



REPORT

LEGISLATIVE REFERENCE BUREAU

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12. Employees' Retirement System, 2014

Proposed Plan and Executive Budget Review

12. Employees' Retirement System (ERS)

I. EXECUTIVE SUMMARY.

Table 12.1. Statement of Changes in Operating Budget, 2013 to 2014.

2012 Actual Budget	\$18,294,065
2013 Adopted Budget	\$24,546,844
Personnel Costs	
Salaries & Wages	\$116,781
Fringe Benefits	\$5,334
Total Changes	\$122,115
Operating Expenses	\$344,000
Equipment Purchases	\$8,000
Special Funds	\$0
Total Changes	\$474,115
2014 Proposed Budget	\$25,020,959

1. Fund balance stable. As of 8/31/13, the fund balance was \$4.5 billion. While it is important to note that the fund has not been restored to its high prior to the Great Recession, the fund has paid out nearly \$1.6 billion in retirement benefit payments since January, 2008.

2. Fund return continues to improve. Plan performance has continued to improve in 2013. In 2011, the fund's net rate of return was -1.43%, underperforming the benchmark of 0.52%. In 2012, the rate of return was 13.88%, outperforming the benchmark of 12.91%. The rate of return through 9/26/13 was 7.9%, near the benchmark of 8.05%.

3. Retirements remain high and projected to continue. Since 2009, the City has experienced a significant number

of retirements. Based on ERS retirement attrition projections, it is estimated that over 54% of current general City employees will be eligible for normal service retirement over the next 10 years. Retirees now outnumber active members, thus placing a greater burden on the employer.

4. System overly complex and burdensome to administer. The inherent structure and complexity of Chapter 36 of the City Charter, 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. In 2012, there were 3 major plan complexities added to the system. The resulting system is burdened with providing the IT and staff structure to administer this system.

5. Department savings from in-sourcing challenged. ERS is able to realize cost savings by in-sourcing work that otherwise is performed through contracted services. Over the course of the past 3 years, ERS has focused its efforts on in-sourcing IT functions when cost-effective, projecting savings of more than \$574,000 in 2014. However, the multi-year extended salary freeze and the department's inability to offer competitive wages is making it difficult to attract and retain qualified candidates, thereby threatening to reverse this in-sourcing effort.

6. City contribution \$61.6 million under Stable Contribution Methodology. The City expects to contribute \$61.6 million to the ERS in 2014 based on an estimate using the new stable contribution method.

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 participation in federal Social Security, 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 8-member Annuity and Pension Board consisting of 3 persons appointed by the Common Council President, 3 persons elected by active system members, one person elected by retired members, and the City Comptroller.

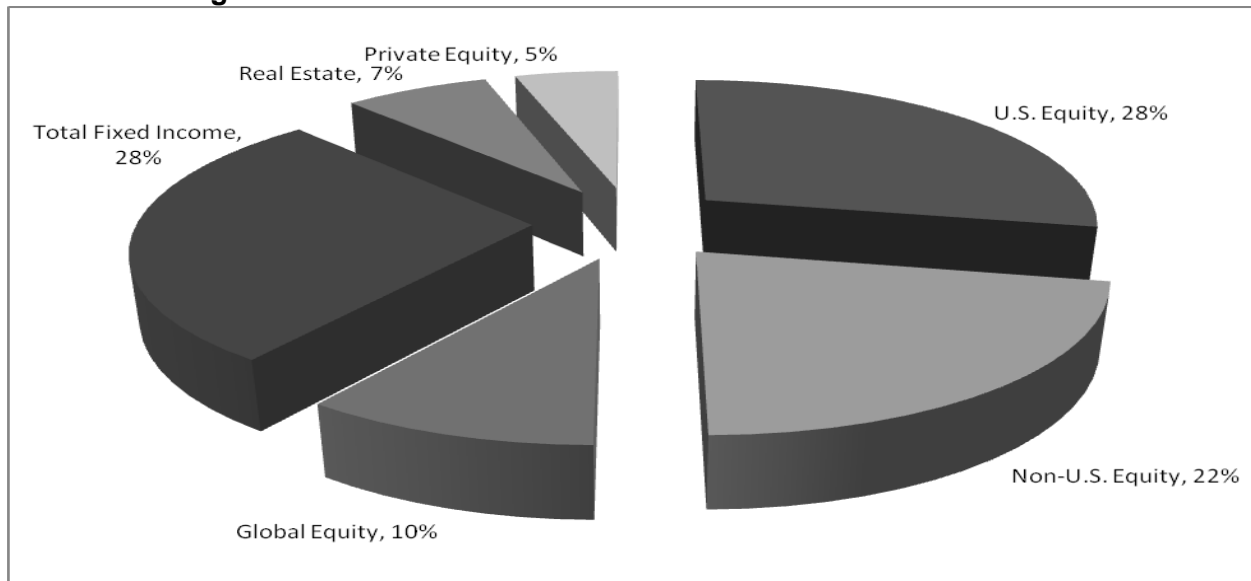
2. Fund Value and Allocation.

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 8/31/13, the fund balance was \$4.5 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 \$1.6 billion in retirement benefit payments since January, 2008.

Although the Fund remains nearly \$1 billion under its high before the economic collapse, the ERS is generally considered well-funded as a percentage of liabilities. As of January 1, 2013, the actuarial funding of the system was 90.8%.

Board policy dictates the targets for fund allocation. These targets have changed minimally in recent years. The targets are shown in Chart 12.1.

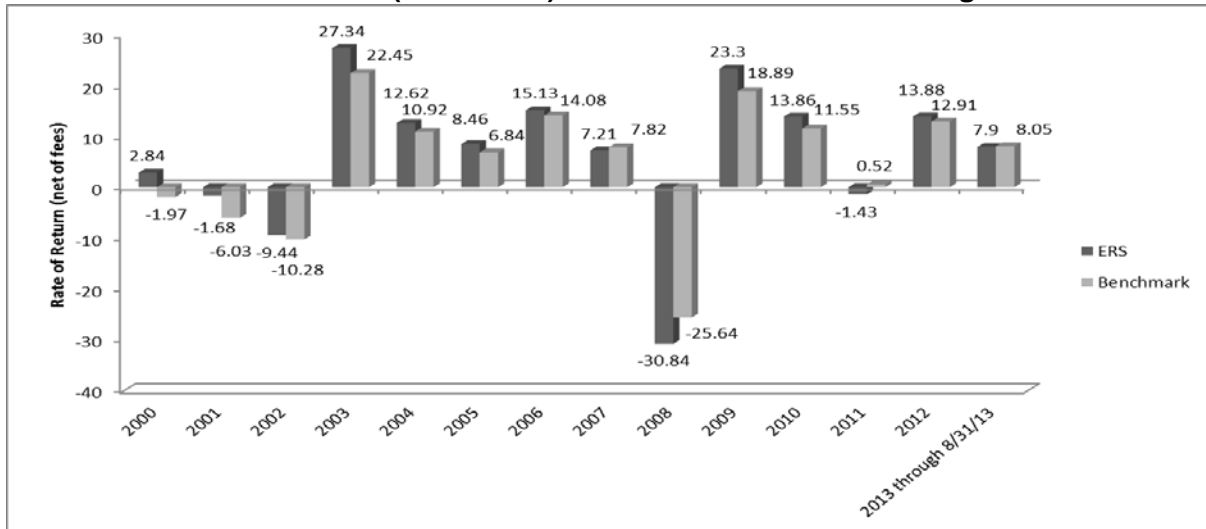
Chart 12.1. Target Fund Allocation.



3. Fund Return.

Plan performance continued to improve in 2012 over the poor performance of 2011. In 2011, the fund's rate of return was -1.43%, underperforming the benchmark of 0.52%. The rate of return in 2012 was 13.88%, outperforming the benchmark of 12.91%. The rate of return through August 31, 2013 has been 7.9%, performing near the benchmark of 8.05%. The history of the rates of return is provided in Chart 12.2.

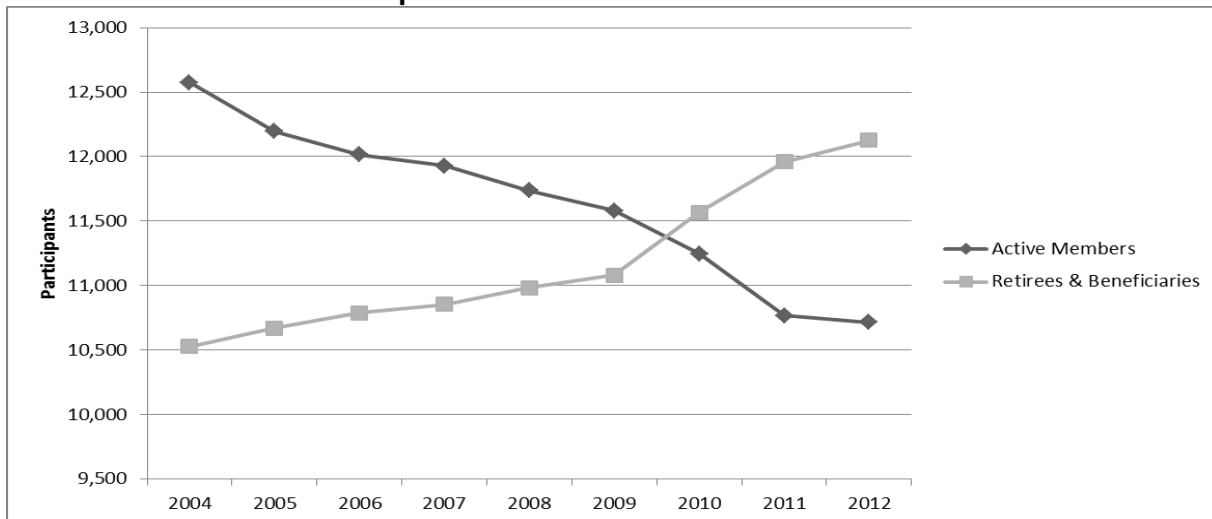
Chart 12.2. Rates of Return (net of fees) and Benchmarks 2000 through 8/31/13.



4. Fund Membership.

Chart 12.3 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. Some City employees contribute varying amounts to the fund, such as new employees, but the majority of the contribution is made by the City. Given the composition of fund membership, the burden on the employer will continue to increase.

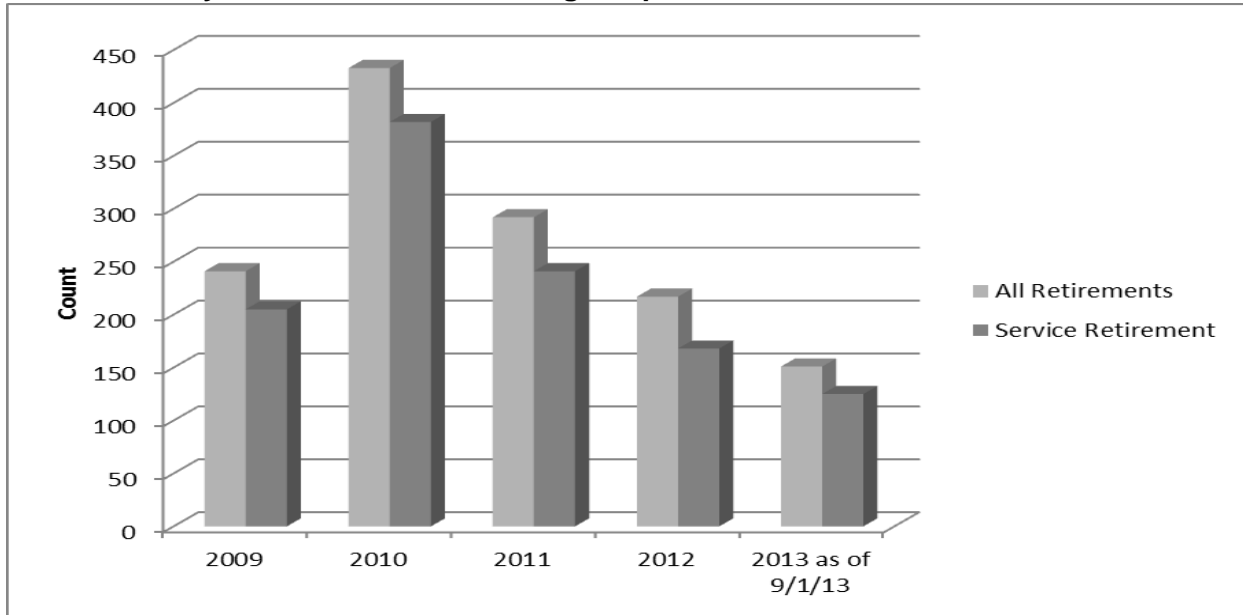
Chart 12.3. Fund Membership.



5. Retirements.

Chart 12.4 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 less incentive was offered.

Chart 12.4. City Retirements, 2009 through Sept. 30, 2013.

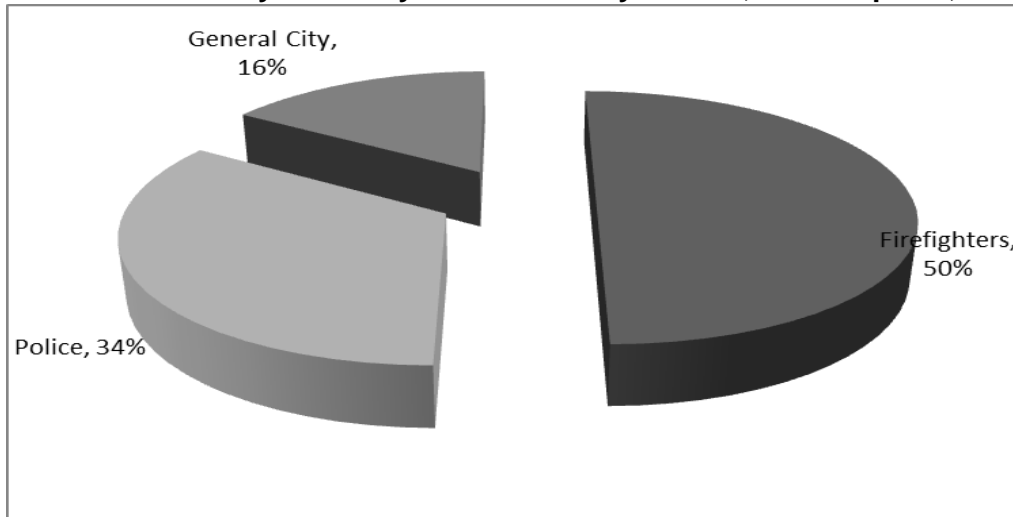


Based on ERS retirement attrition projections, it is estimated that over 54% of current general City, 62% of fire and 52% of police employees will be eligible for normal service retirement in the next 10 years. The following departments will be most affected: Assessor, DCD, Comptroller, Election Commission, City Attorney and DER.

Based on LRB analysis of ERS data, at least one department, Election Commission, will have as much as half of its employees eligible for retirement in only 3 years. The Comptroller and Assessor Offices are not far behind with 46% and 45% eligible to retire in 3 years, respectively.

One type of retirement is disability retirement. Of the 217 City retirements in 2012, 29 were disability retirements, representing 13.4% of all of the retirements. Presently, there are a total of 417 duty-disability retirees. The greatest number, 209, are fire fighters, followed by police, 141, and general City employees, 67. This distribution, by percentage, is presented in Chart 12.5.

Chart 12.5. All Duty-Disability Retirements by Source, as of Sept. 30, 2013.



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 99 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. In 2012 and 2013 alone, the following amendments to Chapter 36 have added to the system’s complexity: “Tier two” benefit structure for General City employees hired beginning January 1, 2014, changes in withdrawal rights that impact deferred members and a new insurance premium deduction program for retired public safety officers. The resulting system is burdened with providing the IT and staff structure to administer this system.

7. Out-Sourcing and In-Sourcing.

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.

A significant amount of IT needs are met through outsourcing. The department reports budgeting \$1,559,772 (minus contingencies) for IT outsourcing for 2014. This is 3.4 times as much as is budgeted for in-house IT salaries. The vast majority of the outsourcing is in support of its Milwaukee Employees' Retirement Information Technology System (MERITS) which was first implemented in 2006. This customized software program is reaching the end of its lifecycle, but with implementation of a product lifecycle management program (MPLM), ERS plans to use MERITS for the foreseeable future.

However, the ERS is able to realize cost savings by in-sourcing work that otherwise is performed through contracted services. It is more cost-effective to create City positions which are compensated at a lower cost than to out-source work. Over the past 3 years, ERS has focused its efforts on in-sourcing IT functions. Positions in-sourced include a Functional Applications Manager and a Systems Administrator.

ERS reports that its in-sourcing efforts (and elimination of other contract positions) as it relates to IT have been accomplished and is estimated to have saved more than \$2.6 million over the past 3 years. However, the extended multi-year pay freeze and the inability to offer competitive compensation rates is making ERS IT salaries increasingly uncompetitive and threatens to reverse progress made on in-sourcing. The result is an increase in costs and a loss in institutional knowledge and destabilization of agency operations.

8. Pension Task Force Recommendation Implementation.

A Pension Task Force was convened in 2011 and issued recommendations at the end of 2012. A charter ordinance revising Chapter 36 was passed in 2013, which implemented these recommendations whereby a "tier two" benefit structure was created for new general City employees (and elected officials taking office) hired beginning January 1, 2014. For general City employees hired on or after this date, the following applies:

- A minimum service retirement age of 65.
- A service retirement allowance equal to 1.6% of the members' final average salary times the total number of years of all creditable service.
- Eligibility for a service retirement allowance when attaining the age of 60 years and the completion of 30 years of creditable service.
- Eligibility for a pension escalator of 2% annually after the fifth anniversary of service retirement, with spouse survivors of service retirees also eligible for the escalator.
- A requirement to contribute 4% of their earnable compensation to the retirement system.

9. 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 would be based on an overall "blended rate" of 18% consisting of rates of 27.94% for firemen, 25.46% for

policemen and 9.54% 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 will take 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 the first year of the 5-year period beginning in 2014 has been determined to be \$61,600,000. This is a \$2,290,000, or 3.9%, increase over the 2013 employer contribution of \$59,310,000. Note, the “full-funding limit” did not operate for the 2012 contribution payable January 1, 2013 because the funded ratio was not less than 100%.

III. EXPENDITURES.

Table 12.2. Changes in Expenditure Amounts by Account.

Expenditure Account	2012 Actual	2013 Adopted Budget	% Change	2014 Proposed Budget	% Change
Salaries and Wages	\$2,368,733	\$2,593,395	9.5%	\$2,710,176	4.6%
Fringe Benefits	\$1,170,834	\$1,268,449	8.4%	\$1,273,783	0.4%
Operating Expenditures	\$14,604,446	\$20,418,000	39.9%	\$20,762,000	1.7%
Equipment Purchases	\$150,052	\$267,000	78.0%	\$275,000	3.0%
Special Funds	\$0	\$0	0%	\$0	0%
Total Operating Budget	\$18,294,065	\$24,546,844	34.2%	\$25,020,959	2.0%

1. Budget Summary.

The total 2014 Proposed Budget is \$25,020,959, an increase of \$474,115 (2%) from the 2013 Adopted Budget amount of \$24,546,844.

2. Personnel Costs.

Personnel costs in the 2014 Proposed Budget are \$3,983,959, an increase of \$122,110 (3.2%). Salaries and wages increase \$116,781 (4.6%). Fringe benefits increase \$5,334 (0.4%).

3. Operating Expenditures.

Operating Expenditures in the 2014 Proposed Budget are \$20,762,000, an increase of \$344,000 (1.7%) from the 2013 Adopted Budget amount of \$20,418,000. Increases in operating expenditures are primarily due to increases in investment manager fees and increased fiduciary insurance deductible costs.

4. Equipment Purchases.

Equipment purchases in the 2014 Proposed Budget are \$275,000, an increase of \$8,000 (6.8%) from the 2013 Adopted Budget amount of \$267,000.

5. Special Funds.

None.

IV. PERSONNEL.

Table 12.3. Changes in Full-Time Equivalent (FTE) and Authorized Positions.

Position Category	2012 Actual	2013 Adopted Budget	Change	2014 Proposed Budget	Change
O&M FTEs	41.5	42.5	1	43.5	1
Non-O&M FTEs	0	0	0	0	0
Total Authorized Positions	52	53	1	54	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 2013 Adopted Budget. The added position is a Database and Research Analyst. However, the department advises that it will pursue an amendment to remove the Database and Research Analyst position since it intends to fill the staffing need through other personnel changes.

2. Vacancies.

There are currently 3 vacant positions in the department which are detailed in Table 12.4.

Table 12.4. Current Vacancies by Position.

Position	Number	Vacancy Date	Reason for Vacancy
Pension Investment Specialist Sr.	1	5/17/13	Promotion
Administrative Assistant II	1	8/2/13	Resignation
Network Administrator	1	5/29/12	New Position

V. SPECIAL PURPOSE ACCOUNTS (SPA).

SPAs are budgeted outside of departmental operating accounts, and control over SPAs is provided to departments by resolution. The 2014 Proposed Budget includes funding for the SPAs identified in Table 12.5.

Table 12.5. Changes in Special Purpose Accounts by Account.

Account	2012 Actual	2013 Adopted Budget	% Change	2014 Proposed Budget	% Change
Group Life	\$2,921,911	\$2,904,000	-0.6%	\$2,190,000	-24.6%
Retiree Benefit Adjustment Fund	\$125,544	\$123,000	2.0%	\$118,000	-4.1%

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

Funding for the Group Life Special Purpose Account is decreased by \$714,000, or -24.6%, for City employees' life insurance fringe benefits. The decrease is the result of projected premium costs and coverage for 2014 under a redesigned benefit.

2. Retiree Benefit Adjustment Fund, \$118,000.

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 \$5,000, or -4.1%, to \$118,000. The decrease is an adjustment based on experience.

VI. REVENUES.

Charges to the Trust offset the ERS budget.

VII. CAPITAL PROJECTS.

None.

VIII. ISSUES TO CONSIDER.

1. The Government Accounting Standards Board is now requiring more conservative reporting of assets and liabilities. This change effects financial disclosure only and not cash contributions. 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 the 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.

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