



REPORT

LEGISLATIVE REFERENCE BUREAU

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11. Employee Retirement System, 2015

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11. Employee Retirement System

\$28,397,088

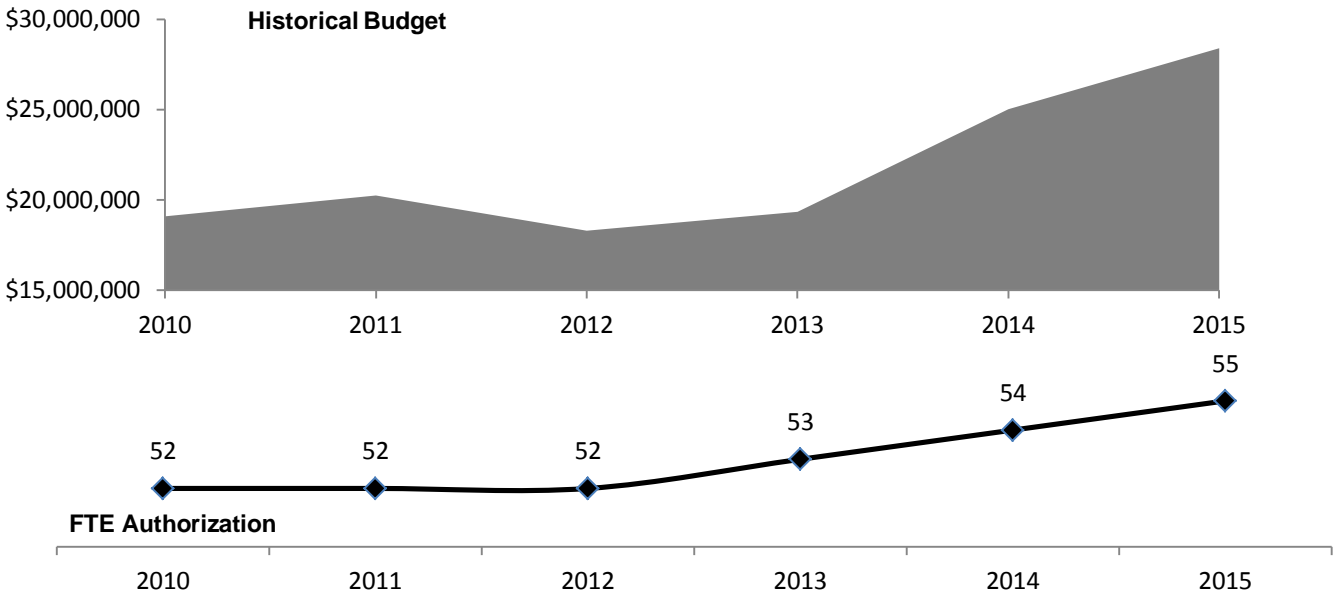
Proposed Department Budget

\$3,376,129

Nominal Change in Proposed Department Budget

13.49%

Percent Change in Proposed Department Budget



1.8%

Percent Change in FTE 2014 to 2015 Proposed

1

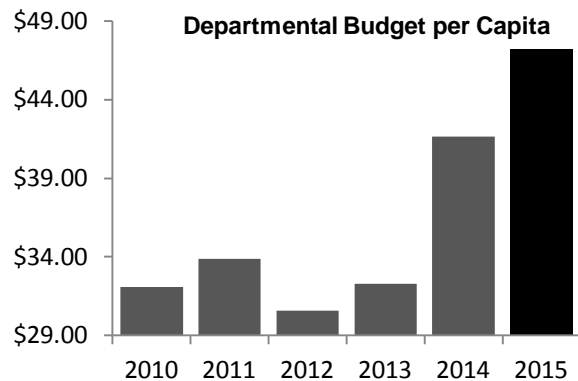
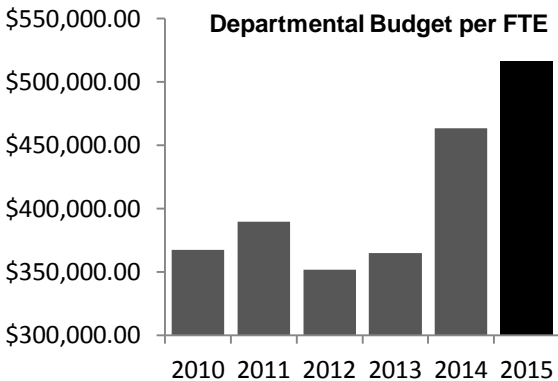
Nominal Change in FTE 2014 to 2015 Proposed

2

Vacant Positions

52%

% Eligible for Retirement within 10 years



19.3%

The Fund's return net of fees, in 2013.

94.8%

The actuarial funding of the system as of January 1, 2014.

53%

The percentage of current Police Department employees that ERS estimates will be eligible for normal service retirement in the next 10 years.

303

Total number of City employees retiring in 2013.

54%

The percentage of current General City employees that ERS estimates will be eligible for normal service retirement in the next 10 years.

\$469,000

Amount provided for server replacement and storage expansion in 2015.

\$60 million

City's 2015 Employer Contribution to the Fund.

\$3,196,000

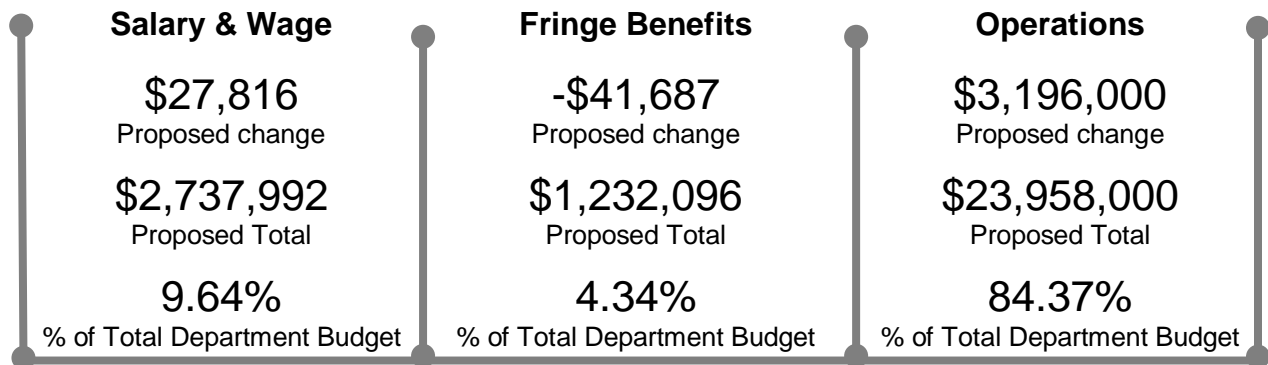
Increase in 2015 operating expenditures are primarily due to increases in investment manager fees

61%

The percentage of current Fire Department employees that ERS estimates will be eligible for normal service retirement in the next 10 years.

\$5.06 billion

Value of the Fund on August 31, 2014.



II. INITIATIVES AND PROGRAMS.

1. Department Overview.

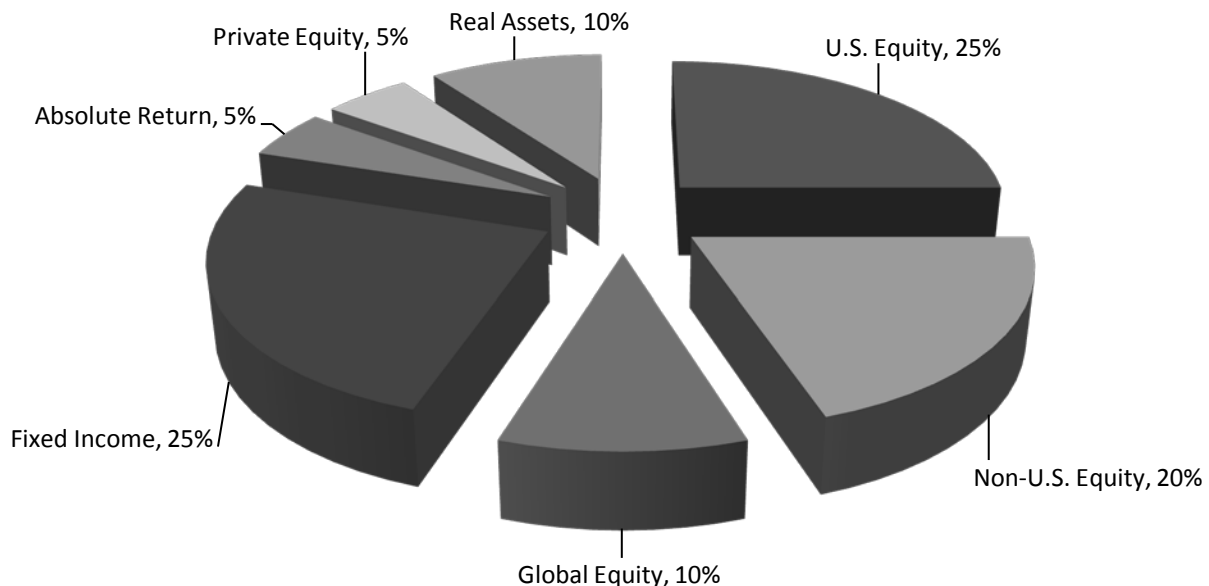
The Employees' Retirement System is responsible for ERS asset management and retirement benefits administration for approximately 27,000 members. The ERS also administers the City's group life insurance program, and health care and COBRA dental benefits for retirees. In addition to City government employees, the ERS includes non-certified MPS employees, and employees of HACM, RACM, MMSD, MATC, Veolia and the Wisconsin Center (known as "city agency" employees).

The ERS is governed by an 11-member Annuity and Pension Board consisting of 3 persons appointed by the Common Council President, 3 persons appointed by the Mayor, 3 persons elected by active system members, one person elected by retired members, and the City Comptroller. On December 17, 2013, in Common Council File Number 131162, the Common Council approved the expansion of the Board from 8 members to 11.

2. Fund Value and Allocation.

Historically, at year-end 2007, the value of the fund was approximately \$5.2 billion; by year-end 2008 it had fallen to \$3.4 billion. By year-end 2009 the fund value had risen to \$4 billion and as of 8/31/14, the fund balance was \$5.06 billion. While it is important to note that the fund has not been restored to its high of pre-2008, the fund has paid out almost \$1.9 billion in retirement benefit payments since January, 2008.

Chart 11.1. Target Fund Allocation.



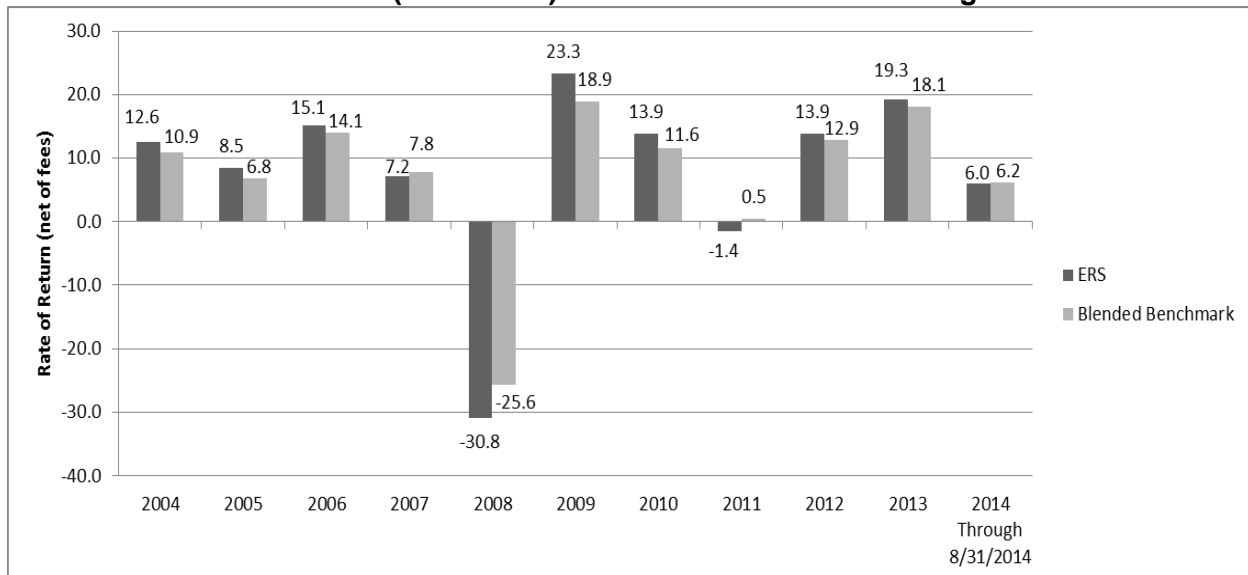
The ERS is generally considered well-funded as a percentage of liabilities. As of January 1, 2014, the actuarial funding of the system was 94.8% (102.4% on a market value basis).

Board policy dictates the targets for fund allocation. The most recently approved asset-liability study, completed in spring 2013, resulted in slight changes to the Fund's target allocation. These changes are meant to better diversify the Fund. The targets are shown in Chart 11.1.

3. Fund Return.

Plan performance was very strong in 2013. The rate of return, net of fees, in 2013 was 19.3%, outperforming the benchmark return of 18.1%. In 2012, the Fund also performed well, with a rate of return of 13.9%, net of fees, outperforming the benchmark return of 12.9%. The rate of return, net of fees, through August 31, 2014 has been 6.0%, slightly underperforming the benchmark return of 6.2%. The history of the rates of return is provided in Chart 11.2.

Chart 11.2. Rates of Return (net of fees) and Benchmarks 2004 through 8/31/14.



4. Fund Membership.

Chart 11.3 indicates that, as of 2010, the number of retirees and beneficiaries outnumbers the number of active members. The ratio for City employees mirrors the membership as a whole. With the recent changes in legislation, all General City employees will now be contributing varying amounts to the fund (at this time, most protective service employees will continue to have contributions made on their behalf by the City). The City will continue to make actuarially required contributions which represent the majority of the contributions.

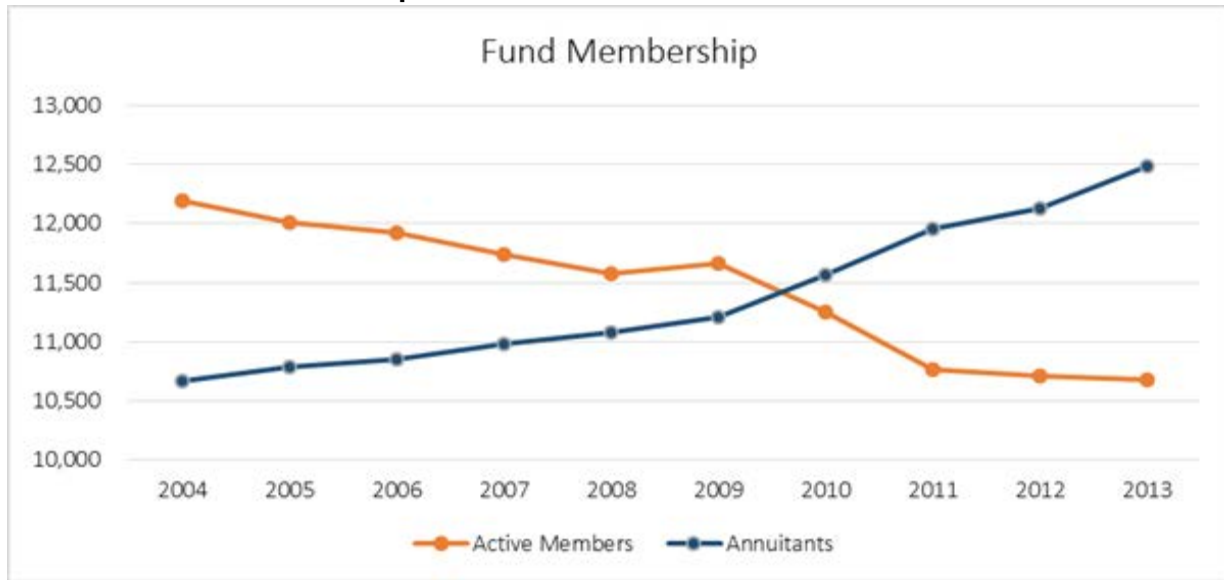
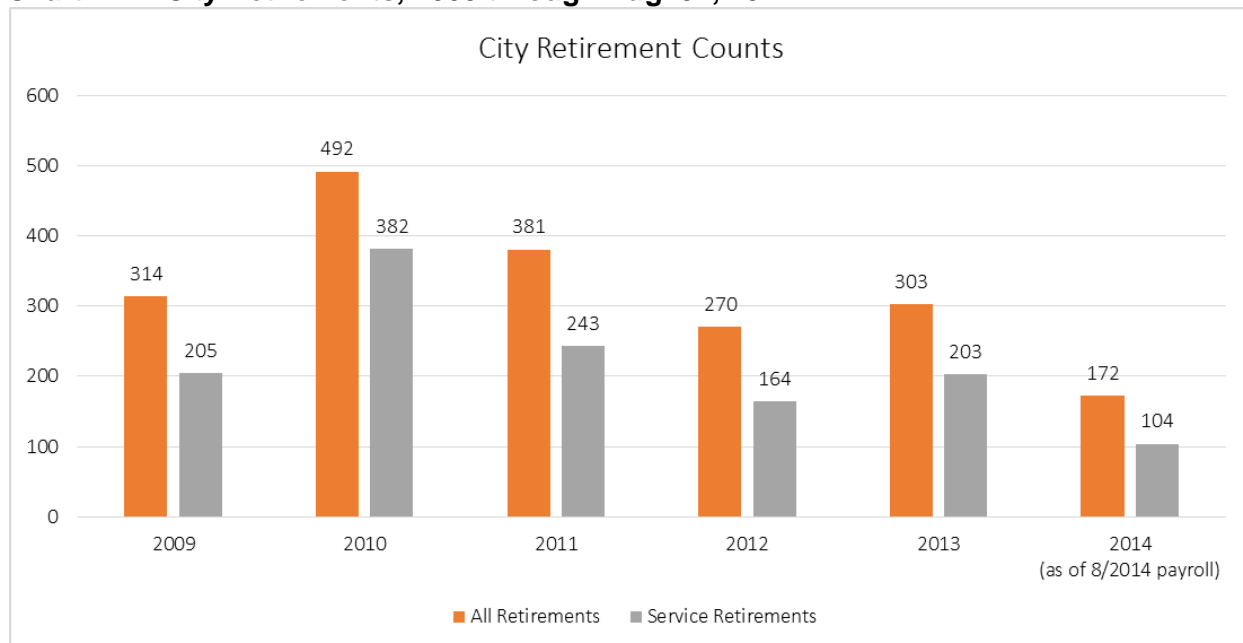
Chart 11.3. Fund Membership.**5. Retirements.**

Chart 11.4 indicates that since 2009 the City has experienced a significant number of retirements. The number of service retirements in 2010 was 382 versus 205 in 2009. This is an increase of 177, or 86%, due in theory to pension sweetener plans offered to City employees. While service retirements are the most appropriate measure of the effect of early retirement incentives, all types of retirements were also up in 2010 and 2011 when a lesser incentive was offered.

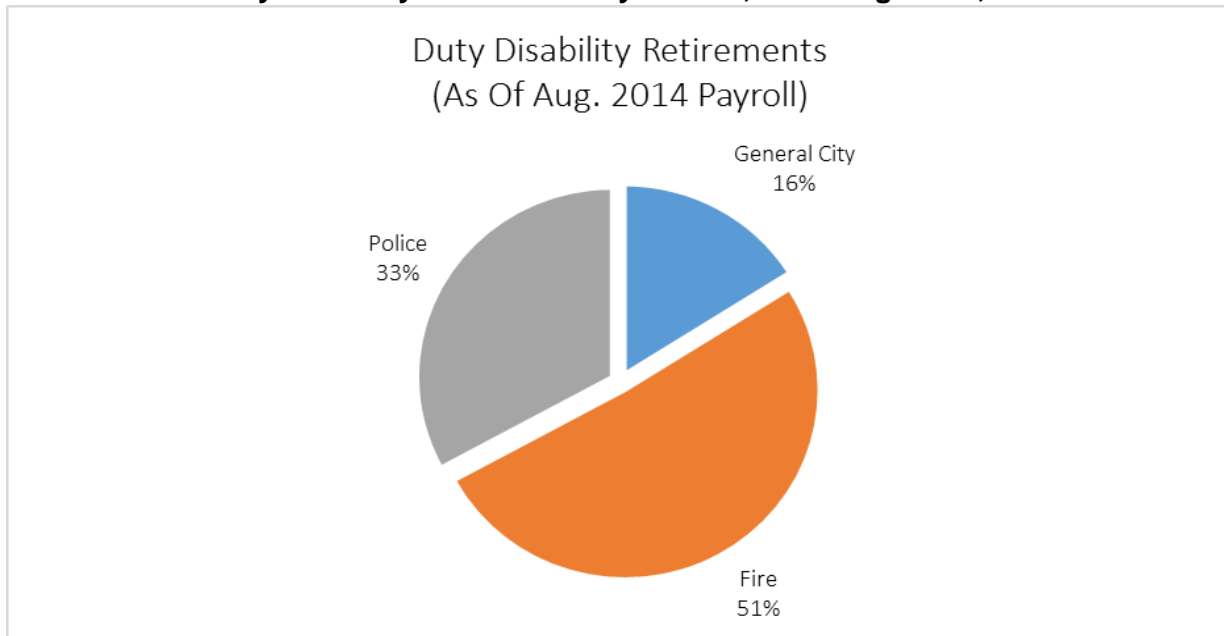
Chart 11.4. City Retirements, 2009 through Aug. 31, 2014.

Based on ERS retirement attrition projections, it is estimated that over 54% of current general City, 61% of fire and 53% of police employees will be eligible for normal service retirement in the next 10 years. The following departments will be most affected: Assessor, DCD, Comptroller, Election Commission, City Attorney and DER.

Based on LRB analysis of ERS data, at least one department, Assessor's Office, will have as much as half of its employees eligible for retirement in only 3 years. The Comptroller and Department of City Development are not far behind with 48% and 46% eligible to retire in 3 years, respectively.

One type of retirement is disability retirement. Of the 303 City retirements in 2013, 28 were ordinary and duty disability retirements, representing 9.2% of all of the retirements. Presently, there are a total of 480 duty-disability retirees. The greatest number, 245, are fire fighters, followed by police, 158, and general City employees, 77. This distribution, by percentage, is presented in Chart 11.5.

Chart 11.5. All Duty-Disability Retirements by Source, as of August 31, 2014.



6. Overly Complex System to Administer.

Chapter 36 of the City Charter is the governing plan document that provides the rules for calculating and distributing ERS benefits. This document is extremely complex, exception-based and nuanced, resulting from codifications of numerous and diverse collectively-bargained labor contracts which span over several decades. The inherent structure and complexity of Chapter 36, in addition to the ERS Rules and Regulations and more than 1,800 legal opinions defining the legal requirements for pension-related benefits have resulted in a complex and burdensome pension system which ERS is charged to administer. This is especially the case when it comes to protective service employees.

For example, presently there exist 10 different types of retirement (which combined with the variations in employee type results in 123 different retirement rules), 27 permutations covering

what happens when a member or survivor dies, and 37 rules governing the conversion of disability retirement to regular retirement. This frequently results in the need for ERS staff to conduct a comprehensive review and discovery of individual wage and service history. Recent complexities include the implementation of a “Tier two” benefit structure for general City employees hired beginning January 1, 2014 and an employee-paid member contribution shift for recently-hired protective service members as a result of collective bargaining. The potential exists for further plan changes and complexities as a result of the recent Wisconsin Supreme Court decision for *Madison Teachers, Inc., Local 61 v. Scott Walker, et al.* The resulting system is burdened with providing the IT and staff structure to administer this system.

7. Information Technology.

The ERS is in a unique position in relation to its IT needs. According to Chapter 36 of the City Charter, the Annuity and Pension Board is accountable for exercising fiduciary duty while overseeing the general administration and operation of the ERS. This duty requires the highest standard of care under the legal system and makes ERS trustees and management personally liable for any breach of fiduciary duty. Strict adherence to the purpose of the trust – acting solely in the interest of plan members and beneficiaries to the exclusion of all other interests is required of ERS fiduciaries. To maintain the operation, especially given the excessive complexity involved, requires the ERS to invest heavily in technology to accomplish this task.

The ERS has realized cost savings by in-sourcing work. Over the course of the past 4 years, the ERS has focused its efforts on in-sourcing IT functions when cost-effective, as well as negotiating contracts with its existing vendors for additional savings. In 2014, all telecommunication and connectivity contracts were re-negotiated and some telecommunication functions were brought in house to support. These efforts resulted in a projected savings of \$98,490 for 2015. Though the department’s inability to offer competitive wages is making it difficult to attract and retain qualified candidates, it will continue efforts in 2015 to maintain a proficient and high performing information technology support team by ensuring that the IT staff is adequately trained to maintain and support all of the IT assets and services that previously had been outsourced.

Over the past 4 years, the ERS has implemented and sustained a disaster recovery plan and business continuity model. The ERS has an intergovernmental agreement with the State of Wisconsin Department of Administration which allows the ERS to co-locate its data center systems within the State’s Femrite Data Center near Madison thus ensuring that critical systems are recoverable and accessible in the event the ERS primary location is unavailable. The ERS staff participates in regular business continuity tests and disaster recovery drills and continuously validate that critical business operations and processes will experience limited to no impact due to a disaster. The ERS will continuously monitor, test and improve upon the disaster recovery plan and business continuity model to ensure internal recovery time objectives are met and the business continues to operate effectively.

8. City Contribution Methodology.

The City’s pension system was designed such that the City’s contribution to the system in a given year was determined based on a so-called “full funding limit”. This system resulted in volatile contribution requirements where the City’s contribution requirement could vary wildly from year to year as a result of the Fund’s investment results. This volatility created a difficult environment from which to budget.

A new funding methodology was developed with the retirement system's actuary which assumed a level contribution over the course of a 5-year period. The contribution is based on an overall "blended rate" of approximately 16% consisting of rates of 24.83% for firemen, 22.63% for policemen and 8.48% for general City employees. This actuarial contribution rate would be based on the full actuarially-determined employer share of normal cost and an amount needed to reduce unfunded past service liability. The "full-funding limit" was repealed, and the new methodology took effect with the employer contribution due January 31, 2014. The actuarial contribution rate will be reset every 5 years subsequent to the completion of the system's 5-year experience review.

The City's contribution under this new methodology for 2015 is forecast to be \$60,000,000, this is a result of a reduction in estimated pensionable wages. This is a \$1,600,000, or 2.6%, decrease over the 2014 employer contribution of \$61,600,000.

9. New Government Accounting Standards Board (GASB) Standards.

The Government Accounting Standards Board has adopted 2 new accounting standards for pension disclosures, Statement #67, effective for public pension plans in 2014 and #68, effective for sponsoring governments in 2015. As a result the reported pension liabilities, assets and funded status for CMERS will be different for financial disclosure purposes than for funding. ERS will be required to have 2 valuations prepared by its independent actuary in order to comply with Statements #67 and #68. Statement #68 requires governments providing defined benefit pension plans to recognize their net pension liabilities on the balance sheet and to enhance footnote disclosures and certain required supplementary information. Implementation of the new accounting standards creates the potential for confusion among the media and public due to separate calculations for financial reporting and funding with different outcomes for each.

III. EXPENDITURES.

Table 11.1. Changes in Expenditure Amounts by Account.

Expenditure Account	2013 Actual	2014 Adopted Budget	% Change	2015 Proposed Budget	% Change
Salaries and Wages	\$2,497,206	\$2,710,176	8.5%	\$2,737,992	1.0%
Fringe Benefits	\$1,152,400	\$1,273,783	10.5%	1,232,096	-3.3%
Operating Expenditures	\$15,569,205	\$20,762,000	33.4%	\$23,958,000	15.4%
Equipment Purchases	\$120,653	\$275,000	127.9%	\$469,000	70.6%
Special Funds	\$0	\$0	0%	\$0	0%
Total Operating Budget	\$19,339,464	\$25,020,959	29.4%	\$28,397,088	13.5%

1. Budget Summary.

The total 2015 Proposed Budget is \$28,397,088, an increase of \$3,376,129 (13.5%) from the 2014 Adopted Budget amount of \$25,020,959.

2. Personnel Costs.

Personnel costs in the 2015 Proposed Budget are \$3,970,088, a decrease of \$13,871 (-0.4%). Salaries and wages increase \$27,816 (1.0%) and fringe benefits decrease by \$41,687 (-3.3%).

3. Operating Expenditures.

Operating Expenditures in the 2015 Proposed Budget are \$23,958,000, an increase of \$3,196,000 (15.4%) from the 2014 Adopted Budget amount of \$20,762,000. Increases in operating expenditures are primarily due to increases in investment manager fees.

4. Equipment Purchases.

Equipment purchases in the 2015 Proposed Budget are \$469,000, an increase of \$194,000 (70.6%) from the 2014 Adopted Budget amount of \$275,000. The increase is due to server replacement and storage expansion.

5. Special Funds.

None.

IV. PERSONNEL.

Table 11.2. Changes in Full-Time Equivalent (FTE) and Authorized Positions.

Position Category	2013 Actual	2014 Adopted Budget	Change	2015 Proposed Budget	Change
O&M FTEs	42.5	43.5	1	43.5	0
Non-O&M FTEs	0	0	0	0	0
Total Authorized Positions	53	54	1	55	1

1. Personnel Changes.

The total number of authorized positions in the department under the 2014 Proposed Budget is 54, an increase of one from the 2014 Adopted Budget. The added position is a net gain resulting from the deletion of 2 auxiliary positions (Pension Specialist – Senior and the Management Accountant – Senior) and the addition of three Board members due to recent Board expansion legislation. While certain (outside) Board members receive a stipend and are included in the budget, they are not employees.

There are currently 2 vacant positions in the department which is detailed in Table 11.3.

Table 11.3. Current Vacancies by Position.

Position	Number	Vacancy Date	Reason for Vacancy
Network Administrator	1	May, 2012	Position created in 2012, but has not been filled.
Pension Specialist-Sr.	1	October, 2014	Promotion

V. SPECIAL PURPOSE ACCOUNTS (SPA).

SPAs are budgeted outside of departmental operating accounts, and control over SPAs is provided to departments by resolution. The 2015 Proposed Budget includes funding for the SPAs identified in Table 11.4.

Table 11.4. Changes in Special Purpose Accounts by Account.

Account	2013 Actual	2014 Adopted Budget	% Change	2015 Proposed Budget	% Change
Group Life	\$2,926,036	\$2,190,000	-25.2%	\$2,190,000	0%
Retiree Benefit Adjustment Fund	\$109,779	\$118,000	7.49%	\$110,000	-6.8%

1. Group Life, \$2,190,000

Funding for the Group Life Special Purpose Account remains the same as the 2014 funding.

2. Retiree Benefit Adjustment Fund, \$110,000.

The Retiree Benefit Adjustment Fund funds the cost of supplemental pension benefits to certain former City employees who retired prior to 1984. Recipients include members and surviving spouses of members of the ERS. The fund decreases by \$8,000, or -6.8%, to \$110,000. The decrease is an adjustment based on experience.

VI. REVENUES.

Charges to the Trust offset the ERS budget.

VII. CAPITAL PROJECTS.

None.

VIII. EMPLOYEE PENSION CONTRIBUTIONS.

On July 31, 2014, the Wisconsin Supreme Court issued a ruling in a case brought by labor unions that Wisconsin Act 10 prohibits the City of Milwaukee from paying on behalf of general City employees and elected officials, including those hired prior to January of 2010, their employee share of required contributions to the City of Milwaukee Employees' Retirement System.

As a result, all general City employees hired prior to January 1, 2010, will begin paying 5.5% of their pensionable earnings as their employee pension contribution and elected officials elected prior to January 1, 2014 will pay 7%. The Budget Office estimates that general city employees will contribute \$7.5 million in 2015.

IX. ISSUES TO CONSIDER.

1. The Government Accounting Standards Board (GASB) recently established new reporting requirements for defined benefit pension plans. How these new standards will affect the ERS and City financial statements need to be considered.
2. Lack of competitive salaries offered by the City may reverse ERS' efforts to save overall costs through in-sourcing. Means of dealing with this situation need to be explored.
3. The overly complex nature of the retirement system and its administration is costly and burdensome. Ways of streamlining and avoiding added complexity need to be explored.
4. Given the complex nature of the retirement system and its administration, institutional knowledge is invaluable. Ways of maintaining this institutional knowledge and professional staffing need to be considered.

Prepared by: Jim Carroll, Legislative Fiscal Analyst
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