



## ***Questions and Answers about Nevada PERS' Contribution Rates, Unfunded Liability and Funded Ratio***

The System received a number of inquiries about the contribution rates scheduled to go into effect with the first full payroll reporting period after July 1, 2013, as well as about the System's funded ratio and unfunded accrued liability. We want to be responsive to those questions in the most efficient way possible. We have compiled the questions below and responses follow each.

### ***Why are the contribution rates increasing for this coming biennium?***

Contributions are based upon the actuarial experience of the plan, both demographic and economic. The Retirement Board adopts assumptions based upon advice from the independent actuary (in accordance with the Nevada Constitution, Article 9, section 3) that help to forecast costs based upon the experience of the plan. The demographic experience and the economic experience of the plan affect the contribution calculation.

As the Great Recession contracted Nevada's economy, the public workforce contracted as well, losing almost 9,000 employees since the highpoint in 2008. Reported public payroll also has contracted—it is projected to be approximately \$330 million dollars less than in the last rate-setting year, 2010. On a System-wide basis, the yearly dollar cost of accumulated benefits remains almost identical to the previous biennium within \$20 million of previous contribution levels (\$1.56 Billion compared to projected \$1.58 Billion in contributions), but the shrinking payroll and employee base means fewer employees and a smaller payroll to spread the costs. These basic facts, coupled with the fact the System has had to absorb losses in the investment markets stemming from the economic downturn, translates to higher per person contributions.

It is important to note that the System is valued on the total experience of all employers (180+) and plan participants (98,000 actives and 50,000 retirees) collectively. Individually, some employer payrolls may not have decreased, but those whose payrolls have not decreased have been offset by employers whose payrolls have significantly declined.



### ***What is the funded ratio of NVPERS?***

As of June 30, 2012, the System's funded ratio was 71%, an increase in funded ratio from the previous year. The following is an excerpt from a letter of the *American Academy of Actuaries on the Subject of State and Local Government Defined Benefit Pension Plans* to Senator Orrin Hatch, July 31, 2012.

*A funded ratio is a single measure of a plan's status at one point in time. No single funded ratio should be used as a measure of a pension plan's financial health. Funded ratios should be scrutinized over several years to examine trends and should be viewed in light of the economic situation at each point in time. Higher funded ratios are expected following periods of strong economic growth and investment returns such as that experienced at the end of the 1990s. Lower funded ratios are expected after recessions such as the one begun in 2008 or after years of poor investment returns...Well-governed plans should have a funding policy in place to meet the full costs of these plans, as well as a history of adhering to this funding policy.*

When the actuarial value of the trust fund is less than the total benefit liability, the gap is considered an unfunded liability. An unfunded liability does not have to be paid immediately or all at once; it is similar to a home mortgage that is financed over a period of years. It is useful as one measure of a plan's current funded status. In Nevada the unfunded liability of NVPERS is scheduled to be retired in under 23 years. In Nevada this amortization period used to be 40 years, but has declined nearly in half as the employers and members have consistently made annual payments to retire the unfunded liability.

Contribution costs have always been paid in Nevada in accordance with the statutory rate-setting mechanism and are sufficient to fund the liabilities of the System over the adopted amortization period (23 years). In other state plans an unfunded liability is solely the responsibility of the participating employers, but in Nevada responsibility is shared with the employees, as they pay half the contribution rate (which fluctuates on the basis of the amount needed for the amortization of the unfunded liability), and have done so since the 1970s.

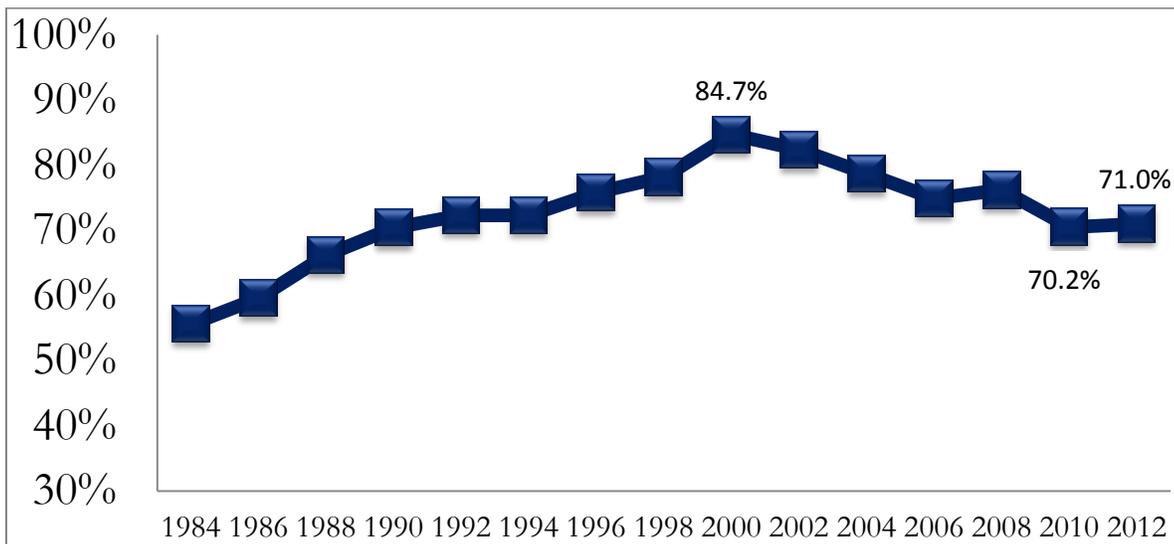
### ***How is the unfunded liability of the System being paid?***

The Board of Trustees of NVPERS adopted a strong, long-term funding policy that provides for intergenerational equity to all stakeholders in the System including members, employers and other taxpayers. Because all members share in the cost of paying the unfunded liability, the Trustees' funding policy uses a year-by-year closed amortization approach (similar to the private sector) to equalize responsibility between current and future generations and to avoid unduly burdening any individual generation based upon single year or short-term plan experience. Additionally, this funding



policy recognizes economic conditions and will accelerate payment on the unfunded liability when economic conditions improve. While all volatility in the amortization payment cannot be eliminated (for example, the extreme market decline of 2008/2009), the Trustees use every tool available to minimize that volatility and maintain a long-term focus on fully financing the pension contract that is part of a public employee's compensation.

Below is a long-term chart showing the funded ratio of NVPERS, including this most recent valuation where the negative trend in funded ratio caused by the Great Recession has begun to reverse itself. The funded ratio trend exactly follows the pattern described in the American Academy of Actuaries' letter to Senator Hatch, described above. The funded ratio increased during positive economic periods and has declined during this most recent decade due to the tough economic times. That trend appears to be reversing, as economic conditions are slowly improving.



### ***Are PERS' contribution rates reasonable?***

Contribution costs, while they have increased in the recent decade due to economic conditions, are comparable to the costs in other states, as well as to retirement security costs in the private sector.



Since Nevada does not participate in Social Security for public employees, when compared to states that do, overall retirement security cost is lower. When comparing costs of NVPERS with other states, the cost of Social Security in those states is part of the cost for an overall retirement benefit. When taking into consideration the cost of Social Security, the Las Vegas Chamber of Commerce concluded in its study of NVPERS before the 2009 legislative session, that on a percentage of payroll basis, NVPERS was one of the lowest cost funds in the nation. This same comparison holds true today.

While costs are competitive, the System strives to minimize contribution volatility with every tool available. The extreme market environment, coupled with the loss in membership of over 9,000 public employees and a commensurate loss in payroll, leaves the System few responsible choices but to increase the rates in accordance with the actuarial valuation to insure the retirement security of the members and beneficiaries of the System.

### ***How do the Trustees insure that the contribution rates are correct?***

The Trustees employ an independent actuary (as required by the Nevada Constitution) to value the System annually, although rates are only adjusted every other year. Annual valuations are performed to insure that the Trustees are kept abreast of emerging trends in plan experience.

But the Trustees don't just take for granted the advice of the independent actuary. The Board requires that, at regular intervals, the System obtain an actuarial audit on the actuarial valuation and process to insure that the valuation is being performed to the Standards of Practice adopted by the American Academy of Actuaries. This audit was last performed in 2010. An RFP was issued to qualified actuarial firms (those possessing experience with large pension plans, both private and public); a firm was selected and a review conducted. That independent review found that the System and the System's actuary valued the System using appropriate standards and controls.

In addition to the audit described above, the Board requires actuarial experience studies every four to six years, to insure that the assumptions used in performing the valuation reflect the experience of the plan. This study will be performed in the spring of 2013 with any changes to assumptions to take affect with the 2013 valuation.

Yearly, the independent financial auditor also reviews the actuarial valuation process (including data collection) as part of the annual financial audit, testing assumptions, data quality and results. Additionally, every five years the Trustees require an internal controls examination, a process that is subject to RFP and independent award. This review was completed in 2011 and concluded that the System maintained effective internal controls over financial reporting, in all material aspects.

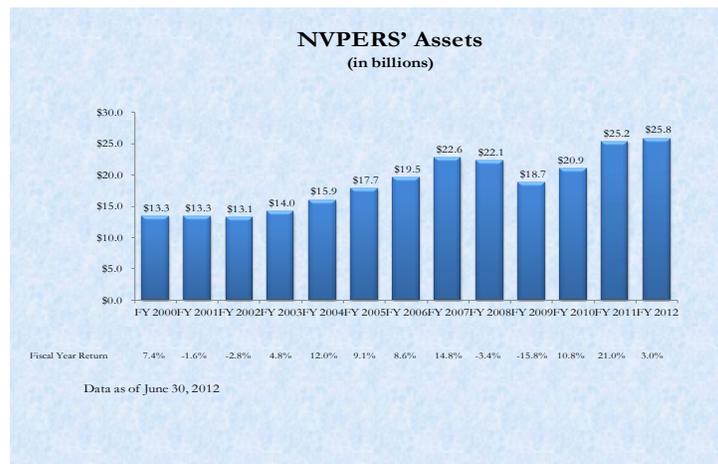


***How do the Trustees decide what the System will assume for investment return for the fund? Have you achieved that return every year?***

The Board of Trustees reviews the asset allocation and investment return assumption every year after seeking advice from the independent investment advisors employed by the Board, as well as industry experts who are focused on the global capital markets. Currently the assumption used for the fund is 8%. That 8% assumption is based upon a financing horizon that matches the liabilities of the plan over 40 to 60 years.

Use of the 8% assumption has been criticized by some economists as too aggressive and unreasonable. Much of this debate is fueled by the difficult market conditions of the last few years. In the late 1990s (a strong return environment for stocks) the fund received criticism that the 8% assumption was too low. We are experiencing an opposite reaction today.

Markets are extremely unpredictable in the short-term and the System does not expect to meet the 8% assumption in every year. However, since the fund’s performance inception (28 years), the plan has generated a 9.3% return, net of all fees. Even in this most recent decade, Nevada PERS exceeded the long-term investment assumption of 8% in six out of ten years. The average return for the 10-year period ending June 30, 2012, is impacted by the return of fiscal 2009 when the System return was -15.8% (ranking for this period was in the top 12% of large institutional investors). Additionally, the average annualized return for the System is 11.4% over the last three years. Following is a chart showing the growth in NVPERS assets since 2000.





No one can accurately predict the future or control investment results associated with market conditions. At Nevada PERS, the System is managed taking into account short-term volatility, but always with a focus on the very long-term investment goal: to match the assets and liabilities of the System over the 40 to 60 year time horizon necessary to fund retirement security for the members and beneficiaries of the System. The Trustees balance both short and long-term factors when setting the investment return assumption. The investment return assumption has been 8% since 1984. In some periods it appears low and in others it appears high. The Trustees will continue to monitor the markets, and if a change is warranted, they will make it in the same manner they make all changes to the plan, with a long-term view in mind.

All retirement investors, regardless of whether they are a large pension fund investor like Nevada PERS or an individual investor investing in a defined contribution account, must focus on the very long-term goals of income security. Nevada PERS does so in an economically efficient, cost effective manner.

Public pension financing is a complex, multifaceted topic that carries significant impact to employers, members, beneficiaries, indeed all taxpayers--including public employees. Almost 150,000 Nevadans are directly affected by the System, with perhaps another 500,000 indirectly affected by Nevada's contractual benefit that replaces both Social Security's poverty prevention promise and provides a pension allowance for public workers in Nevada. The Board of Trustees takes this responsibility very seriously and works continuously on behalf of our members and beneficiaries.