

Pension Study Task Force
Ald. Michael Murphy, Chair

Public Employee Pension System
Comparison Summary

August 25, 2011

Presentation Goals

1. Establish an information base to apply to policy judgments regarding ERS plan design for General City employees hired in 2012 and after
2. Identify estimates of how modifications to various plan design components affect normal cost and future Plan liabilities

Pension Replacement Ratio

1. The percentage of a worker's preretirement income (i.e., final salary) that the pension will replace.
2. Retirement plan analysis of replacement ratio adequacy should account for impact of Social Security
3. Milwaukee's general city employees participate in Social Security
4. Defined benefit plan participants benefit from a stable replacement ratio that does not depend on post-retirement investment results
5. Post-retirement adjustments are often used in defined benefit plans to maintain replacement ratios.

AON Replacement Ratio Study

1. 2008: 7th periodic update
2. Replacement ratio needs vary by income level
 - 90% desirable for low wage workers
 - 78-80% desirable for workers with annual earnings of \$50K-\$90K
 - Analysis assumes age 65 retirement
3. Social Security replacement ratios (age 65 retirement/primary beneficiary):
 - \$30,000 FAS: 59%
 - \$50,000 FAS: 51%
 - \$70,000 FAS: 42%
 - \$90,000 FAS: 36%
 - Age 62 SS retirement=> 25% reduction for primary born 1943-54
4. Replacement ratio analysis integrates social security projected income with projected pension/retirement savings income
5. Policy questions for plan design:
 - Desired replacement ratio
 - Normal retirement age
 - What constitutes “career service”
 - Role of employee savings
 - Impact of post-retirement inflation on the replacement ratio

Milwaukee ERS Replacement Ratios: General City Employee

Example

- Age 62 retirement
- 35 years of City service credit
- FAS of \$55,000
- No actuarial deduction
- 1. Retirement allowance: \$38,500
- 2. Social Security: \$20,006 (reflects 25% ER penalty)
- 3. Total: \$58,506
- 4. Replacement ratio: 106% of FAS
 - 1.5% COLA begins after 2 years of retirement
 - 2% COLA begins after 5 years of retirement

Comparative Information on Major Public Employee Retirement Systems (PERS)

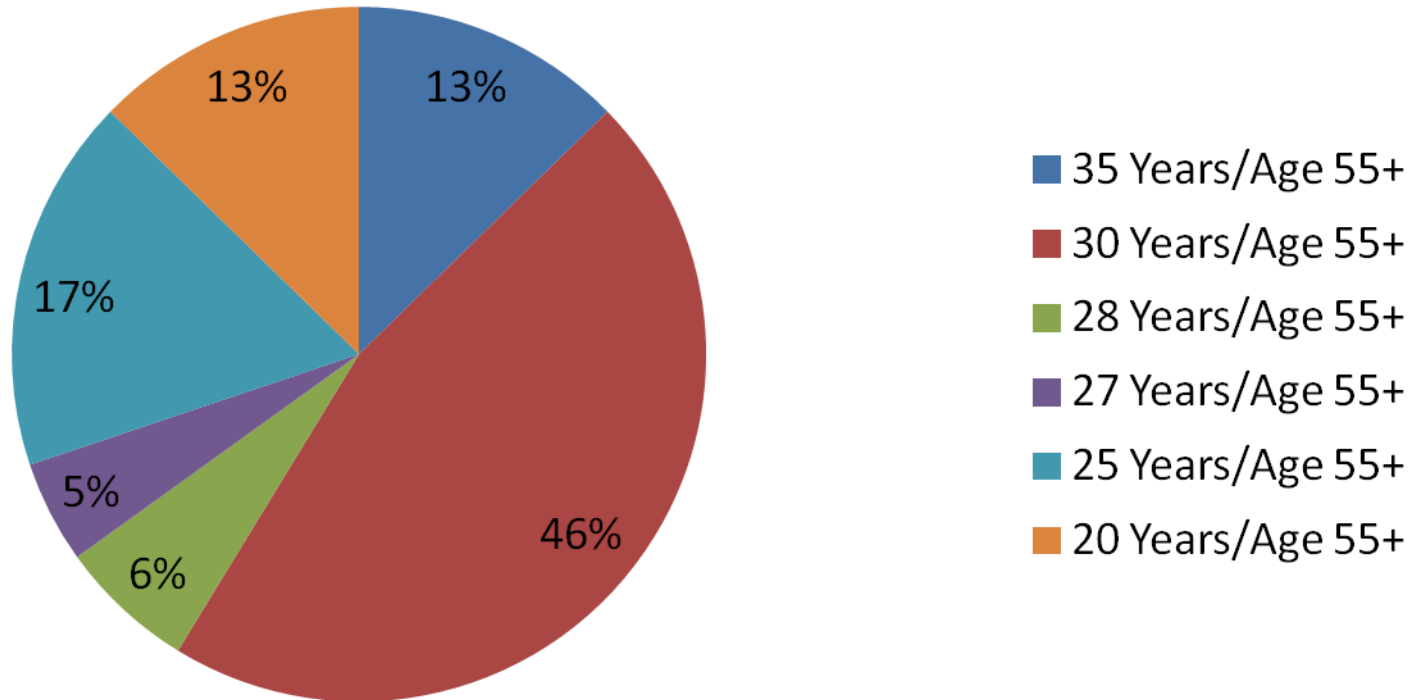
- The following section allows for some benchmarking of current ERS plan design features with other major PERS
- In the last 2 years significant plan changes have occurred in several systems, which this survey does not capture

- In 2008, the Wisconsin Legislative Council produced a comparative study of 87 public employee retirement systems throughout the country
 - Information was updated and revised as of May 2010
- The following information restates and summarizes many of the findings from that study in relation to the City of Milwaukee Employees Retirement System (ERS)
- Focus is on general city employees

Normal Retirement

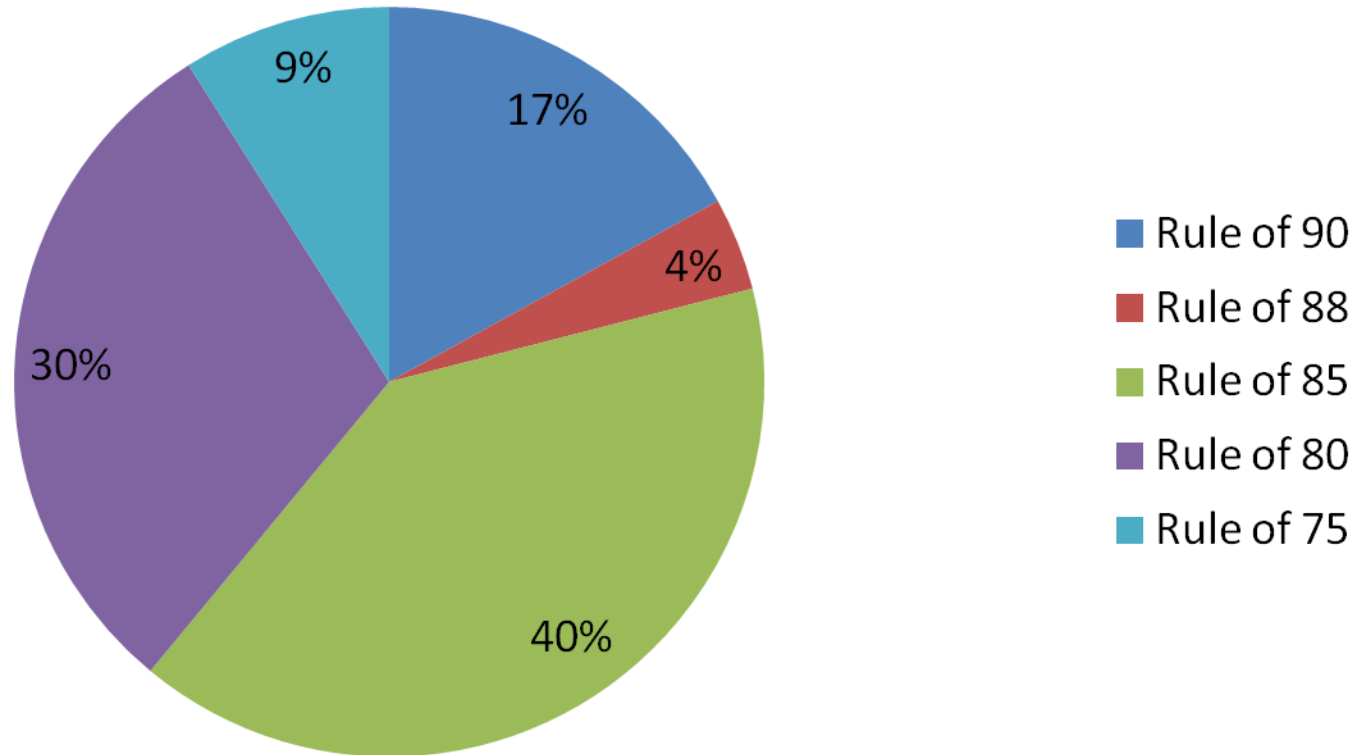
- Normal retirement refers to the age, number of years of service, or both, that a person must attain in order to qualify for full retirement benefits without an actuarial reduction in annuity
- Many of the plans surveyed have adopted “X years and out” provisions which allow an employee to retire at a minimum age with normal benefits after “X” years of service
- Other plans have adopted “Rule of Y” provisions where a person can retire with normal benefits when that person’s number of years of service, plus age, equals a specific number
- In addition,
 - 97% of the surveyed plans allow normal retirement at age 62 or earlier
 - 65% of plans permit normal retirement at age 62 or earlier with 10 or less years of service
 - Only 2 surveyed plans restrict normal retirement age to 65
 - 74% of surveyed plans have a vesting period of 5 years or less (vesting has been trending this way, possibly due to federal vesting guidelines on private pension plans)

Normal Retirement "X Years and Out" Provisions (63 Plans)



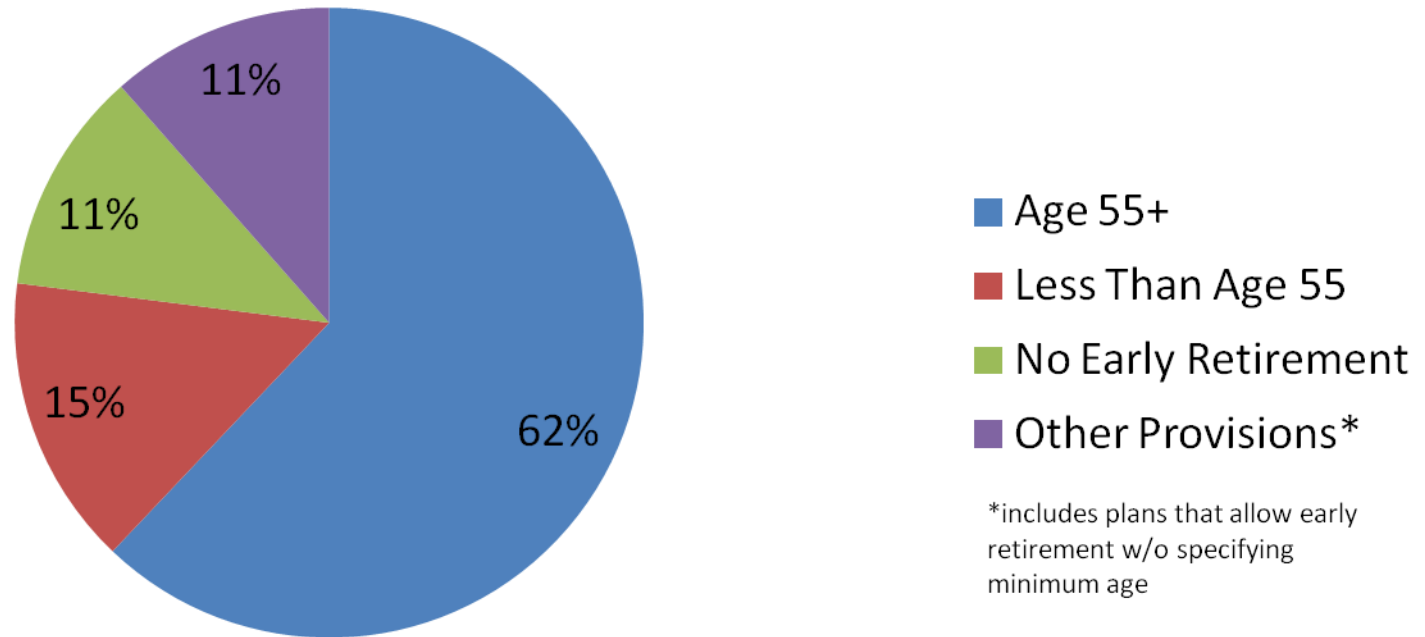
•Milwaukee's plan provides for retirement at 30/55 which is in line with the majority of summarized plans.

Normal Retirement "Rule of Y" Provision (23 Plans with this provision)



- Milwaukee's plan does not provide for a combination of years and age. For comparison, Milwaukee County's plan provides for a rule of 75, which places them in line with 17% of plans surveyed.
- Some rule of Y plans contain a minimum age to qualify for benefits

Early Retirement Provision (With a reduced benefit)

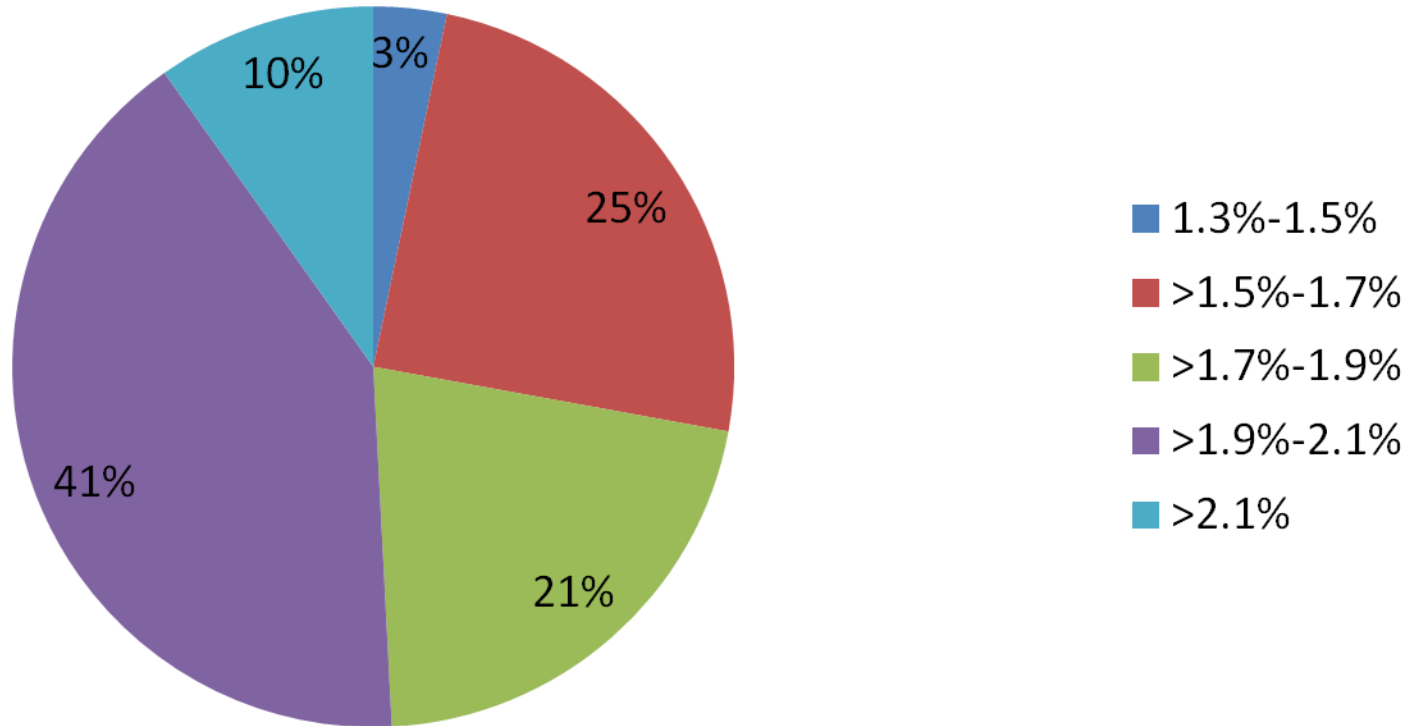


•Milwaukee's early retirement provision is age 55 with 15 years of service. Its minimum early retirement age is in line with a majority of surveyed plans. The actuarial deduction is approximately 40% for those retiring at the earliest eligible age. Retirement at age 59 carries a reduction of ~ 10%.

Formula Multipliers

- Formula multipliers represent the percentage of the final average salary that an employee earns as a retirement annuity for each year of service
- For 2008, the average formula multiplier among the surveyed plans that coordinate with social security was 1.94%, with a range from 1.3%-over 2.1%
- Average multiplier for plans that do not coordinate with social security was 2.3% with a range from 2%-3.3%.

Formula Multipliers (61 Plans)

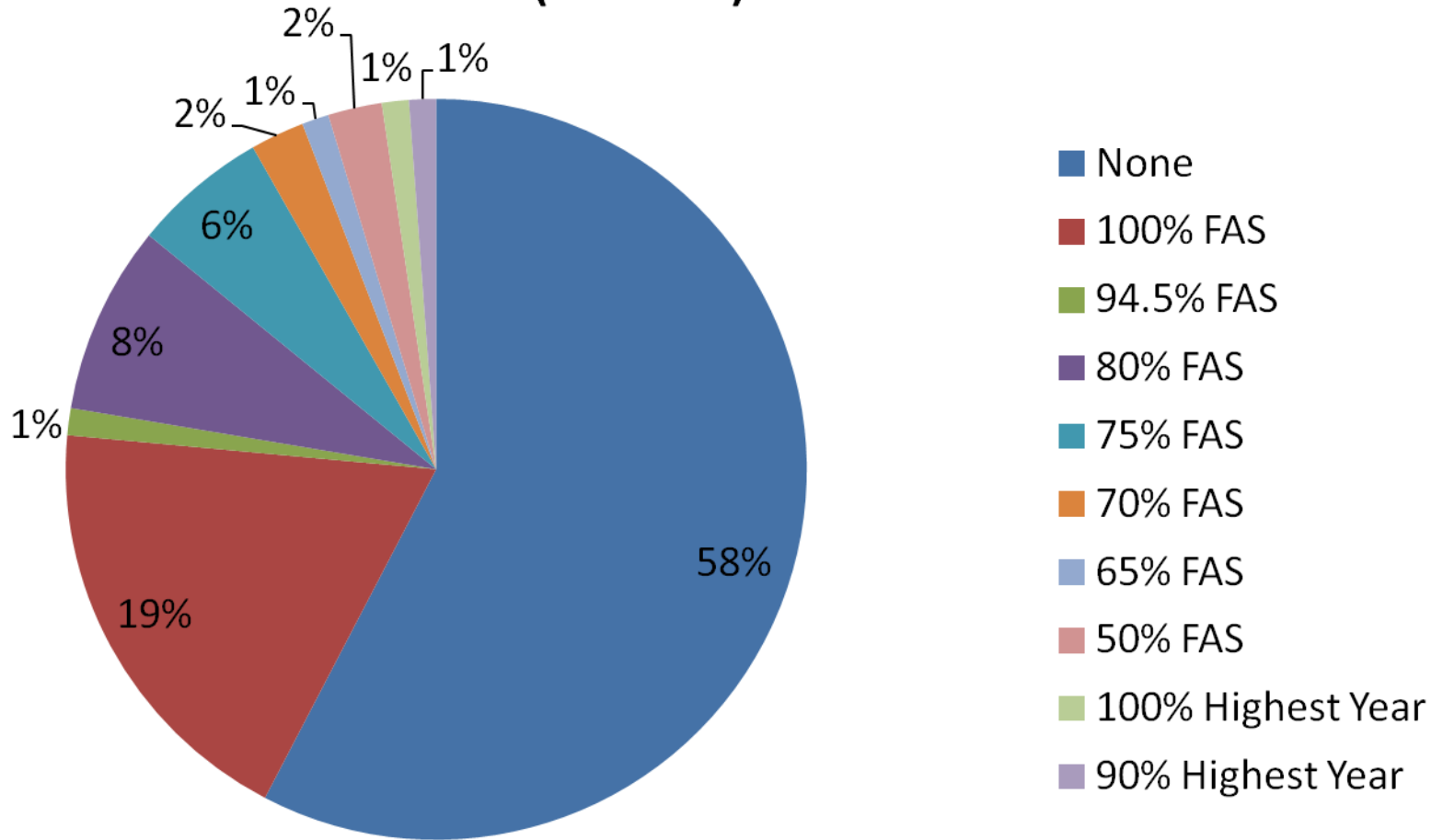


•Milwaukee's plan provides for a 2% annual multiplier for general employees. This is in line with the largest category (41%) of surveyed plans but provides a larger benefit than 49% of plans.

Limitations on Benefits

- Several plans have established a limit on the amount of pension benefits that may be received by a retiree
- The limit is normally expressed as:
 - Maximum percentage of FAS
 - Maximum percentage of highest salary
- The majority of surveyed plans place no limit on benefits
 - An employee may receive a pension amount that is in excess of their salary
- Milwaukee ERS has a maximum benefit of 70% of Final Average Salary

Limitations on Benefits (85 Plans)

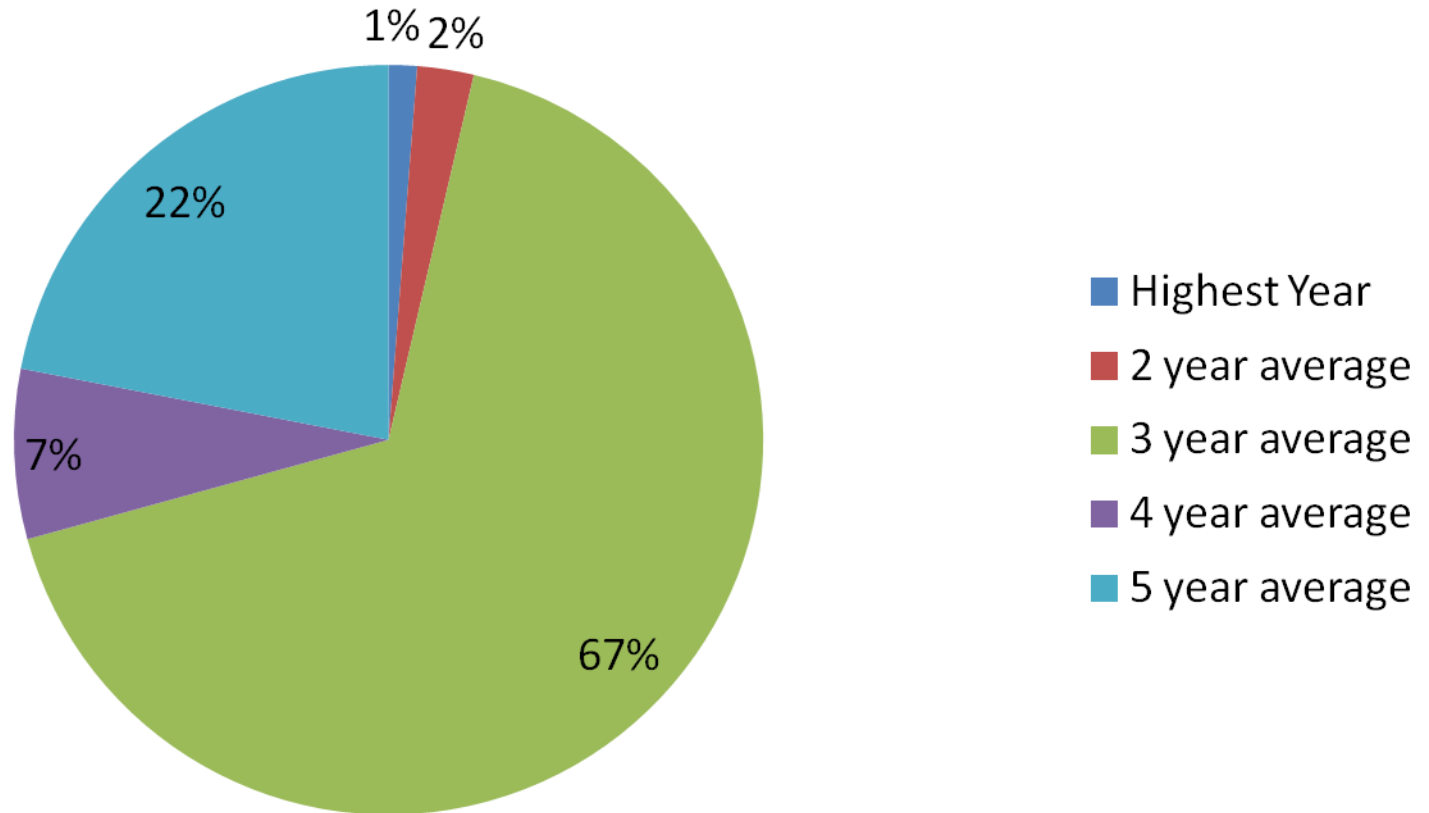


•Milwaukee's plan caps benefits at 70% of final average salary. Only 7% of the plans surveyed provided the same or less benefit than Milwaukee's plan

Final Average Salary (FAS)

- FAS is generally described as the employee's highest earning over a specific number of years or months
- The majority of surveyed plans used either a 3 or 5 year highest average salary
- For comparison, Social Security uses a career average salary calculation

Final Average Salary (82 Plans)



•Milwaukee’s plan calculates benefits based upon the 3 highest years average salary. This provides for a larger final benefit amount than 29% of surveyed plans, but is in line with the 67% of plans.

Cost of Living Adjustments (COLAs)

- Of the plans survey 70% have provisions for some form of automatic annual COLAs
 - Adjustments indexed to CPI
 - COLA is indexed to the change in CPI. There is often a cap on the percentage of any annual CPI increase (1.5%-3%)
 - Average CPI increase of 2.7 % from 2000-2009
 - Automatic percentage increase
- Other plans provide options for potential COLAs
 - Investment surplus
 - COLA is tied to the performance of the pension investments
 - Ad hoc
 - Any increase must be authorized by decision making body
- Automatic annual increases add substantially to employer liability and risk

COLA Policy Considerations

1. ERS general city (GC) “normal cost” (cost of benefit as it is accrued in a given year) = 11.5% of covered compensation
2. Existing COLA accounts for ~ 20% of total normal cost for GC employees
3. Current career service replacement ratio (w/ SS integration) is > 100%
4. Wisconsin Retirement System (WRS) offers an interesting perspective on post-retirement inflation “risk sharing” between plan sponsor and participant

WRS Dividend Process

1. WRS: no guaranteed post-retirement adjustments
2. WRS “dividends”: based on meeting investment return benchmark
3. Dividends adjust guaranteed base pension and may compound
 - Dividend performance has maintained purchasing power
4. Dividends may be reduced if investment return declines
5. Dividend concept acts as a “braking” mechanism on liability increases
 - Enables “less stressful” improvement to funded status after investment downturns

Summary Data Analysis

- Retirement age: ERS is in line with most major PERS as 97% of the plans allow normal retirement at age 62 or earlier.
- By using a retirement allowance limitation of 70% of Final Average Salary (FAS), Milwaukee's plan avoids problems such as "pension spiking" which can add significantly to liabilities and that detract from taxpayer perceptions of the legitimacy of PERS.
- Currently, general city (GC) employees with 35 years of service can expect to receive post-retirement income of more than 100% of FAS, even with a reduced Social Security benefit for age 62 retirement. Milwaukee ERS could lower its formula multiplier for GC employees and be in line with a majority of surveyed plans, as well as meet benchmarks for adequate FAS replacement income.
- A majority of plans index post-retirement COLAs to the CPI. Milwaukee's COLA adjustments amount have been less than the average annual CPI-U change during the last decade.
- Milwaukee could potentially save on annual pension payouts by switching to a 4 or 5 year highest average salary. Although, the majority of surveyed plans allow for the 3 highest year average, 29% of plans use 4 and 5 year averages.

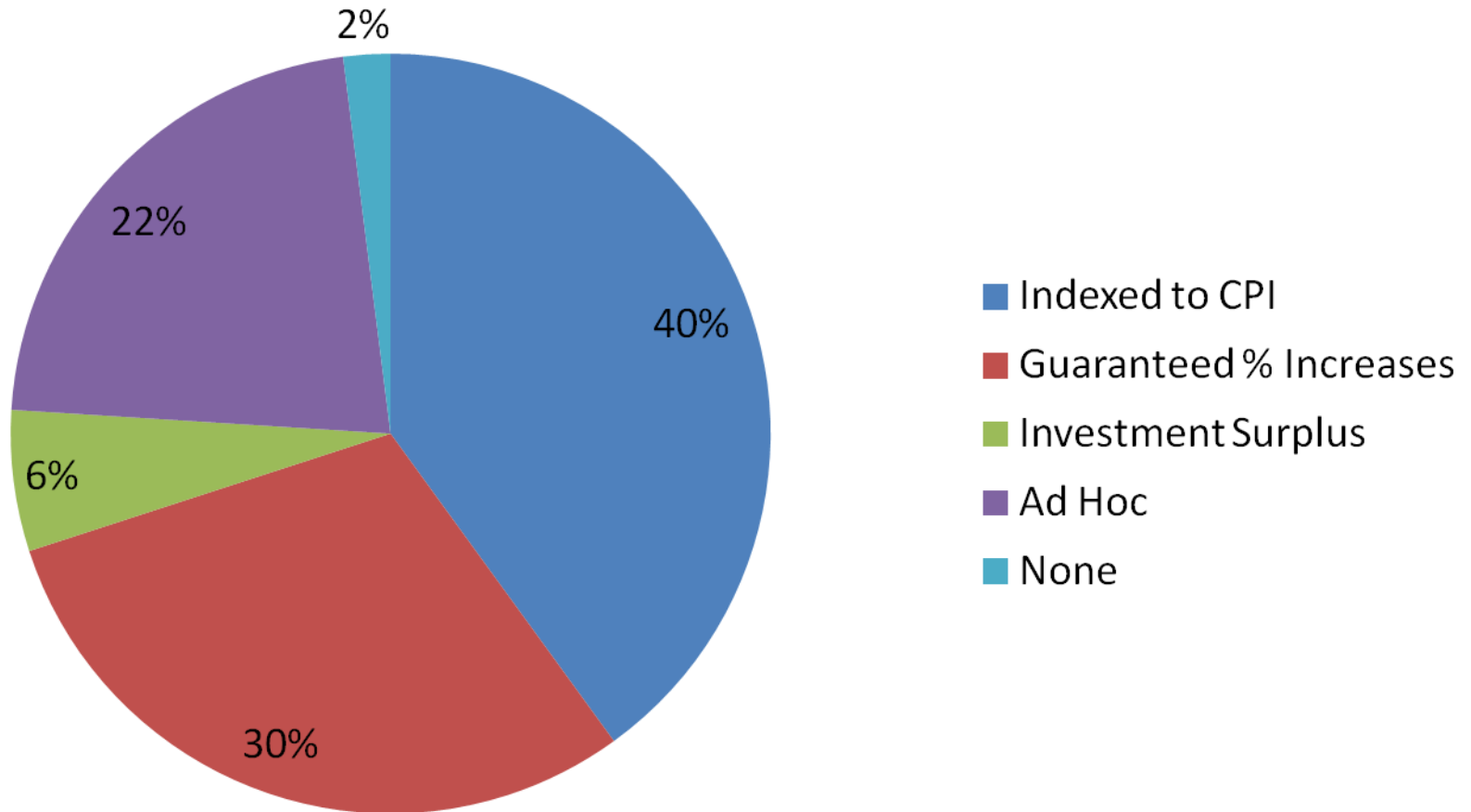
Comparable Plans

- 17 retirement systems were chosen to directly compare their plans with Milwaukee's
- Chosen based upon
 - Midwest location
 - Size (largest and smallest plans on list)
 - Plans only offered to local and state employees

Normal Retirement Age/Years of Service

	System Name	Age/Years of Service
City of Milwaukee	ERS	60 years/Any; 55/30
Milwaukee County	County	60/Any; Rule 75
State of Wisconsin	WRS	65/Any; 57/30
Illinois	SERS (State)	60/8; Rule 85
Illinois	MRF (Local)	60/8; 55/35
Kentucky	ERS (State)	65/4; Any/27
Kentucky	CERS (State)	65/4; Any/27
Michigan	SERS (State)	60/10; 55/30
Michigan	MERS (Local)	Varies with Plan
Minnesota	MSRS (State)	62; 60/6; Any/30; Rule 90
Minnesota	PERA (Local)	65/1; Any/30; Rule 90
Missouri	SERS (State)	65/5; 65/4 active; 62/5; 60/15; 48/Rule 80
Missouri	LAGERS (Local)	60/5; Rule 80 option
Texas	ERS (State)	60/5; Rule 80
California	PERS (S,L)	55/5
New York	ERS (S,L)	62/5; 55/30
Vermont	SRS (State)	62/Any; Any/30
North Dakota	PERS (S,L)	65/5; Rule 90

Cost of Living Adjustments (COLA) (87 Plans)



•Milwaukee's Plan provides for automatic annual increases of 1.5% in years 2-4 of retirement and 2% thereafter. This places Milwaukee in line with the 30% of plans that provide for automatic increases. Increases in this category range from 1.5% to 3.1% annually.

Observations

- There is a wide variety of combinations of retirement age and years of service within the plans in the comparison group
 - No consensus on the proper retirement age within the comparable plans

FAS Period

	System Name	FAS Period
City of Milwaukee	ERS	3 Highest
Milwaukee County	County	3 Highest Consecutive
State of Wisconsin	WRS	3 Highest
Illinois	SERS (State)	4 Highest Consecutive (10 year period)
Illinois	MRF (Local)	4 Highest Consecutive (10 year period)
Kentucky	ERS (State)	5 Highest
Kentucky	CERS (State)	5 Highest
Michigan	SERS (State)	3 Highest Consecutive
Michigan	MERS (Local)	3 Highest Consecutive
Minnesota	MSRS (State)	5 Highest
Minnesota	PERS (Local)	5 Highest
Missouri	SERS (State)	3 Highest Consecutive
Missouri	LAGERS (Local)	5 or 3 Highest Consecutive
Texas	ERS (State)	3 Highest
California	PERS (S,L)	3 Highest
New York	ERS (S,L)	3 Highest Consecutive
Vermont	SRS (State)	3 Highest Consecutive
North Dakota	PERS (S,L)	3 Highest (10 year period)

Observations

- 11 of the plans in the comparison group (including Milwaukee) allow for the FAS to be calculated based upon the 3 highest years of earnings
 - Of those, 6 require the 3 highest to be in consecutive years

Multiplier

	System Name	Multiplier
City of Milwaukee	ERS	2%
Milwaukee County	County	2%
State of Wisconsin	WRS	1.6%
Illinois	SERS (State)	1.67%
Illinois	MRF (Local)	1.67% for years 1-15; 2% thereafter
Kentucky	ERS (State)	1.97%
Kentucky	CERS (State)	2%
Michigan	SERS (State)	1.5%
Michigan	MERS (Local)	1.3-2.5% (employer option)
Minnesota	MSRS (State)	1.7%
Minnesota	PERS (Local)	1.7%
Missouri	SERS (State)	1.7% (and 0.8% to age 62 if Rule 80 met)
Missouri	LAGERS (Local)	1%-8% (employer option)
Texas	ERS (State)	2.3%
California	PERS (S,L)	2% at age 55; 2.5% >= 63
New York	ERS (S,L)	1.67% years 1-19; 2% years 20-30
Vermont	SRS (State)	1.67%
North Dakota	PERS (S,L)	2%

Observations

- Half of the plans in the comparison group offer multipliers lower than Milwaukee's annual 2%
 - The average multiplier in that group is 1.68% annually

Post Retirement COLA

	System Name	COLA Calculation
City of Milwaukee	ERS	1.5% years 1-4; 2% thereafter
Milwaukee County	County	2%
State of Wisconsin	WRS	Based on investment earnings
Illinois	SERS (State)	3%
Illinois	MRF (Local)	3%
Kentucky	ERS (State)	1.5%
Kentucky	CERS (State)	1.5%
Michigan	SERS (State)	3% (\$300 max)
Michigan	MERS (Local)	2.5% (average per employer agreements)
Minnesota	MSRS (State)	CPI (2.5% cap + investment surplus)
Minnesota	PERS (Local)	CPI (2.5% cap + investment surplus)
Missouri	SERS (State)	80% of CPI (5% cap)
Missouri	LAGERS (Local)	CPI (4% cap)
Texas	ERS (State)	Ad Hoc
California	PERS (S,L)	2%
New York	ERS (S,L)	50% of CPI (max 3% on first \$18,000)
Vermont	SRS (State)	50% of CPI (5% cap)
North Dakota	PERS (S,L)	Ad hoc

Observations

- 15 of the plans (including Milwaukee) offer a specific increase annually based upon either a set percentage or a calculation based upon CPI
- If CPI is at the average of 2.7%, 10 of the plans will have a COLA that is equal to or higher than Milwaukee's

Limitation on Benefits

	System Name	Limitation on Benefit (Max FAS %)
City of Milwaukee	ERS	70% of FAS
Milwaukee County	County	80% of FAS
State of Wisconsin	WRS	70% of FAS
Illinois	SERS (State)	75% of FAS
Illinois	MRF (Local)	75% of FAS
Kentucky	ERS (State)	None
Kentucky	CERS (State)	None
Michigan	SERS (State)	None
Michigan	MERS (Local)	80% of FAS for multiplier of 2.25% and over
Minnesota	MSRS (State)	None
Minnesota	PERS (Local)	None
Missouri	SERS (State)	None
Missouri	LAGERS (Local)	None
Texas	ERS (State)	100% FAS
California	PERS (S,L)	65 years
New York	ERS (S,L)	None
Vermont	SRS (State)	50% FAS
North Dakota	PERS (S,L)	None

Observations

- 50% of the comparison group offers no limitations on benefits
- Only Vermont has a lower max FAS than Milwaukee

Actuarial Observations: Impact of Potential Plan Design Changes

The ERS Plan actuary will provide observations regarding how potential plan design changes for new general city employees may affect normal cost and ultimately Plan liabilities.