
Urgent Changes for a Sustainable System



Our Pension & Health Care Plans are in
Jeopardy

A Recommendation to City Council

Toward a Sustainable System

- On August 5, 2010 the results of Task Force II were presented to City Council
- Since first convening on October 5, 2010 the newly constituted CRS Board of Trustees has reviewed both this presentation as well as the supporting materials used in its development.
- The Board of Trustees applauds the work of Task Force II. In particular, Task Force II identified the most promising areas for change that would address the economic imbalances in the System.

Toward a Sustainable System

- Task Force II also identified the events that have brought CRS to its knees. These events have, over many years, increased unfunded liabilities resulting in a System burdened with extensive and largely intractable legacy costs.
- It is the sense of the Board that the urgency of today's situation demands changes that will result in a Retirement System that will be sustainable over the long term. This Board will recommend changes that will begin the march to achieve that goal.

Toward a Sustainable System

- The Board wants to acknowledge that CRS participants, both active and retired, are not the villains in this unfortunate situation. And, it's fair to say that the out of control costs are not the fault of any single constituency within the City past or present.
- Rather, over the years, benefits were initiated, enhanced and embellished with good intentions, but perhaps too little analysis. And once established they were then swept along by the same macroeconomic forces that have buffeted all enterprises and institutions, private and public.

Toward a Sustainable System

- Several additional observations by the Board:
 - Large “cash infusions” of hundreds of millions of dollars (such as were included in several Task Force II options) to get the system back on the “right track” are economically unrealistic.
 - The status-quo is no longer an attractive option for any stakeholder.
 - From a cost perspective, the “tail is wagging the dog” because legacy actuarial liabilities of retirees and beneficiaries now constitute more than 2/3rds of CRS’s liability burden .

Toward a Sustainable System

- Several additional observations by the Board:
 - Task Force II analysis showed that if the City contributes 17% of payroll each year in addition to employee contributions, and assets earn 8% per year, then the trust will run dry during 2028 (Task Force II).
 - Approximately \$200,000,000 of pension and healthcare benefits are now paid to retirees each year from the trust. If the trust runs dry in 2028, these payments will need to be paid directly from the City's General Fund and Enterprise Funds. The liability becomes a "second" payroll.

Toward a Sustainable System

- Several additional observations by the Board:
 - To achieve a sustainable system, changes must be made to both the pension and the health care plans.
 - The Board believes that only by making changes to the benefits now being paid to retirees and beneficiaries can a sustainable system be achieved.
 - The Board believes that in the future, expressing pension and health care costs in dollars (versus a percentage of active payroll) will result in a more realistic budgeting approach, especially if the number of full-time active employees begins to fall.

Toward a Sustainable System

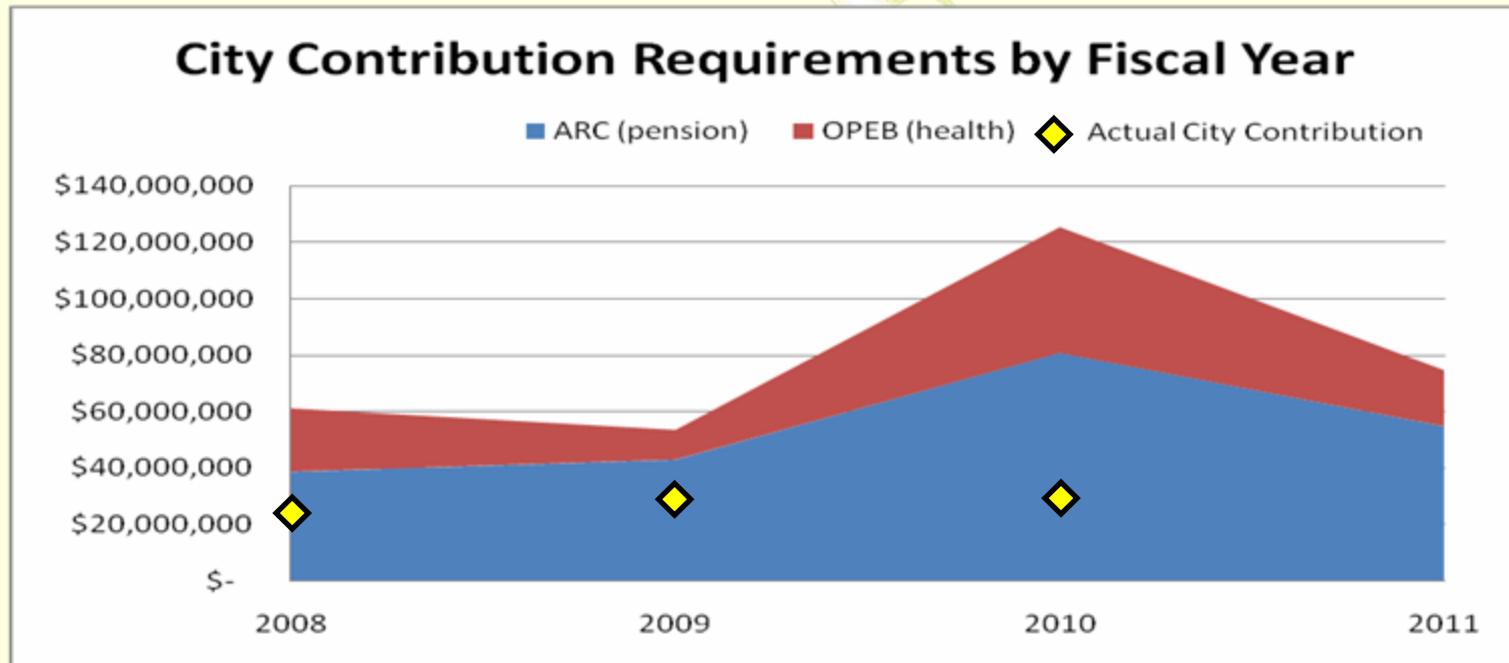
- Several additional observations by the Board:
 - The funded status of the plan is even weaker when viewed through a more realistic lens. For instance, when the funding ratio is measured using the market value of assets, the funded ratio of the pension and health care plans together drops from 79.2% to 66.3%. A more complete explanation is provided in the [Appendix](#).
 - Once changes are enacted, it will be critical that the City commit to actually making the required contributions to support the System.

Feeding the Beast - The Big Disconnect

- The City has shown it can not afford to pay it's share of contributions for the pension and health care plans with substantial legacy costs that have come home to roost. What's the recent history?
 - 2008 City Contribution:
 - \$61,269,221 requirement
 - Actual City contribution: \$28,224,000 (46.1% of required)
 - 2009 City Contribution:
 - \$53,630,000 requirement
 - Actual City contribution: \$32,247,000 (60.1% of required)
 - 2010 City Contribution:
 - \$125,571,000 requirement
 - Actual City contribution: \$31,818,007 (projected, 25.3% of required)
 - 2011 City Contribution
 - ARC: \$74,818,000 (reflects change in amortization period from 15 to 30 years)
 - Actual City contribution: to be determined

Feeding the Beast - The Whole Picture

- Despite increasing the amortization period for funding, City contribution requirements exceed the City's ability to fund.



What's the Cost of Inaction?

- One easy way to understand the cost of inaction is to remember the basic retirement funding equation (the “no free lunch” equation):

$$\blacksquare C + I = B + E$$

- C = Contributions
- I = Investment Income
- B = Benefits Paid
- E = Expenses (administration)

What's the Cost of Inaction?

- Inaction results in an escalating increase in benefits paid to participants.
- Inaction results in trust assets continuing to fall, thereby further increasing contribution requirements.
- Inaction results in a spiral that will deplete all trust assets within the next two decades.
- Inaction will force taxpayers to eventually dig much deeper to pay for the City's inability to take action now.

Pension Changes Recommended

- The CRS Board has studied the following changes and recommends their adoption, subject to a comprehensive set of grandfather and transition rules to protect participant benefits earned to date.
 - COLA will be based on simple interest, not compound
 - COLA will no longer be guaranteed at 3% but will be indexed to follow the CPI-U up to a maximum of X% per year
 - With the assistance of legal counsel, the Board will review pension benefits being paid to retirees and beneficiaries to determine what changes, if any, may be made to those benefits.

Pension Changes Recommended

- The final average salary used in benefit calculations will be changed from a 3 year average to a 5 year average.
- In calculating pension benefits, only up to 30 years of service will be used.
- Retirement ages and service requirements will increase as shown on the following two slides.
- With the exception of the spousal joint and survivor death benefit for active participants, all additional survivor death benefits, and attendant health care coverage, will be eliminated.
- The retiree \$7,500 death benefit will be eliminated.

Retirement Age and Service

Current Rules

- Normal Retirement (pre-2010 hires):
 - 30 years of service, any age
 - 5 years of service, age 60
- Normal Retirement (post-2009 hires)
 - 30 years of service, age 55
 - 5 years of service, age 65

Proposed Rules

- Normal Retirement (pre-2011 hires):
 - 5 years of service, age 65
- Normal Retirement (post 2010 hires)
 - 5 years of service, age 67

Retirement Age and Service

Current Rules

- Early Retirement (pre-2010 hires):
 - 25 years of service, age 55
- Early Retirement (post-2009 hires)
 - 25 years of service, age 60
- Actuarial reduction applies

Proposed Rules

- Early Retirement (pre-2010 and post-2009 hires):
 - 15 years of service, age 57
- Actuarial reduction applies

Grandfather and Transition Rules

- Group A: Existing retirees not protected under the 3% compound COLA
- Group B: Existing retirees protected under the 3% compound COLA
- Group C: Current active employees with eligibility to retire prior to 1/1/2011
- Group D: Current active employees with eligibility to retire after 12/31/2010 and prior to 1/1/2014 who retire by 1/1/2014
- Group E: Current active employees with eligibility to retire after 12/31/2010 and prior to 1/1/2014 who retire after 12/31/2013
- Group F: Current active employees who do not belong to Group C, D or E
- Group G: Employees hired on and after 1/1/2011

Grandfather and Transition Rules

- Change 1: Simple COLA
- Change 2: COLA simple, indexed (non-guaranteed) with maximum of X%
- Change 3: 3 year final average salary changed to 5 year final average salary
- Change 4: 30 year service limitation for benefit calculations

Grandfather and Transition Rules

- Change 5: Revised retirement ages –
 - Normal Retirement: 65 & 5 (67 & 5 for post-2010 hires),
 - Early Retirement: 57 & 15 (actuarially reduced).
 - Each participant's accrued benefit as of 1/1/2011 is protected and retiree gets better of:
 - a) 1/1/2011 actuarially adjusted accrued benefit plus post 12/31/2010 accruals, or
 - b) benefit calculated as if 1/1/2011 changes had always been in effect.
- Change 6: Except for the spousal death benefit for actives, eliminate all other survivor death benefits.
- Change 7: Eliminate \$7,500 death benefit for retirees.

Grandfather and Transition Rules Application Matrix

	Group A	Group B	Group C	Group D	Group E	Group F	Group G
Change 1	Yes ¹	No	No	Yes	Yes	Yes	Yes
Change 2	No	No	No	Yes	Yes	Yes	Yes
Change 3	No	No	No	No	Yes ²	Yes ³	Yes
Change 4	No	No	No	No	Yes ²	Yes ³	Yes
Change 5	No	No	No	No	Yes ²	Yes ³	Yes
Change 6	No	No	No	Yes	Yes	Yes	Yes
Change 7	Yes	Yes	Yes	Yes	Yes	Yes	Yes

¹3% simple COLA, not indexed.

²Benefits earned prior to 1/1/2014 will be maintained and benefits for subsequent service will be paid under the new basis.

³Benefits earned prior to 1/1/2011 will be maintained and benefits for subsequent service will be paid under the new basis.

Health Care Changes Recommended

- Initially, move all retirees to the same medical plan and same premium cost share approach as actives (excluding certain PPA requirements).
- Future premium cost sharing approaches for all retirees will be considered and may be based on years of service, age, or both.
- Require retirees to pay 100% of premiums for dental and vision benefits if they choose to continue coverage.
- Eliminate the Medicare Part B subsidy for all retirees and spouses.

Health Care Changes Recommended

- Set 57 as the minimum age requirement for retiree healthcare eligibility. This will correspond to the new Early Retirement Age (age 57 and 15 years of service) within the pension plan.
- Increase cost sharing for retirees prior to age 65.
- Reduce or eliminate employer contributions to the health care trust until the pension trust achieves an 80% funded level.

Estimated Costs

- **ACTUARIAL PRICING
IN PROGRESS**

DRAFT

What Else Could Effect Future Costs?

- If City Council enacts these recommended changes, it's important to understand what factors could adversely effect the magnitude and timing of future costs.
 - Short term (1-2 years)
 - Significant asset losses during 2010/2011/2012.
 - Liability losses caused by a rush to retire in the near term, exceeding actuarially projected levels.
 - Reduced employer contributions to the health care trust may result in actuary decreasing rate of return and discount rate assumptions thereby increasing unfunded liabilities.

What Else Could Effect Future Costs?

- Mid term (3-5 years)
 - The long-term return on CRS assets could settle below 8%.
 - GASB (Governmental Accounting Standards Board) has begun the process of revising their accounting standards for pension and retiree health care benefits of governmental entities.
 - If GASB adopts a more mark-to-market approach to determining costs and disclosing unfunded actuarial liabilities this could result in earlier cost recognition by the City and greater transparency for unfunded liabilities on financial statements.

What Else Could Effect Future Costs?

- Long term (6+ years)
 - The long-term return on CRS assets could settle below 8%.
 - Health care costs continue to spiral at rates greater than assumed in actuarial calculations so that actuarial assumptions must be reevaluated.
 - Longevity continues to improve in the population at rates greater than assumed in actuarial calculations and rates of morbidity (ill health) in this older population grow so that actuarial assumptions must be reevaluated.

Appendix

Funded Status of the Trust

- Let's look closer at the funded ratio of the entire trust.
 - Combined, as of December 31, 2009, the pension and health care actuarial reports showed that the ratio of our actuarial liabilities to our assets equaled 79.2%
 - This doesn't sound so bad, BUT
 - How are we measuring our assets?
 - How are we measuring our liabilities?
 - Things may not be as "good" as they look.

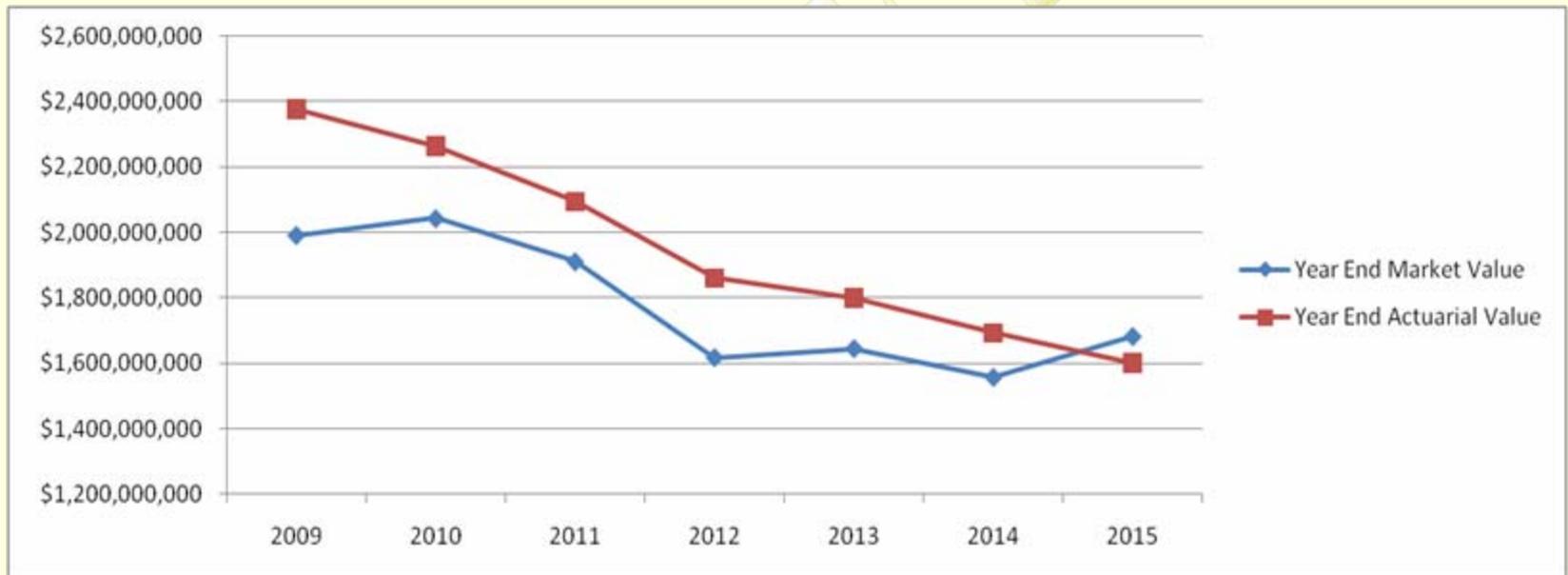
How are we Measuring Pension Assets?

- December 31, 2009 actuarial value of total assets: \$2,377,435,706
- December 31, 2009 market value of total assets: \$1,991,824,000
- Which one is the “real” total asset value?
- Answer: the market value of \$1,991,824,000 , which is \$385,611,706 less than actuarial value!
- Well, what then is actuarial value all about?

What's Actuarial Value? A Five Year Rolling Average of Market Value

A hypothetical example of returns into the future.

2010: 12%, 2011: 4%, 2012: -7%, 2013: 14%, 2014: 6%, 2015: 22%



Money that's not Really There

- Actuarial value is not a “real” value of assets, rather, it’s a smoothed value that government accountants allow pension and health care plans to use for smoothing out the “ups and downs” of market value in calculating contributions.
- Also, governmental accounting rules allow the use of a smoothed asset value for reporting asset values.
- As shown in the previous slide, actuarial values can be greater than or less than the market value.

How are we Measuring Pension Liabilities?

- Actuarial liabilities are fundamentally different than asset values. For the most part, every asset has a readily determined market value.
- However, an actuarial liability in a pension or health care plan is a value assigned to the promise of a future benefit for each participant using an actuarial technique that estimates the probability of future events such as life expectancy, ill health, turnover, retirement age, and the economic value today of future cash flows (i.e., pension and health care benefits paid years from now).

How are we Measuring Liabilities?

- Pension and health care actuarial liabilities disclosed by governmental accountants generally use a discount rate equal to the assumed return on assets for determining the value today of a future cash flow (in CRS's case, that's 8%).
- The approach that virtually all sponsors of pension plans in the private sector must take, is to use a rate that approximates a lower level of risk (mirroring, say, investments in high grade corporate bonds). This would be a rate of about 6% as of 12/31/2009.

How are we Measuring Liabilities?

- Actuarial Liabilities calculated using 8% as of 12/31/2009:
 - Inactive Participants: \$ 2,188,436,225
 - Active Participants: \$ 814,701,101
 - Total \$ 3,003,137,326
- Actuarial Liabilities (estimated) calculated using 6% as of 12/31/2009:
 - Inactive Participants: \$ 2,900,000,000
 - Active Participants: \$ 1,100,000,000
 - Total \$ 4,000,000,000

Why Does This Matter?

- If governmental accounting rules allow us to follow rules that we use today, why should we care about the results of using a more “realistic” approach?
- This matters because these governmental accounting rules are now being evaluated for potential changes by the body – the Governmental Accounting Standards Board or “GASB” – that issues these rules.
- If GASB adopts a more “mark-to-market” approach to determining costs and disclosing unfunded actuarial liabilities this could result in earlier cost recognition by the City and greater transparency for unfunded liabilities on financial statements.

Why Does This Matter?

- And today's political environment with the backdrop of a nationwide "crisis in governmental plans" may force a shift to an even more "mark to market" and transparent reporting approach.
- Who might demand this transparency? Users of governmental financial statements such as underwriters, lenders, investors in municipal and governmental securities, companies thinking of relocating to, or moving from, a particular jurisdiction, and even the SEC.

What's the Impact on our Funded Ratio ?

- December 31, 2009 market value of assets:
\$1,991,824,000
- December 31, 2009 actuarial liability (valued at 8%):
\$ 3,003,137,326
- December 31, 2009 actuarial liability (valued at 6%):
\$ 4,000,000,000
- $\$1,991,824,000 / \$ 3,003,137,326 = 66.3\%*$
- $\$1,991,824,000 / \$ 4,000,000,000 = 49.8%*$
- Return to presentation

*Recognize that there is no “precise” value for the funded ratio, rather a range of values that depend upon how we estimate actuarial liabilities.