CORRESPONDENCE/MEMORANDUM

Date: August 18, 2011

To: Members, Pension Task Force

From: Ald. Michael Murphy
Task Force Chair

Re: Agenda & Materials for August 25 meeting

The third meeting of the Pension Task Force has been scheduled for Thursday August 25 beginning at 9:00 a/m. in Room 301-B City Hall.

The primary purpose of the meeting is to begin to identify possible retirement benefit plan design features for new general city employes.

The agenda follows. Attachments are included.

I want to thank Aaron Cadle, Joe'Mar Hooper, and Mark Nicolini for their assistance in preparing these materials.

AGENDA

1. Review Meeting Goals
2. Presentation of Public Employe Retirement System Plan Design Comparative Material (attached)
3. Presentation of Information Regarding Potential Impacts of Plan Design Changes on Cost & Liabilities
4. Discussion of Homework assignment (attached)
5. Identification of Plan Design Features for Additional Review
6. Meeting Wrap up and Information about Next Meeting

HOMEWORK ASSIGNMENT

Background

1. Currently, ERS liabilities grow almost 5% annually. This is clearly unsustainable given the City's revenue structure and tax base.

2. General City employes make up ~ 56% of the employes in City government that are ERS members. Police make up ~ 30% of the covered active members, and Fire make up ~ 13%.

   - There are an additional 4,562 active general city members from other agencies such as MMSD and MPS.
   - The focus of this discussion is on City government general city employes.

3. General City employes generate an estimated 34% of the total ERS liability for City government.

4. Recent State legislation (2011 Wisconsin Act 10) has made retirement benefits a prohibited subject of bargaining for general city employes. Benefit plan design cannot be changed for current employes but may be modified for future new employes.

5. Beginning in 2012, all general city employes will pay 12% of the premium for health care benefits. Since January 1, 2010 new general city employes have paid the 5.5% of salary member contribution for pension financing.

6. Beginning in 2013, it is projected that the City Budget employer contribution for all pension benefits will average at least $70 million annually for the foreseeable future. Contributions to support general city pension benefits will make up about 25-27% of this total.

7. A significant proportion of general city employes are engaged in relatively physically demanding occupations.

Assignment

1. The Committee's primary purpose is to identify potential plan design changes that would apply to new general city employes.

2. In order to have a basis for considering such changes, certain key questions involving value judgments need to be addressed. Discussion about these key questions will be a focus for the Committee's August 25 meeting.

3. The following guiding principles may serve as useful context for developing judgments about the key questions, which follow the guiding principles.

Guiding Principles

- **GP # 1**: The level of City pension benefits should be set with the goal of providing a reasonable level of income replacement for career-service employes and fiscally sustainable contributions for employers and the taxpayers.

    - **Rationale:** City employes perform work that is essential to public health and safety and to the operation of the regional economy. A pension serves as a very meaningful benefit towards recruiting and retaining qualified employes. Post-retirement income for City of Milwaukee employes also has a positive impact on the housing market and the level of City per capita income.

      However, substantial changes to factors such as life expectancy, the competitive pressures facing private sector employers and employes, and the City's structural budget condition have created an imbalance between the benefits and costs of a City pension. These factors must be taken into account in the benefit and financing equation in order for the pension liabilities to be sustainable and politically acceptable.

- **GP # 2**: Task Force Recommendations should enable both near-term and ongoing improvement to the financial condition of the Employes' Retirement System (ERS).

    - **Rationale:** Pension liabilities are by definition long-term in nature. Short-term "fixes" that merely postpone meaningful action will compound the challenges facing future generations of taxpayers. However, the City's capacity to maintain a level of service comparable to its current baseline is in large part dependent on reducing the impact of pension finance within the next two years. Therefore, the feasibility to accomplish some changes within the existing legal, budgetary, and collective bargaining frameworks should accompany the interest in potential systematic and structural changes.

- **GP # 3:** Task Force recommendations should reduce normal cost for new entrants to a level that places less demand on the City's revenue structure.

    - **Rationale:** The City of Milwaukee serves as Plan Sponsor. The City's primary source of local revenue is the property tax. The majority of the property tax is based on the residential and commercial sectors, so the income of City residents is a key factor in the "affordability" of pensions whether on a short-term or ongoing basis.

      Growth in liabilities that exceeds the rate of tax base and personal income growth (especially in light of the declining State commitment to Shared Revenue and tax base equalization) will render the pension system in a financially and politically unsustainable position. Developing a plan for new entrants design with a lower normal cost than the existing 11.5% of payroll is essential.

- **GP # 4:** Task Force recommendations should include an appropriate balance of risk and financial responsibility for retirement benefit financing among Plan members and the Plan sponsor.

  - **Rationale:** Mature defined benefit (DB) pension plans have three primary sources of finance: first, and foremost, investment return. Employe and employer contributions provide substantially lower proportions of Plan finance. Historically, public sector DB plans in Wisconsin generally receive most of the employe contribution from the employer (so-called "employer pickup") as a result of collective bargaining. This will change as a result of 2011 Wisconsin Act 10.

    DB plans allocate investment and longevity risk to the Plan sponsor while guaranteeing benefit levels. Therefore, the member is effectively shielded from responsibility for pension financing. On the other hand, private sector defined contribution (DC) plans generally provide significant employer match to employe contributions, while public sector employes finance DC retirement savings on their own.

    Given the impact these circumstances have on the political and economic sustainability of the Plan and the City's overall Budget, it makes sense to determine whether the balance of risk and responsibility that applies to City retirement benefit finance should be modified.

<u>Key Questions</u>

1. What should be the percentage of "income replacement" that the City should seek to provide through its pension for a "career service" general city employe?

   - For example, with the 70% pension "cap" and expected 40-50% income replacement from Social Security, a general city employe can achieve about 110-120% income replacement with 35 years of service. If a participant elects an early Social Security retirement option (e.g., age 62) the replacement ratio remains above 100%. Should this be the goal, or should private savings be expected to play a part in reaching 100% (or some lower percentage)? Should more than 35 years of service be the expectation for the target level of income replacement?

2. What responsibility should the employe versus the plan sponsor (employer) assume for (a) investment risk, especially pertaining to achieving the target level of “income replacement” at an employe’s retirement; (b) post-retirement inflation risk and (c) longevity risk (i.e., members “outliving” the actuarial assumptions about mortality)?

    - Under the current ERS defined benefit plan structure, the plan sponsor is largely responsible for all three risks. Is it reasonable to consider some sharing of responsibility, or placing the plan sponsor in charge of (a) while allocating some share of (b) and (c) to the employe via private savings or risk sharing?

3. Given current longevity and advances in health care, what should be the minimum retirement age for an unreduced pension benefit for general city employes? How should the ratio of expected years “in retirement” relate to expectations regarding what equates to “career service”?

4. Finally, the underlying issue is what level of normal cost can the City as plan sponsor take on, and remain sustainable as a service provider? The current rate of about 11.5% appears unsustainable. What might be a sustainable rate of normal cost?