



Department of Administration
Budget and Management

January 30, 2013

Tom Barrett
Mayor

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Ref: 13004

Common Council
City of Milwaukee

Subject: Charter Ordinance Relating to Employer Contributions to the Combined Fund of the Employees' Retirement System

Dear Honorable Members:

We have submitted a Charter Ordinance regarding revised provisions to section 36-08 relating to employer contributions to the Combined Fund of the Employees' Retirement System (ERS) for introduction at the February 5, 2013 Common Council meeting.

Background

1. The ERS "Combined Fund" accounts for more than 99% of ERS liabilities, and practically speaking, represents the source of funds for all ERS benefit payments. Current City Charter provisions provide for employer contributions to the Combined Fund based on the results of an annual valuation performed by the System's independent actuary. These Charter provisions have the following limitations:
 - The calculation of each year's contribution is hyper-responsive to annual investment results. Relatively modest deviations from the assumed 8.5% rate of return can generate relatively large annual changes, as a proportion of the tax levy, to the employer contribution. This feature conflicts with the objective of maintaining pension contributions that are relatively stable as a percentage of covered compensation, an objective that is common among state and local government retirement plans. The current approach to calculating the annual employer contribution is also inconsistent with the objective of effective budget planning.
 - Current Charter provisions include a "full funding limit". The practical effect of the full funding limit is that no employer contributions occur in a year when the actuarial value of the assets is 102% or more of the actuarial accrued liability. The full funding limit can produce significant destabilizing budget impacts, as the difference simply between city government's share of the "normal cost" (each year's cost of pension benefits accrued in that year) and a \$0 contribution is more than \$40 million. This feature can also lead to intergenerational inequity among taxpayers. As a result of the existing Charter provisions, there were no employer contributions made between 1996 and 2009

inclusive. {It should be noted that even without a “full funding limit”, no employer contributions would have been actuarially required in those years due to the extent of the Plan’s surplus.}

- Contributions driven by annual valuations are inconsistent with the reality of financial market cycles, which exhibit persistent cyclical and volatility. Investment returns constitute approximately 80% of ERS funding. The ERS entered 2012 with an actuarial funded status of 96%, compared to an average of 78% funded status for a Moody’s rating agency database of 162 public employee retirement systems (PERS) with accrued liabilities of more than \$2.9 trillion.
2. The 2010 city budget included an employer contribution of \$49 million, the first employer contribution since the 1995 budget. No employer contributions were required by Charter for the 2011 or 2012 city budgets due to the full funding limit.

However, based on recommendations from the Budget and Management Division (BMD), the Mayor and the Common Council included a total of \$44 million of voluntary employer contributions to the Employers’ Reserve in 2011 and 2012 to help reduce the budget impact of Charter required contributions that returned to the 2013 budget in the amount of \$60.7 million. Current forecasts project that the Plan’s funded status will remain below 100% over the next five years.

3. During 2012 the BMD engaged the ERS independent actuary in a contract to determine whether a revised approach to employer contributions could improve budget planning and stabilize contributions, and comply with actuarial standards of practice. Specific engagement objectives included:
- Annual budgeting for the normal cost, regardless of funded status;
 - Reducing unfunded liability at a pace consistent with actuarial standards of practice;
 - Maintaining asset coverage equal to or greater than retired lives’ liabilities;
 - Stable and predictable contribution levels over 5 year periods that maintain the actuarial integrity of the ERS;
 - No change to member contributions as percentages of covered compensation.
4. The actuary used Asset Liability Modeling (ALM) techniques to perform the analysis. The use of ALM enabled the actuary to project actuarial valuations into the future under multiple investment return scenarios.
5. The actuary has completed an extensive preliminary analysis. This analysis will be updated to reflect modest changes which the Annuity and Pension Board has made to its assumptions as part of its five year experience review that it completed earlier in December, 2012. The conclusions from this analysis are:
- A level contribution approach based on stable percentage of covered compensation rates over five year intervals is feasible, and consistent with the objectives which BMD established.

- An overall “blended rate” of 18% of covered compensation is projected as adequate for the first five-year interval. This consists of rates of 25.46% for policemen, 27.94% for firemen, and 9.54% for general city employees.
- Under a wide range of investment return scenarios the funded ratio under the stable contribution alternative is not materially different from the “expected” case under the existing Charter provisions. The projected median funded status is higher under the 18% “blended” stable rate than under the current Charter provisions.

Summary of Proposed Charter Ordinance

1. The proposed Charter Ordinance revises the methodology used to determine employer contributions to the Combined Fund. Currently the employer contribution is based on the results of the annual actuarial valuation.
2. This proposal contains a methodology that would establish an “actuarial contribution rate” as a percentage of covered compensation for each of the three member (police, fire, general city) categories. The ERS independent actuary would establish these rates consistent with actuarial standards of practice. The rates would be based on the full actuarially determined employer share of normal cost and an amount needed to reduce unfunded past service liability.

As under current law, the actuary would inform the city and city agencies annually by August 15 of the employer contributions due and payable by January 31 of the following year. The revised methodology would take effect with the employer contribution due January 31, 2014 (the 2014 budget).

3. The proposed Charter Ordinance eliminates the full funding limit. In the interests of funding discipline and intergenerational equity, the proposal requires that the annual employer contribution include the employer share of the normal cost, as determined by the actuary, even if the funded status of the Plan exceeds 102%.
4. The proposed Charter ordinance provides for a reset of the actuarial contribution rate every five years, subsequent to the completion of the System’s five year experience review. This establishes a close linkage between the System’s actuarial updates and the resetting of the actuarial contribution rate to govern employer contributions.

Recommendation

1. The Administration recommends that the Common Council adopt the proposed Charter ordinance changes. The revised approach is consistent with actuarial standards of practice. This legislation will provide for responsible, stable, and predictable funding of pension obligations and will help maintain the ERS’s position as one of the best funded PERS.
2. The Government Finance Officers Association (GFOA) has issued a resolution pertaining to state and local government pension funding policy. GFOA’s statement supports pension funding policy that is based on actuarially determined annual contributions. GFOA also supports pension funding policy objectives that include practicing funding discipline; maintaining intergenerational equity; managing contributions as a stable percentage of payroll; and ensuring accountability and transparency. This proposal meets GFOA’s benchmarks for sound pension funding policy:

- The proposed Charter Ordinance requires annual employer contributions which are based on an actuarial contribution rate that is consistent with actuarial standards of practice. The ordinance also requires the actuary to provide the annual contribution amounts payable each year by August 15. The five year interval for resetting actuarial contribution rates is linked to the completion of the five year experience review.
 - The proposed Charter Ordinance incorporates funding discipline through provisions that require the actuarial contribution rate to include the full employer share of the normal cost, regardless of funded status; and by requiring amortization of any unfunded past service liability in a manner consistent with actuarial standards of practice.
 - The proposed Charter Ordinance maintains intergenerational equity by providing that the normal cost be funded every year, even if a fund surplus exists.
 - The proposed Charter Ordinance manages contributions as a stable percentage of payroll by establishing actuarially determined rates of covered compensation to be contributed for each of the three member categories for five year intervals. This facilitates effective budget planning and reduces the potential that policy makers will fail to make required contributions due to the impact of unforeseen fiscal circumstances.
 - The proposed Charter Ordinance ensures accountability and transparency by incorporating employer contribution provisions as part of Chapter 36, which establishes the Common Council's home rule authority with respect to the retirement system. In addition, the ALM analysis that serves as the actuarial basis for this legislation will be made available as part of the public record.
3. Based on current estimates, the proposed Charter revisions would result in annual employer contributions from *city government* sources of approximately \$63 million annually, beginning with the 2014 budget. Additional employer contributions would be required of the city agencies such as MPS, MMSD, and HACM.

We are requesting the file as drafted by the Legislative Reference Bureau to be introduced at this time and will provide the detailed fiscal note and additional materials prior to the hearing of the Committee to which this file is assigned. Please contact me at extension 5060 or Dennis Yaccarino at extension 8552 for further information regarding this request.

Respectfully submitted,



Mark Nicolini
Budget and Management Director

MN:dmr
Attachments
ERS/2013/I-CC-intro-36-08-dr6