

Report of  
AN ACTUARIAL VALUATION  
December 31, 1981 of the  
Fairmont Policemen's Benefit Association  
Fairmont, Minnesota

 **FILE COPY**

JUL 12 1982 LCP&R

GABRIEL, ROEDER, SMITH & COMPANY

TABLE OF CONTENTS

<u>Pages</u>	<u>Item</u>
1	Signature Page
A-1	Comments
A-2	Contribution Rate
A-3	Present Actuarial Condition
A-5	Comparative Contribution Schedule
A-6	Contribution Worksheet
B-1	Retirant and Beneficiary Data
B-4	Active Member Data
B-6	Assets Available for Benefits
B-7	Brief Summary of Benefits
C-1	Valuation Method and Assumptions
D-1	Accumulated Plan Benefits Schedule (for FASB 35 compliance)
Appendix I	Financial Principles and Operational Techniques
Appendix II	Meaning of Unfunded Accrued Liabilities

GABRIEL, ROEDER, SMITH & COMPANY  
ACTUARIES & CONSULTANTS

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July 1, 1982

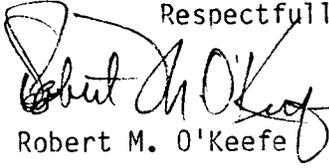
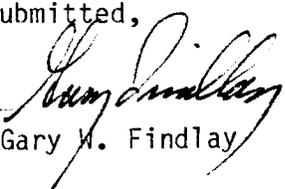
Board of Trustees  
Fairmont Policemen's Benefit Association  
Fairmont, Minnesota

Submitted in this report are the results of the 1981 gain/loss analysis of the financial experiences of the Fairmont Policemen's Benefit Association.

The composite results of this study are reported on Schedule 1, and comments regarding the results are on page 10.

The gain/loss analysis was based upon statistical data furnished by the Association regarding active and retired member changes and related financial transactions.

The actuarial assumptions used for regular valuation purposes and which produce "expected" experience data are shown in the appendix of this report. A brief summary of the Association's benefits is also included in the appendix.

Respectfully submitted,  
  
Robert M. O'Keefe  
  
Gary W. Findlay

SECTION A  
RESULTS OF THE VALUATION

COMMENTS

Economic Assumptions and Financing Method

The economic assumptions of 5% annual investment return and 3 1/2% annual salary increases are established by state law. State law also specifies that the annual minimum obligation of the municipality shall be determined by adding (i) the employer normal cost percent times covered payroll to (ii) the level dollar amount required to amortize the unfunded accrued liability by December 31, 2010.

Over the past few years, both the actual rates of salary increase and investment return have generally exceeded the assumed rates, resulting in increases in the dollar amount of unfunded accrued liabilities. If the financial experiences of recent years persist, and the economic assumptions and financing method are not changed, it is reasonable to expect that unfunded accrued liabilities will increase in actual dollar amount for a number of years. This is true even though a level dollar amortization schedule is being followed. Accordingly, it is reasonable to expect that under the described conditions the actual dollar contributions required to make amortization payments will increase for a number of years. On the other hand, if inflation subsides and actual economic activity approaches assumed experience, it is reasonable to expect the dollar amount of the contribution to amortize the unfunded accrued liability to remain relatively constant. The notion that amortization dollar amounts may be increasing is not necessarily cause for alarm. If adjusted for changes in purchasing power, any future increases in the dollar contributions may or may not reflect increases in terms of real dollars (inflation adjusted dollars).

It is also worth noting that when the same assumptions and methods are applied to plans which differ in nature, the valuation results may not be comparable (for example, it is currently not valid to compare valuation results for a plan having full escalation to valuation results for a plan having a 3 1/2% cap on escalation). Caution should be exercised when attempting to assess the financial condition of one Association relative to another on the basis of valuation results produced using the assumptions and methods mandated by state law.

Fairmont Policemen's Benefit Association

CONTRIBUTION RATE TO PROVIDE BENEFITS

Member portion & Employer portion

Effective January 1, 1983

<u>Contributions for</u>	<u>If Paid Equally Throughout Year</u>	
	<u>Normal Cost % of Active Payroll for 1983</u>	<u>U.A.L. Dollars</u>
Normal cost of annuities:		
Age & service: to members	24.89%	
Age & service: to survivors	5.18	
Disability	2.15	
Death before retirement	2.18	
Refunds of member contributions	0.61	
Total Normal Cost	<u>35.01%</u>	
Amortization of unfunded accrued liabilities (UAL) (28 year level dollar payment)		
Retired lives		\$ 42,290
Active members		<u>76,901</u>
Total		<u>119,191</u>
Total Cost of Benefits	35.01%	+ \$119,191
Member contributions	8.00%	
COMPUTED EMPLOYER RATE:		
(a) If Paid Equally Throughout Year	27.01%	+ \$119,191
(b) IF PAID AT CALENDAR YEAR END	27.68%	+ \$122,134

Fairmont Policemen's Benefit Association  
Present Actuarial Condition

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The Association accrued actuarial assets were in excess of \$750,000 on December 31, 1981 -- a considerable sum of money if unencumbered and allocated among a small group of persons. This is not the case with Association assets.

The following schedule puts the \$750,000 into perspective by showing the relationship between accrued assets, accrued liabilities, and the number of persons with actual and potential claims on the Association's assets.

	<u>Accrued Actuarial Assets</u>	<u>Accrued Liabilities</u>	<u>Unfunded Accrued Liabilities</u>	<u>% Funded</u>
Retirants and Beneficiaries				
Retired Members (8)		\$1,196,352		
Surviving Spouses (2)		98,174		
Surviving Children (0)		0		
Total (10)	\$648,868	\$1,294,526	\$ 645,658	50%
Deferred Members (0)	0	0	0	
Active Members (10)	<u>102,464</u>	<u>1,276,552</u>	<u>1,174,088</u>	8
Total	\$751,332	\$2,571,078	\$1,819,746	29%

Accrued liabilities represent the value, computed as of December 31, 1981 of:

- (i) retirement allowances likely to be paid the 10 retirants and beneficiaries;  
and
- (ii) the contributions assumed to have been made for the 10 active members  
from their entry into the plan until December 31, 1981.

To illustrate, the value of retirement allowances likely to be paid the 10 retirants and beneficiaries, discounted for investment earnings and mortality, was computed to be \$1,294,526 as of December 31, 1981. This means that if the 10 retirants and beneficiaries live and die according to the assumed mortality and if the \$1,294,526 can be invested to yield an average annual return of 5.0 percent over the remaining lifetimes of the 10 retirants and beneficiaries, then the \$1,294,526 together with investment earnings thereon will just be sufficient to pay the 10 retirants and beneficiaries their allowances for their remaining lifetimes.

With respect to active members, the accrued liability of \$1,276,552 represents the amount that would have been accumulated by December 31, 1981 if the normal cost (which is expressed as a level percentage of pay) had been contributed from the date of hire until December 31, 1981 for each of the 10 actives, if these amounts had earned 5.0% interest and if the members in the past had lived, died, withdrawn, retired and received salary increases according to the actuarial assumptions shown in this report.

Historical Funding Ratio Schedule  
(\$ in thousands)

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<u>Valuation Date December 31</u>	<u>Accrued Liabilities</u>	<u>Accrued Assets</u>	<u>Percent Funded</u>
1978	\$1,626	\$464	29%
1979	N/A	N/A	N/A
1980	2,306	624	27
1981	2,571	751	29

Fairmont Policemen's Benefit Association  
 Computed Contributions - Comparative Schedule

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Year Ended December 31		Total Normal Cost as a Percent of Valuation Payroll*	Contribution For Unfunded Accrued Liabilities - \$ or %
<u>Valuation</u>	<u>Fiscal</u>		
1978	1980	29.03%	\$ 68,523
1979	1981	N/A	N/A
1980	1982	34.11	108,448
1981	1983	35.01	119,191

\* Includes funds received from state and funds received from local mill tax.

Fairmont Policemen's Benefit Association  
CONTRIBUTION FOR CALENDAR YEAR EFFECTIVE JANUARY 1, 1983

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For any period of time the percent-of-payroll contribution rate is converted to dollars. The amount of dollars for any calendar year depends upon the results of the last actuarial valuation, and upon the timing of contributions within the year. The later the contribution date, the greater the dollar amount will be.

The municipality's dollar contribution for the year may be determined as follows:

(1) Estimated covered payroll for 1983	\$ _____	
(2) Total normal cost % from page A-2	35.01%	
(3) Total normal cost (Line 1 times line 2)		\$ _____
(4) Amortization payment on UAL from page A-2		119,191
(5) Total contributions required (Line 3 plus line 4)		_____
(6) Employee contributions (Line 1 times 8%)	\$ _____	
(7) State amortization aid based on 12/31/78 UAL of \$1,161,771	17,485	
(8) Estimated insurance premium aid	_____	
(9) Estimated total contributions from other sources (Line 6 plus line 7 plus line 8)		_____
(10) Employer's Minimum Obligation if payment is made in equal installments throughout the year. (Line 5 minus line 9)		\$ _____
(11) EMPLOYER'S MINIMUM OBLIGATION IF PAYMENT IS MADE AT YEAR END (Line 10 times 1.0247)		\$ _____

SECTION B  
VALUATION DATA  
AND  
SUMMARY OF BENEFIT PROVISIONS

Fairmont Policemen's Benefit Association  
 Retirants and Beneficiaries December 31, 1981  
 By Type of Annuity Being Paid

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<u>Type of Annuity Being Paid</u>	<u>No.</u>	<u>Monthly Amounts</u>	<u>Computed Accrued Liabilities</u>
Retirants receiving:			
Age & Service	8	\$6,600.00	\$1,196,352
Disability	<u>0</u>	<u>          </u>	<u>          </u>
Totals	8	6,600.00	1,196,352
Beneficiaries receiving:			
Spouse	2	472.50	98,174
Child	<u>          </u>	<u>          </u>	<u>          </u>
Totals	2	472.50	98,174
Totals	<u>10</u>	<u>\$7,072.50</u>	<u>\$1,294,526</u>

Inactive Members Eligible for Deferred Benefits  
 December 31, 1981

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<u>No.</u>	<u>Monthly Amount</u>	<u>Computed Accrued Liabilities</u>
0	\$0	\$0

Fairmont Policemen's Benefit Association  
 Retirants and Beneficiaries December 31, 1981  
 By Attained Ages

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<u>Attained Ages</u>	Number		
	<u>Age &amp; Service Retirants</u>	<u>Disability</u>	<u>Death Before Retirement</u>
45-49			1
55-59	4		
60-64	2		
65-69	2		
70-74	<u>1</u>	<u>—</u>	<u>—</u>
Totals	9	0	1

Fairmont Policemen's Benefit Association  
Retirants and Beneficiaries Added to and Removed from Rolls

Comparative Statement

Valuation Date <u>December 31</u>	<u>No. Added to Rolls</u>	<u>No. Removed from Rolls</u>	<u>Rolls End of Year</u>		<u>% Incr. in Annual Allowances</u>	<u>Average Allowances</u>	<u>Discounted Value of Allowances</u>	
			<u>No.</u>	<u>Annual Allowances</u>			<u>Total</u>	<u>Average</u>
1978			12	\$60,413	- %	\$5,034	\$1,016,268	\$ 84,689
1979	0	1	11	70,479	17	6,407	1,146,741	104,249
1980	0	1	10	76,863	9	7,687	1,213,143	121,314
1981	0	0	10	84,870	10	8,487	1,294,526	129,453

Fairmont Policemen's Benefit Association  
 Active Members December 31, 1981  
 By Attained Age and Years of Service

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Attained Age	Years of Service to Valuation Date							Totals	
	0-4	5-9	10-14	15-19	20-24	25-29	30 Plus	No.	Valuation Payroll
30-34		1						1	\$ 19,800
35-39		1	3					4	81,936
40-44			1	2				3	62,136
45-49				1				1	23,748
55-59					1			1	26,231
Totals		2	4	3	1			10	\$213,851

While not used in the financial computations, the following group averages are computed and shown because of their general interest.

Age: 40.7 years.

Service: 13.9 years.

Annual Pay: \$21,385.

Fairmont Policemen's Benefit Association  
 Comparative Schedule  
 Of Active Members

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Valuation Date December 31	Active Members	Valuation Payroll	Average			% Incr.
			Age	Service	Pay	
1978	11	\$151,800	36.5 yrs.	10.1 yrs.	\$13,800	- %
1979	11	177,936	37.5	11.1	16,176	17
1980	11	213,947	38.5	12.1	19,450	20
1981	10	213,851	40.7	13.9	21,385	10

Fairmont Policemen's Benefit Association

Brief Summary (12/31/81) of Benefit Provisions Evaluated and/or Considered

Age & Service Retirement

Eligibility. 20 years of service and 50 years of age.

Amount. For first 20 years service, 50% of base pay. For years in excess of 20 an additional 2% is added to a maximum of 60% of base pay for 25 years service. (Service after attainment of age 55 is not considered for benefit purposes.)

Pay Used For Plan Purposes. "Base pay" means maximum salary paid to a first class patrolman.

Disability Retirement

Eligibility. Disabled to the extent that unable to perform duties of a police officer before being eligible for age & service retirement.

Amount. 50% of base pay.

Member's Death While Active, Or In Deferred Status, Or Retired

Eligibility.

Spouse. Legally married to member at separation from service and residing with member at time of death. Benefits terminate upon remarriage.

Child. Younger than age 18.

Amount.

Spouse. 25% of base pay.

Child. 6.25% of base pay per child. Children's maximum is 25% of base pay if spouse is receiving or 50% of base pay if no spouse is receiving.

Vested Deferred. 20 years of service and separated before age 50. Payment beginning is deferred to attainment of age 50.

Post Retirement Adjustments ("Escalator"). Each time base pay is changed, payments to benefit recipients are simultaneously changed by the same percent that base pay is changed.

Member Contributions. 8% of base pay. Total member contributions are refundable, without interest, if no monthly benefit is payable upon separation from service.

SECTION C

VALUATION METHODS AND ASSUMPTIONS

Fairmont Policemen's Benefit Association

Valuation Methods and Assumptions

The Entry Age Normal Cost method was used to determine the normal cost of all benefits.

The rate of investment return (interest) used in making the valuation was 5.0 percent per annum, compounded annually. State law requires use of this assumption.

The mortality table used was the United States Life Table, 1959-61, White Males and White Females.

Sample Ages	Single Life Values: Present Value of \$1 Monthly				Future Life Expectancy (Years)	
	Level For Life		Increasing 3.5% Yearly		Men	Women
	Men	Women	Men	Women		
45	\$169.61	\$186.84	\$263.23	\$304.86	27.33	32.52
50	154.85	174.20	229.51	270.80	23.22	28.08
55	139.29	159.62	197.24	236.11	19.45	23.81
60	122.79	142.73	166.26	200.76	16.01	19.69
65	106.31	124.22	137.82	166.16	12.97	15.88
70	89.86	104.31	111.71	132.82	10.29	12.38
75	73.39	83.92	87.66	101.94	7.92	9.28
80	57.54	64.24	66.29	74.77	5.89	6.67

Age & service retirement was assumed to occur at age 53, or attained age if older.

Sample Rates of Separation From Active Employment Before Retirement, Death or Disability

Sample Ages	% of Active Members Separating Within Next Year
20	3.00%
25	2.50
30	2.00
35	1.50
40	1.00
45	0.50
50+	0.00

Pay Adjustment Factor used to Project Current Pays

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<u>Sample Ages</u>	<u>Present Pay Resulting in Pay of \$1,000 at Age 60</u>	<u>Percent Increase in Pay During Next Year</u>
20	\$ 253	3.5%
25	300	3.5
30	356	3.5
35	423	3.5
40	503	3.5
45	597	3.5
50	709	3.5
55	842	3.5
60	1,000	3.5

Use of the pay adjustment factor illustrated above is required by state law.

Disability retirements were assumed to occur as indicated below:

<u>Sample Ages</u>	<u>% of Active Members Becoming Disabled Within Next Year</u>
20	0.08%
25	0.08
30	0.08
35	0.08
40	0.20
45	0.26
50	0.49
55	0.89

SECTION D  
ACCUMULATED PLAN BENEFITS

Fairmont Policemen's Benefit Association  
Statement of the Present Value of Accumulated Plan Benefits  
December 31, 1981

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Actuarial Present Value of  
Accumulated Plan Benefits

Vested Benefits:	
Participants currently receiving payments	\$1,295,993
Other participants	<u>291,108</u>
Total Vested Benefits	<u>1,587,101</u>
 Non-Vested Benefits	 <u>545,770</u>
 Total Actuarial Present Value of Accumulated Plan Benefits	  \$2,132,871

The accompanying notes are an integral part of the Statement of the Present Value of Accumulated Plan Benefits.

1. The actuarial present value of accumulated plan benefits presented in this statement was determined using the following assumptions:
  - a. Future salary increases prior to retirement were not considered for active members.
  - b. Future service was considered only to the extent that it would permit active plan participants to become eligible for benefits attributable to service rendered prior to the date of determination.
  - c. Regular valuation assumptions were used as to mortality, withdrawal, retirement ages, and disability.
  - d. Investment return was assumed to be at the rate of 7% compounded annually.
  - e. Salary increase related post retirement benefit adjustments were assumed to be at the rate of 5 1/2% compounded annually unless a lower rate is specified by law.
  
2. The calculation of the actuarial present value of accumulated plan benefits was made because of the requirements of the Financial Accounting Standards Board. Comparison of this value with plan assets is not indicative of the future ability of the plan to pay benefits when due or of their security in a termination situation.

Calculation of contribution requirements and related benefit value information in a "going concern" environment according to the principles of level cost financing is made by the annual actuarial valuations. The results of the contribution rate calculations cannot be simply replaced by the accumulated plan benefit results. To do so will mislead.

APPENDICES

APPENDIX I

FINANCIAL PRINCIPLES AND OPERATIONAL TECHNIQUES

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Promises Made, and Eventually Paid. As each year is completed, the plan in effect hands an "IOU" to each member then acquiring a year of service credit -- the "IOU" says: "The Pension Plan owes you a portion of your retirement benefits, payments to be made in cash, commencing when you qualify for retirement."

The related key financial questions are:

Which generation of taxpayers contributes the money to cover the IOU?

The present taxpayers, who receive the benefit of the member's present year of service?

Or the future taxpayers, who happen to be in town paying taxes at the later time when the IOU becomes a cash demand?

A sound principle of sound retirement plan financing is to have this year's taxpayers contribute the money to cover the IOUs being handed out this year. By following this principle, THE CONTRIBUTION RATE WILL REMAIN APPROXIMATELY LEVEL FROM GENERATION TO GENERATION -- our children and grandchildren will contribute the same percents of active payroll we contribute now.

A PENSION PLAN BECOMES CLOSED

The diagram in this appendix shows two important activities which occur after a plan has been closed to employees hired in the future.

Cash benefits paid continue to increase for decades, while active member payroll begins to decrease to zero.

Funding Method. A funding method is the long-term, planned pattern for employer contributions.

For an open plan (a plan covering future employees), the level-percent-of-active member payroll funding method is the basic funding method.

The level-percent funding method can also be applied to a closed plan. However, the resulting contribution percent usually jumps to a high rate, because the number of covered active members is decreasing.

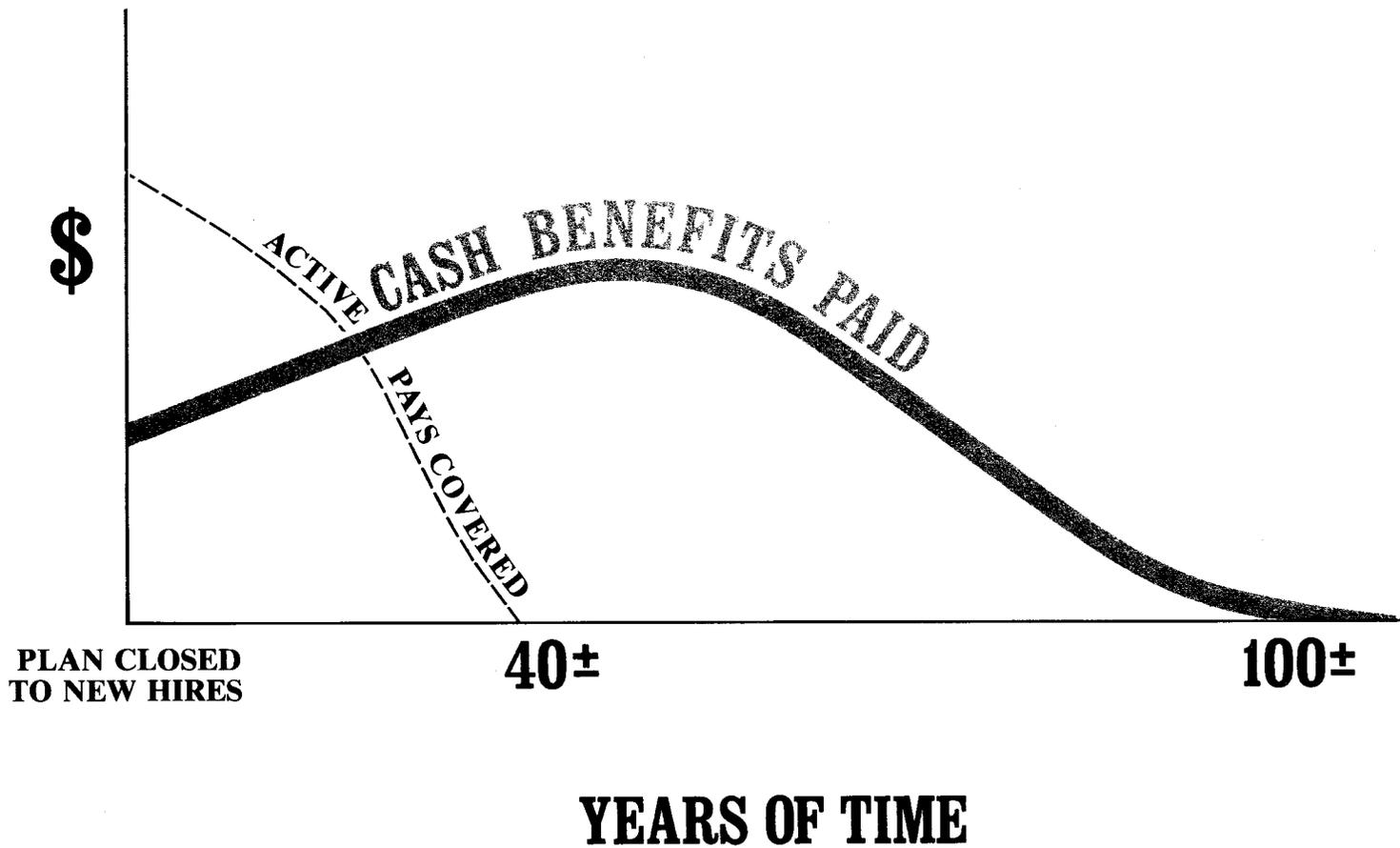
A preferred funding method for a closed plan consists of: level-percent funding for normal cost (the cost of members' service now being rendered); plus a level dollar contribution for unfunded accrued liabilities over a limited period of years. The period of years must be limited so that plan assets don't become zero while benefits are still payable.

Computing Contributions to Support Plan Benefits. From a given schedule of benefits and from the employee data and asset data furnished him, the actuary determines the contribution rates to support the benefits by means of an actuarial valuation and a funding method.

In making an actuarial valuation, assumptions must be made regarding anticipated financial experiences for the next year and for decades in the future. Only the subsequent actual experience of the plan can indicate the degree of accuracy of the assumptions. Reconciling Differences Between Assumed Experience and Actual Experience. Once actual experience has occurred and been observed, it will not coincide exactly with assumed experience, regardless of the wisdom of the assumptions or the skill of the actuary and the millions of calculations he made. The future can be predicted with considerable but not 100% precision, except for inflation which seems to defy reliable prediction.

A well managed plan copes with these continually changing differences by having periodic actuarial valuations. Each actuarial valuation is a complete recalculation of assumed future experience, taking into account all past differences between assumed and actual experience. The result is continuing adjustment in financial position.

# A CLOSED PENSION PLAN



A plan becomes closed when no new hires are admitted to active membership. The persons covered by the plan at the time of closing continue their normal activities and continue to be covered by the plan, until the last survivor dies.

**CASH BENEFITS LINE.** After a pension plan becomes closed, the usual pattern is for cash benefits to continue to increase for decades of time. Eventually the cash benefits will peak, and then gradually decrease over more decades of time, ultimately to zero. The last cash benefit is likely to occur a century after the time the plan is closed.

The precise amounts of cash benefits cannot be known now, and must be estimated by assumptions of future experiences in a variety of financial risk areas.

MEANING OF UNFUNDED ACCRUED LIABILITIES

Almost every pension plan (public or private) has "unfunded accrued liabilities", so whatever they are, they aren't rare. Since the term is not part of everyday conversation, it needs some definition.

"Accrued liabilities" are the present value \$ of plan promises to pay benefits in the future based upon service already rendered - - - a liability has been established ("accrued") because the service has been rendered, but the resulting monthly cash benefit may not be payable until years in the future. Accrued liabilities \$ are the result result of complex mathematical calculations, which are made by the plan's actuary (which is the name given to the specialist who makes such calculations).

If "accrued liabilities" at any time exceed the plan's accrued assets (cash & investments), the difference is "unfunded accrued liabilities". This is the common condition. If the plan's assets equalled the plan's "accrued liabilities", the plan would be termed "fully funded". This is a rare condition.

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 Each time a plan adds a new benefit which applies to service already rendered, an "accrued liability" is created, which is also an "unfunded accrued liability" because the plan can't print instant cash to cover the accrued liability. Payment for such unfunded accrued liabilities is spread over a period of years, commonly in the 20-40 year range.

Unfunded accrued liabilities can occur in another way: If actual financial experience is less favorable than assumed financial experience, the difference is added to unfunded accrued liabilities. In plans where plan benefits are directly related to an employee's pay near time of retirement (a common plan provision) rather than his average pay throughout his working career, unfunded accrued liabilities have been increasing in recent years because unexpected rates of pay increase have created additional accrued liabilities which could not be matched by reasonable investment results. Some of these unexpected pay increases are the direct result of inflation, which is a very destructive force on financial stability.

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The existence of unfunded accrued liabilities is not bad, then (any more than a mortgage on your house is "bad"), but the changes from year to year in amount of unfunded accrued liabilities are important - - - "bad" or "good" or somewhere in between.

Nor are unfunded accrued liabilities a bill payable immediately (your food costs are payable immediately), but it is important that policy-makers prevent the amount from becoming unreasonably high and it is vital that your plan have a sound method for making payments toward them so that they are controlled.

The existence of large amounts of unfunded accrued liabilities indicates that total contributions in past years were less than level - - - an almost certain history if retired life liabilities are not fully funded now.