan's actuarial assets do not match the expected assets under the budget, an unfunded/overfunded liability exists.

Unfunded Liability

The Unfunded Actuarial Accrued Liability may either be amortized over a period of level dollar amounts or as a level percentage of projected payroll.

In accordance with the Board of Trustees for the City's funding policy for the annual contribution, the unfunded actuarial accrued liabilities established as of December 31, 2018 unrelated to Assumption Changes will be amortized by level dollar contributions to a 100% funding target over 15 future years as of the December 31, 2018 fiscal year.

The unfunded actuarial accrued liabilities established as of December 31, 2018 related to Assumption Changes will be amortized by level dollar contributions to a 100% funding target over 5 future years as of the December 31, 2018 fiscal year. The change in liability is due to a remeasurement at change in the reporting standards

New Unfunded Liability

Volatility in contribution determination can occur when new unfunded liability arises once the amortization period is within 15-20 years of the funding target.

The City will amortize any new unfunded liability over a 15-year period established as of the date the new unfunded liability emerged using level dollar contributions to a 100% funding target.

ACTUARIAL VALUE OF PLAN ASSETS

General Purpose

The Actuarial Value of Plan Assets is the figure used annually to determine the level of underfunding in the OPEB Plan. The Actuarial Value of Plan Assets does not necessarily equal the Fair Market Value of Assets. While the Actuarial Value of Plan Assets does not represent dollars that are available on that day to make benefit payments, use of an Actuarial Value of Plan Assets recognizes that assets will not all be distributed at a single point in time.

The objective of using an Actuarial Value of Plan Assets that differs from the Fair Market Value of Assets is to redistribute contributions over the life of the OPEB Plan in a manner that is less volatile. The overall level of contributions over the life of the Plan is not expected to change. To achieve this, gains and losses on the Fair Market Value of Assets are recognized in the Actuarial Value of Plan Assets over a period of time. In order to be successful as part of long-term funding, the Actuarial Value of Plan Assets should be equally likely to fall above or below the Fair Market Value of Assets.

Key parameters:

- → Years – the number of years to smooth market value gains and losses.
- → Corridor – A limitation placed on the Actuarial Value of Plan Assets. This parameter will limit the Actuarial Value of Plan Assets in relation to the Fair Value of Assets.

Recommendation

The current recommendation is the Actuarial Value of Plan Assets will be equal to the Fair Value of Assets, with unexpected gains and losses on the Fair Value of Assets smoothed over a 5-year period.

It is anticipated that the Actuarial Value of Plan Assets will not stray too far from the Fair Value of Assets with the 5-year smoothing parameter. The City has selected a corridor of 80% to 120% to ensure that the Actuarial Value of Plan Assets does not stray too far from the Fair Value of Assets.

Operational Procedures

Funding Recommendations

The City's Chief Financial Officer (CFO) or his/her designee will use the policies and procedures set forth in this document to recommend a contribution amount to be made by the CFO to the OPEB Trust each year.

Actuarial Assumptions

The City will review the actuarial assumptions used for determining the Plan's funding levels at least every 3-5 years. The City will use assumptions that are the best estimate of the future anticipated experience under the plan. By getting the best estimate on actuarial assumptions, short-term changes in unfunded liability are expected to be offset over a long-term period of time. Review of the assumptions every 3-5 years will help to minimize the impact of assumption changes that have deviated from actual experience over a long period of time.

If any events occur that could impact assumptions immediately (for example, a change in the Investment Policy or strategy), the City will assess the associated assumption on a more immediate basis and will not be limited by the 3-5 year cycle.

See Addendum 1 for current selections used in determining the OPEB liability from a funding standpoint. These assumptions may vary from the GASB 74/75 financial statement reporting assumptions.

Monitoring the Funding Policy

When monitoring the progress of the Funding Policy, the City should consider:

- → A review of the progress being made on the unfunded liability that exists at implementation.
- → An analysis of cash flow to monitor the continuous ability of the plan to pay benefits.
- → An analysis of the causes of any changes in unfunded liability over recent preceding years.
- → An analysis of the actuarial expectations versus actual experience over recent preceding years.

ADDENDUM 1 – CURRENT ACTUARIAL ASSUMPTIONS

Economic Assumptions

Assumption	Selection	Reason
Expected Rate of Return on Assets	5.00%	Based on the current target allocation in the OPEB Trust and Discussion with the Investment Consultant.
Total Payroll Increases	2.50%	Based on the current employee population.
Insurance Claims and Healthcare Trend Rates	N/A	There is no implicit liability to the City due to the Retiree-only medical insurance. The explicit benefits are fixed, not subject to future increases.

Demographic Assumptions

Assumption	Selection	Reason
Election at Retirement	100% AFSCME 100% Firefighters 100% Non-Union	Represents the anticipated percentage of employees who will continue City OPEB benefits in retirement.
Dependent Election	80% AFSCME 80% Firefighters 80% Non-Union	Represents the anticipated percentage of employees continuing coverage in retirement who will elect dependent coverage.
Plan Participation Rate	N/A	

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ADDENDUM 1 – CURRENT ACTUARIAL ASSUMPTIONS CONTINUED

Demographic Assumptions - Continued

Assumption	Selection	Reason
Retiree/Spouse Mortality	MERS 2017	Based on the MERS Actuarial Valuation as of December 31, 2017 with additional details in the MERS Experience Study Report for the period January 1, 2009 through December 31, 2013.
Termination Rates	MERS 2017	Long-term anticipated experience for ASFCME, Firefighter, and Non-Union employees based on a study of the actual experience for municipal employees in the state of Michigan.
Disability Rates	MERS 2017	Long-term anticipated experience for ASFCME, Firefighter, and Non-Union employees based on a study of the actual experience for municipal employees in the state of Michigan.
Retirement Rates	MERS 2017	Long-term anticipated experience for ASFCME, Firefighter, and Non-Union employees based on a study of the actual experience for municipal employees in the state of Michigan.