

## **Statement of the Board of Actuaries of the Civil Service Retirement System**

This report from the Board of Actuaries (Board) is intended to accompany the September 30, 2015 actuarial valuations included in the Civil Service Retirement and Disability Fund (CSRDF) Annual Report produced by the Office of the Actuaries (OA) of the Office of Personnel Management (OPM).

### **BACKGROUND**

The Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) provide defined-benefit retirement, disability and survivor protection to millions of non-military federal employees, retirees and beneficiaries. CSRS is a closed plan that generally covers employees hired prior to 1984, and FERS covers employees hired thereafter.

In the Board's opinion, the systems deliver consistent, predictable income with pooled longevity risk and are, from an actuarial perspective, an effective and appropriate way to provide retirement security to the federal government workforce.

Statutory authority for the Board of Actuaries dates back nearly 100 years. Initially, the Board had direct, hands-on involvement in conducting actuarial valuations of the system. Today, actuarial valuations of the system are conducted by the OA. The Board meets annually to establish the key actuarial assumptions used by the OA and provide guidance on other actuarial issues. The Board's work is done with the support and input from the OA.

The actuarial valuation reflected in the CSRDF Annual Report is intended to estimate the full cost of the system and to allocate the cost over time. The results of the valuation may be used to understand the size of the obligation ultimately borne by U.S. taxpayers.

### **ACTUARIAL ALLOCATION OF CONTRIBUTIONS**

The CSRS and FERS system is funded by contributions from employees and from participating federal agencies plus the Treasury. For FERS, the total annual contributions to the system are intended to cover the actuarially determined normal cost<sup>1</sup> plus a provision to amortize unfunded liabilities. FERS unfunded liabilities are amortized over 30 years while payments for CSRS do not target funding of the full liability over any specific period. In aggregate, these approaches are designed to spread costs smoothly over time. Contributions in excess of the total amount needed to cover benefit payments are held in special-issue U.S. Treasury securities<sup>2</sup>. Annual contributions are required from participating federal agencies using a payroll-based allocation methodology.

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<sup>1</sup> Normal cost is the cost of the plan benefits accrued to employees in a single year, as allocated by the actuarial method, without regard to any surplus or deficit in the system.

<sup>2</sup> Government Account Series securities cannot be traded on public markets.

### Annual Contributions to the CSRDF

	Dollars in Billions*	
	10/1/2014 – 9/30/2015	10/1/2013 – 9/30/2014
CSRS	\$35.2	\$34.9
FERS	\$32.8	\$27.8
Total	\$68.0	\$62.7

\*numbers rounded for additive purposes

### **FINANCIAL OBLIGATION OF U.S. TAXPAYERS**

It is useful to understand the total financial obligation of the program because it sheds light on financing needs, tax payer burdens, and the sustainability of the system. The U.S. tax payer ultimately pays the cost of the system's promised pension benefits. The annual cash demands on the U.S. tax payer follow a different pattern than the aggregate annual contributions. The liquidation of funds to pay benefits involves an immediate call on tax revenues because the system's funds are invested in U.S. Treasury securities.

Employees are required to contribute after-tax dollars to CSRS and FERS. These contributions represent federal income. The amount needed for payment of benefits and expenses, in excess of the employee contributions, represents the amount of net annual federal outlays for the system.

### Annual Payments for Beneficiaries

	Dollars in Billions*	
	10/1/2014 – 9/30/2015	10/1/2013 – 9/30/2014
CSRS	\$70.4	\$69.7
FERS	\$11.3	\$ 9.7
Total	\$81.7	\$79.4

### Annual Payments for Beneficiaries, Less Employee Contributions

	Dollars in Billions*	
	10/1/2014 – 9/30/2015	10/1/2013 – 9/30/2014
CSRS	\$69.1	\$68.5
FERS	\$ 9.1	\$ 7.9
Total	\$78.2	\$76.4

\*numbers rounded for additive purposes

The total value of the system costs accrued to date is referred to as the actuarial liability. The actuarial liability represents the governmental obligation to pay the future CSRS and FERS benefits that have accrued for current plan participants, measured at present value according to the actuarial methodology and assumptions recommended by the Board and the OA in accordance with statute and regulations.

Actuarial Liability

	Dollars in Billions	
	9/30/2015	9/30/2014
CSRS	\$1,056.4	\$1,094.0
FERS	\$ 606.5	\$ 568.9
Total	\$1,662.9	\$1,662.9

**CURRENT ISSUES**

The Board looks at some issues every year and takes up other issues when appropriate. The issues under current consideration are described below.

**System financing**

Significant unfunded actuarial liabilities exist for previously accrued costs under the closed CSRS plan that were not fully addressed with past statutory contribution requirements. The current statutory contribution provisions do not target paying off these legacy CSRS unfunded liabilities over a specific period. The implicit period over which the CSRS unfunded liabilities are allocated is long – currently projected to be nearly 70 years. By the standards of other pension systems such as those sponsored by state and local governments, this period is extraordinarily long. However, state and local governments fund their systems with irrevocable contributions from current tax revenues that are invested in private securities. Funds for the federal system are held in the CSRDF which is composed of U.S. Treasury securities that represent a call on future rather than current tax revenues. The unfunded liability is also a call on future tax revenues. Thus, from an overall federal budget perspective, CSRS and FERS may be viewed as a pay-as-you-go system regardless of the ongoing contributions from federal agencies and the Treasury. However, the CSRDF is necessary for administration and payment of the system’s benefits, and its securities allow for direct representation of federal debt for future obligations of CSRS and FERS.

Policy considerations, that the Board does not opine on, with regard to the appropriate allocation of costs over time include:

- Are federal agency budgets being appropriately charged for amortization costs?
- Is there an appropriate balance between explicit federal debt (the U.S. Treasury securities held in the CSRDF) and implicit federal debt (the system’s unfunded liability which is not yet denominated as U.S. Treasury debt) to be achieved?

**Projected cash flows**

From a tax payer perspective, the cash needed to pay promised benefits is increasing and will represent an ongoing demand on U.S. tax payers in the coming decades. The actuarial report prepared by the OA includes a projection of CSRS and FERS benefit payments over the next 75 years. The projection is made in accordance with the economic and demographic assumptions used for the current actuarial valuation but also includes estimated benefits for future plan participants. The Board thinks that the projection can

help policy makers and the public at large understand the demands the system will have on future tax payers.

### **Economic assumptions**

Some of the actuarial assumptions upon which the OA valuations are based are considered economic assumptions. Plan costs allocated to federal agencies are highly dependent on the economic assumptions, as is the estimated value of the taxpayers' obligation. One key assumption is the interest rate used to discount projected future cash flows.

The economic assumptions are reviewed annually by the Board. The interest assumption is based on a judgment associated with the expected "rate of return" on U.S. Treasury securities both now and in the future. The interest rate assumption was reduced to 5.25% from 5.75% beginning with the actuarial valuation as of September 30, 2011. The interest rate assumption could be lowered further (thereby increasing contribution allocations) in coming years in light of the current economic environment with historically low interest and inflation rates.

### **Demographic assumptions**

With the agreement of the Board, the staff at the OA is undertaking a regularly scheduled study of recent demographic experience – including mortality, employee turnover, and retirement rates. This thorough review is expected to be completed in 2017. The Board will carefully review the results of this study and provide guidance to OA with regard to any potential changes in the demographic assumptions used in the annual actuarial valuation.

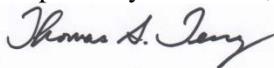
### **Contribution allocations for the U.S. Postal Service (USPS)**

Historically, actuarial assumptions used in the development of federal agency contributions have been based on actuarial valuations using the same assumptions for all agencies. The USPS has formally questioned whether this approach is appropriate going forward for FERS given their contention that there are non-trivial differences in demographic experience (e.g. salary increases and rates of retirement) between the USPS and the other federal agencies. The Board has considered the USPS requests and has recommended that OPM explore amending its regulatory provisions. The Board continues to support use of Government-wide assumptions until such time as regulations provide otherwise.

### **Borrowing from the pension trust**

The Board is aware that the CSRS and FERS trust fund securities are, from time to time, used to finance U.S. Government activities that would otherwise have to be curtailed due to the imposition of statutory limits on explicit debt. Each time this has happened in the past, the fund has been made whole after the debt ceiling has been raised. The Board feels strongly that the retirement system trust fund should be made whole as soon as practical after these events in order to avoid confusion about the financial status of the system.

Respectfully submitted,



Thomas S. Terry  
Chairperson, Board of Actuaries  
January 26, 2017