Pension Funding

This presentation will provide a general overview of how pension plans are funded as well as some aspects of the Charlotte Firefighters' Retirement System (CFRS) in relation to its funding status. The CFRS is your pension plan. It is a qualified governmental defined benefit plan. Meaning, it is qualified under Internal Revenue Service Codes for tax favored status (pre-tax contributions) and it is not subject to ERISA (Employee Retirement Income Security Act).

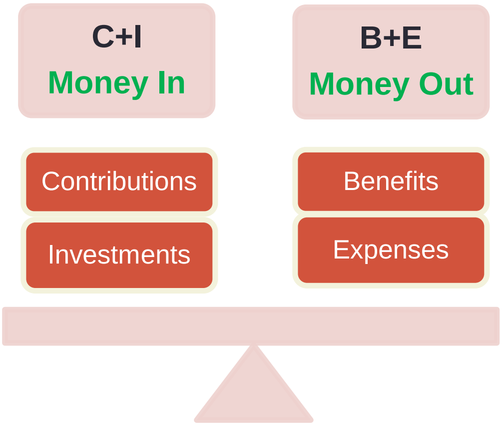
Public pension funds are made up of employee and employer contributions as well as the dividends and interest earned on such contributions.

It is the responsibility of pension Boards to manage the fund in a prudent manner so that the benefits promised to employees can be paid when due. This includes establishing an Investment Philosophy and Policy.

Investment results are considered to be a critical element in achieving the System's funding goals. The assets of the System should be invested with a risk orientation that is consistent with a moderate ability to assume risk.

Basic Pension Plan Funding Equation

Retirement plans follow a basic retirement funding equation:



Money paid out of a plan must equal the money put in the plan.

C + I = B + E

Contributions

- Employee and Employer contribute a certain percentage of payroll on a predetermined schedule.
  - The City of Charlotte and its eligible firefighters contribute on a weekly basis.

Investment Income

- Employee and Employer Contributions are invested in stocks and bonds and are subject to the volatility of the stock market. The stock market can produce significant gains or losses from one day to the next. However, pension funds typically invest for long-term performance.

Benefits

- Benefits are the accrued, or earned pension benefits, that will be paid to employees in the future at their retirement date. Also included are the benefits currently being paid to retirees and beneficiaries.

Expenses

- Expenses of a pension fund includes all the costs associated with operating the pension fund. Examples include staff wages and benefits, external legal counsel, actuarial and investment consulting services, custodian/banking fees, pension administration system fees and other various administrative expenses necessary to run the plan and maintain an office.

Actuarial Valuation

To determine the contribution levels necessary to fully fund a pension plan, an actuarial valuation is performed.

- This valuation is typically done annually at the end of a plan’s fiscal year by an actuary hired by the pension fund.
    - The fiscal year for the CFRS is July 1 through June 30th.
- The actuary is provided information of active employees and retirees.
    - For active employees, such information includes date of hire, date of birth, salary and service as of the end of the fiscal year.
    - For retirees, such information includes date of birth, date of retirement, benefit amount, option elected, and beneficiary date of birth.

Actuarial Valuation

Using the demographic information provided and certain assumptions and methods approved by the pension Board, the actuary will determine the cost of the plan, or the required contribution of the plan.

Some assumptions and methods the actuary uses include:

- Future estimated rate of return on the investments
- Expected payroll growth
- Estimated number of retirements within the year
- Estimated number of withdrawals within the year
- Rate of Inflation projections
- Mortality projections (life expectancies)
- Unused annual sick leave
- Amortization method

Actuarial Valuation

- It is important to periodically align the assumptions used to determine the cost of the plan with what is actually occurring.
- The Assumptions the actuary uses are typically reviewed every five years based on the actual experience of member behavior (such as age & service at retirement; accumulation of unused sick and vacation time) and external influences (such as the rate of inflation, actual payroll growth, mortality, the actual return on investments, etc.).
- Adopting new assumptions to determine the cost of the plan can impact the funding level of the plan. Two biggest influences are the rate of return on investments and updated mortality tables.
  - If the assumed rate of return on investments is higher than what is projected to be in the future based on current market conditions, the funding level will decrease, and higher contributions may be necessary to make up for lower earnings on the investments.
  - If the mortality tables are updated due to people living longer, it adds more costs since benefits are paid for a longer period than originally projected.

Actuarial Valuation

The cost of the plan is typically expressed as a percentage of payroll.

Two components are included in the full cost of a plan – the “normal cost” and the “amortization payment”.

- Normal cost = the cost of benefits accrued (earned) in the current year. This also includes expenses.
- Amortization payment = the annual portion of the amount necessary to pay off any unfunded liability.
  - Unfunded liability is the cost of benefits promised for which assets have not yet been accrued. An example of this would be the unused sick time added to CFRS members’ service.

Funding Status

The valuation results provide useful information for the pension plan's Board, including the plan's funded level. The funded level is one indicator of the health of the plan.

- A funded level over 100% means there are currently more funds than necessary to pay all benefits including projected future benefits. When there are excess funds, additional benefits could be considered in the form of a post-retirement benefit or enhancement to the employee's pension benefit formula.

- A funded level at 100% means there is currently a sufficient amount of funds necessary to pay all promised benefits and therefore, if a post-retirement benefit or an enhancement to active employee's benefit is granted, the funding level would decrease since more liability has been added to the plan.

- A funded level less than 100% means the plan does not currently have sufficient funds necessary to pay all benefits. This does not necessarily mean a plan is unhealthy. As previously mentioned, the market can be quite volatile and the funded status can change on an annual basis, either upwards or downwards.

Funding Status

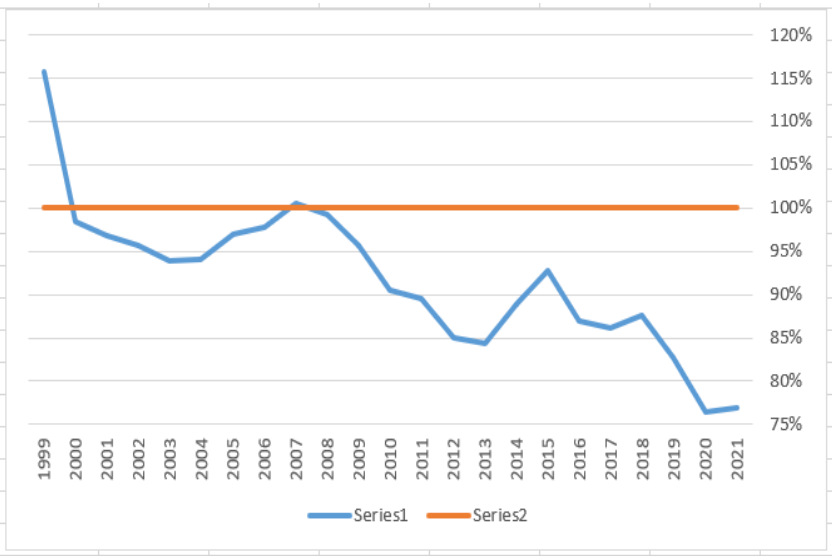
- When the funded level falls below 100% action by a Board may be necessary. Actions may range from monitoring the funded level over a period of time, to taking corrective actions that may include increasing contribution levels, changing benefit provisions, or even changing the fund's investment strategy.

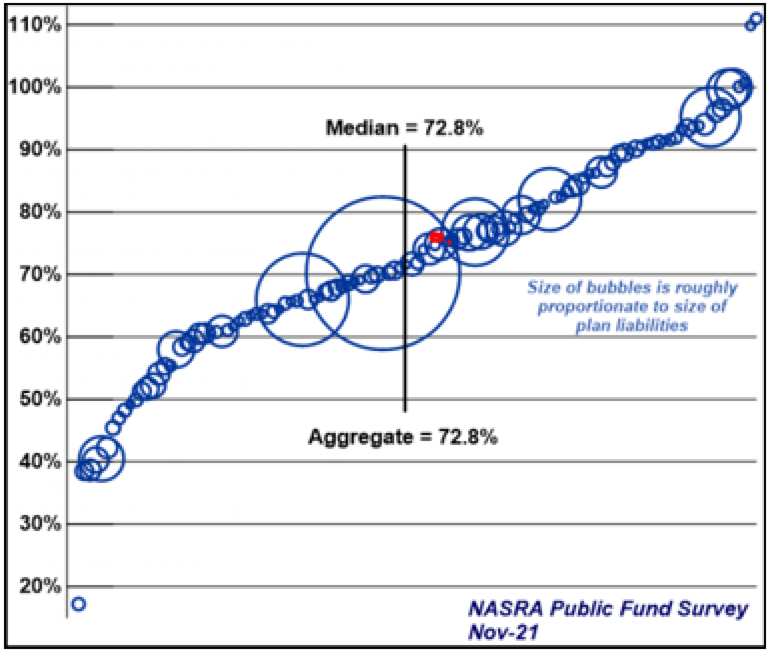
A healthy plan includes the commitment to funding and proper fiduciary oversight.

While the CFRS pension plan's funded level will vary each year, the Board has taken action to align employer contributions with the amount necessary to ensure appropriate funding for future benefit payments.

- For example, the Board has requested an increase in the employer contribution rate by 2% incrementally to maximum 24% by 2026, which will help improve the CFRS' funding level over time.

CFRS Funded Status History





- The 2008-09 market crisis had a negative impact on the fund but recovered into the low 90% funded range by 2015.
- In 2016, changes to mortality rates and the assumed rate of return impacted the funded status.
- As of June 30, 2021, the median funded level of 120 pension plans as surveyed by National Association of State Retirement Administrators (NASRA), was 72.8%. CFRS funded level as of June 30, 2021 was 76.9%, (red dot on NASRA survey)

Resources

The CFRS' Annual Valuation Reports may be found on the website: CharlotteFireRetire.com\reports

The Board meetings are open to the public for anyone to attend. To learn more about the annual valuation process and results, we invite you to attend the CFRS Board meeting with the Annual Valuation on the agenda, generally the October Quarterly Board meeting.