PUBLIC OVERSIGHT HEARING ON THE OTHER POST-EMPLOYMENT BENEFITS FUND FOR FISCAL YEAR 2018

Before the
Committee of the Whole
Council of the District of Columbia

The Honorable Phil Mendelson, Chairman

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John A. Wilson Building, Room 412
1350 Pennsylvania Avenue, NW
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Testimony of
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Good morning, Chairman Mendelson, and members of the Committee of the Whole. I am Bruno Fernandes, Deputy Chief Financial Officer and Treasurer of the District of Columbia. I am pleased to testify on the Fiscal Year 2018 performance of the Other Post-Employment Benefits Fund, hereafter referred to as the “Trust Fund” or the “Plan”.

The Trust Fund’s assets are used to pay health and life insurance benefits for participating District annuitants and the associated administrative expenses. The Trust Fund is administered by the Office of Finance and Treasury (“OFT”) pursuant to the Annuitants’ Health and Life Insurance Employer Contribution Plan document.

As you are aware, Council legislation established the Other Post-Employment Advisory Committee (“Advisory Committee”) comprised of independent, outside subject-matter experts, who provide an additional level of oversight on important issues that can impact the performance and value of the Trust Fund, including actuarial assumptions, investment objectives and recommendations regarding best practices. The last Advisory Committee meeting was held on June 28, 2018. At that meeting OFT provided the Advisory Committee with a performance overview of the program and shared with them similar information in this testimony.

As of September 30, 2018, the Trust Fund was valued at $1.462 billion and had 1,683 beneficiaries participating. For comparison, the program was valued at $1.366 billion for Fiscal Year 2017 and had 1,538 beneficiaries participating. The Trust Fund’s investment portfolio had a rate of return of 5.22% over the past fiscal year. For comparison, the benchmark policy index had a rate of return of 7.09%. The Trust Fund had a return of 9.23% for the three-year period and 6.06% for the five-year period. The actuarial rate of return remains at 6.50%.

OFT has made a considerable effort over the past few years to monitor the Trust Fund’s investments, actuarial analysis and all other necessary elements to ensure the Trust Fund is funded at a level to provide for the District’s cost portion for annuitants’ health and life insurance needs.

A plan’s “Funding Ratio” is the ratio of the value of plan assets to the actuarial accrued liability at a point in time. A plan is considered fully funded when it has a funding ratio between 90% and 120% as of the actuarial analysis date. The funding ratio that was published in the Fiscal Year 2018 CAFR was 105.11%. This figure is likewise presented in terms of dollars and that dollar value is equivalent to a net asset of $71 million. Accordingly, we continue to be a fully funded program.

As you know the District is in a unique position where employees hired before 1987 fall under the civil service retirement plan and receive retiree health benefits through that federal program. The Trust Fund was established to pay for health benefits for employees hired after 1987, and the initial modeling assumptions for participation rates were very conservative to ensure the Plan was appropriately funded.

The funding status of the Plan also allowed us to make changes to the actuarial assumptions in the previous year by adjusting the amortization period from a 30-year closed to a 20-year closed and adjusting the target rate to 6.50%. The amortization and return assumptions remained the same for fiscal year 2018 and match those of the D.C. Retirement Board (“DCRB”). The Plan also incorporated a 5-year smoothing of asset values, which also matches assumptions used by DCRB. The prior and current actuarial work is used to determine the Actuarially Determined Contribution (“ADC”), previously known as the Annual Required Contribution. For

FY18, the ADC was $44.5 million and the fiscal year 2019 ADC calculated by our actuary is $46 million.

OFT works directly with our investment consultant, Segal Marco Advisors (Segal), to constantly review the performance of our investment managers. Segal also works with us to determine the proper asset allocation to achieve the Plan's investment return target. The goal of the allocation is to provide the best risk adjusted returns. Last year, we did not make any asset allocation changes.

Although the District's Trust Fund is well-funded, we continue to review the Trust Fund's program to ensure it not only meets best practices, but exceeds them, which is consistent with one of the Office of the Chief Financial Officer's goals of continuous improvement. We provided and will continue to provide an annual report to the Mayor, Council, and the public that includes: Trust Fund information, the audited financial statements, Plan performance, and actuarial information. The financial statements for Fiscal Year 2018 were completed and given an unqualified (clean) audit opinion by the CAFR auditors, SB & Company.

In June 2018, the Council and Mayor approved legislation to clarify that all administrative expenses be paid out to the Plan. Although most expenses were already paid out of the plan, the legislation confirms legal authority for the Trust Fund to pay for all services and personnel expenses in support and administration of the Plan.

To ensure all aspects of the program are reviewed, we engaged our actuary, PRM Consulting Group, to perform an experience study. Specifically, PRM analyzed the participation rates of the Plan and other assumptions to make sure they align with the modeled assumptions The study was completed in October 2018. Many assumptions tracked well with experience. However, some varied and PRM recommended increases to future participation rates for Police and Fire and reductions to participation rates for Teachers and General Employees. We also issued a new RFP for actuarial services and the contract was awarded to Cheiron, who began performing actuarial services in Fiscal Year 2019. Cheiron will be using the assumptions recommended by the prior actuary, PRM, in their analysis to determine the potential future financial impact. We will continue working with Department of Human Resources, the Advisory Committee, and the actuary to make sure we have the most appropriate model.

In summary, the Trust Fund is in excellent shape. Our goals are to become more transparent, improve oversight of the Plan and ensure that the Trust Fund is managed using best practices.

This concludes my remarks. I would be pleased to answer any questions you may have.