Retiree Health Insurance Subsidy
Actuarial Assumption Estimating Conference

Executive Summary for September 24, 2014

The Florida Retirement System Actuarial Assumption Conference met on September 24, 2014 to adopt assumptions to be used in the actuarial valuation of the Retiree Health Insurance Subsidy (HIS) program. While the program is intended to be "pay-as-you-go" as opposed to pre-funded, GASB[1] accounting principles require that the benefit be treated as a pension benefit even though the benefit is subject to legislative authorization.

The HIS valuation relies primarily on the related FRS assumptions since all the retired members and beneficiaries in pay status are part of the FRS valuation. The investment return assumption is the one outlier beyond the FRS assumptions that is needed to complete the HIS valuation. Newly implemented GASB rules recommend using bond indices for investment return assumptions for valuations like the HIS for which there is no long-term funding. There are a few different bond indices to choose from that are produced by major rating agencies and public finance publications. The conference adopted the Bond-Buyer 20-bond index. This index includes 20 general obligation bonds with 20-year maturities with an average rating of AA. This index is also used in another conference to set rates for estimating PECO bonding capacity. The value of this index was 4.29% as of June 30, 2014, which is slightly higher than the 4.0% investment rate that has been adopted for the HIS at prior conferences but will reflect the current bond market in future valuations as opposed to a fixed rate.

[1] The Governmental Accounting Standards Board (GASB) provides the generally accepted accounting principles (GAAP) used by state and local governments.

Investment Return Assumption for HIS and National Guard Valuations

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Investment Return Assumption

- Currently, HIS and National Guard are effectively funded on a pay-as-you-go basis
- Incoming standards (GASB 67 & 68) give specific direction on the investment return assumption to be used for financial reporting of plans funded on a pay-as-you-go basis
  - The assumption should reflect an index of 20-year, tax-exempt, high-quality (AA/Aa or higher) general obligation municipal bonds
  - The assumption selected should based on market conditions as of the date of the financial reporting in question

Investment Return Assumption

- The needed assumption is solely for GASB-mandated financial reporting
- GASB does not require a specific index
- Two options to consider are:
  - Bond Buyer General Obligation 20-Bond Municipal Bond Index
  - S&P Municipal Bond 20-Year High-Grade Index

Bond Buyer Index

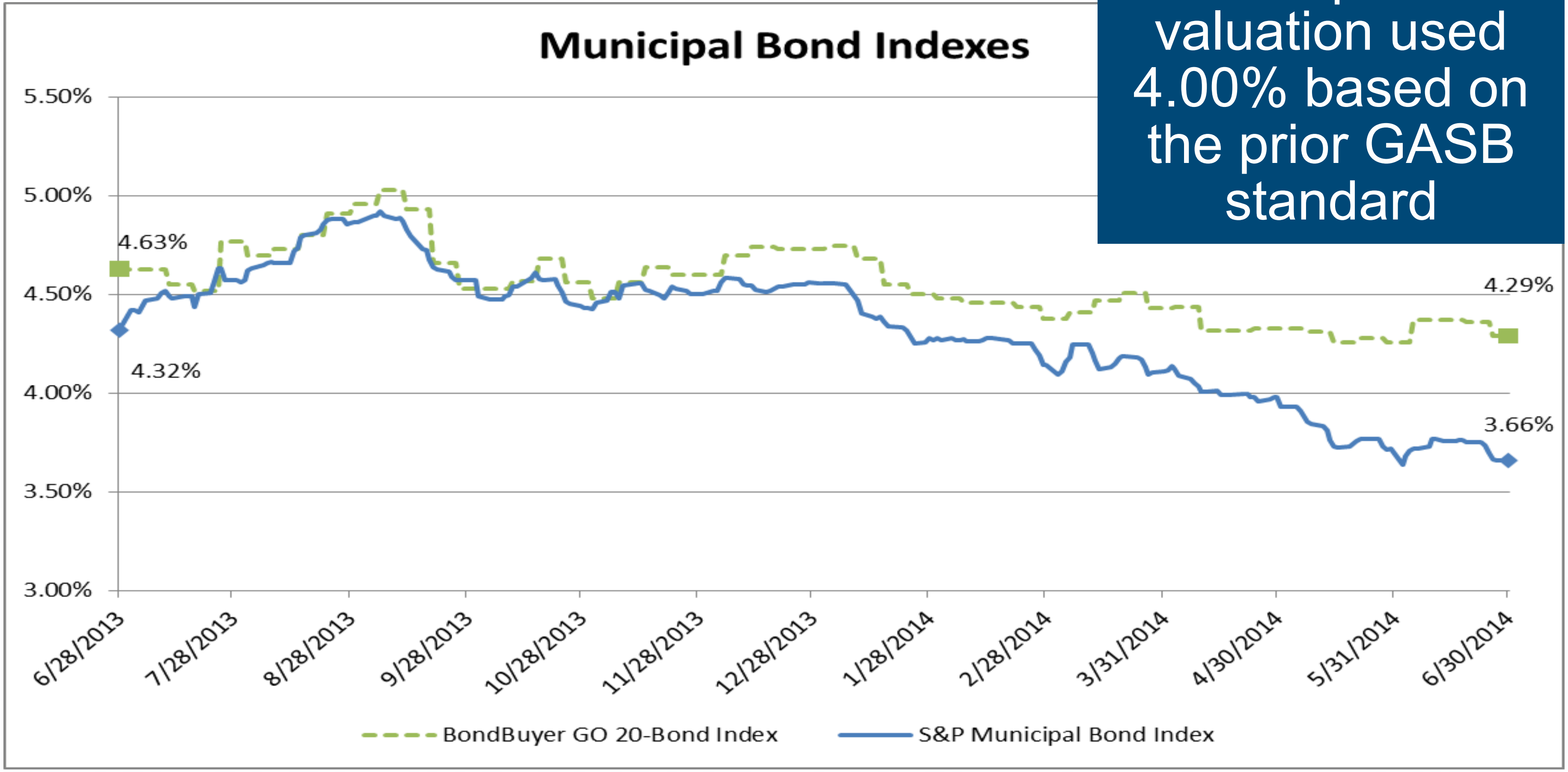
- Bond Buyer says its index:
  - *"consists of 20 general obligation bonds that mature in 20 years. The average rating…is roughly equivalent to Standard & Poor's Corp's AA…The index represents theoretical yields rather than actual price or yields quotations. Municipal bond traders are asked to estimate what a current-coupon bond for each issuer in the index would yield if the bond was sold at par value. The index is a simple average of the average estimated yields."*
- Strengths: 20-year tax-exempt, general obligation bonds
- Weaknesses: Based on estimates instead of market prices; not published daily; not investable; individual bonds in index are below the average rating; number of bonds in index could lead to volatility

Standard & Poor’s Index

- S&P says its index:
  - *“consists of bonds in the S&P Municipal Bond Index with a maturity of 20 years. Eligible bonds must be rated at least AA by Standard and Poor’s Rating Services, Aa2 by Moody’s or AA by Fitch. If there are multiple ratings, the lowest rating is used.”*
- Strengths: Daily valuation based on market prices; investable; each individual bond in index meets rating requirements, which should lower index volatility
- Weaknesses: Not based exclusively on general obligation bonds

Comparison of Bond Indices

The prior valuation used 4.00% based on the prior GASB standard



We need an assumption identified by the Conference for the 2014 valuations of HIS and National Guard