City of Alexandria, Virginia

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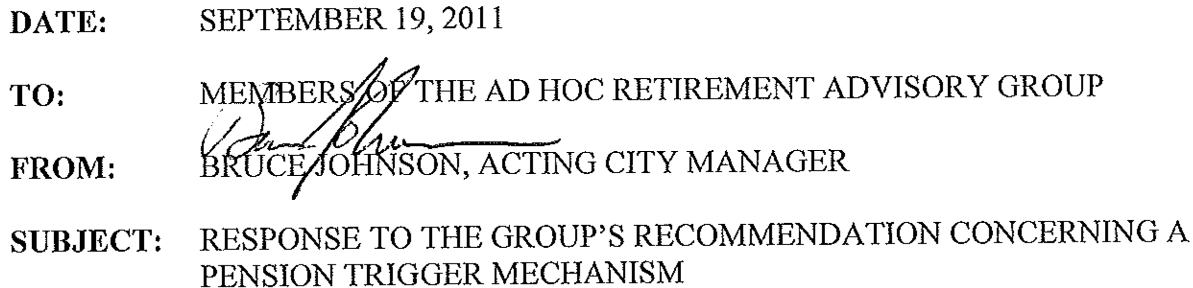
MEMORANDUM



DATE: SEPTEMBER 19, 2011

TO: MEMBERS OF THE AD HOC RETIREMENT ADVISORY GROUP

FROM: BRUCE JOHNSON, ACTING CITY MANAGER

SUBJECT: RESPONSE TO THE GROUP'S RECOMMENDATION CONCERNING A PENSION TRIGGER MECHANISM

This memorandum responds to the Ad Hoc Retirement Advisory Group's (the "Group") recommendation contained in the Co-Chairman's "mark" that the City Council consider a "trigger mechanism" to protect the City and its employees from the risks associated with future pension plan costs. A "trigger mechanism" would be some indicator event that would automatically trigger a pre-determined cost-sharing or cost-saving plan for the duration of any downturn. Since most benefit and compensation events are annual, the "trigger mechanism" would most likely operate on an annual time frame.

The first step would be choosing the type of cost-sharing or cost-saving action that would be triggered, changes to contribution rates or changes to benefits. It is important to note here that currently the Virginia Retirement System Plan could not be included in any "trigger mechanism" as the Plan can only be modified through General Assembly action. In addition, the Supplemental Retirement Plan for Deputy Sheriffs, Medics and Fire Marshals has statutory limitations that would restrict (but not eliminate) the City's options for implementing a "trigger mechanism."

On the other hand, the "trigger mechanism" could cause a temporary cessation of benefit accruals, a temporary reduction in the rate of benefit accruals, or a temporary cessation of service credit for retirement eligibility purposes. With this option, there would be the possibility of establishing a retroactive restoration of benefits when the situation returns to "normal." Absent a retroactive restoration of benefits, some employees would receive smaller monthly benefit payments at retirement.

The City Manager and staff feel that a percentage increase in employee contribution rates would be the most appropriate way to promote financial sustainability. Contribution rates are more easily adjusted (both increases and decreases as the situation requires) and would tie directly to the actuary's recommended contribution rate. Benefit changes would be more complicated to administer, and would have a more complicated and deferred impact on the actuary's recommended contribution rate.

The second step in setting up such a plan would be determining what type of event would be set as the "trigger mechanism." Potential "trigger mechanisms" include:

- A drop in the pension funding ratio (assets/liabilities);
- An increase in the actuary's recommended contribution rate as a percentage of salary;

- An increase in the unfunded liability above a pre-set limit;
- A decline in pension fund investment returns or performance; or
- Some external standard such as a decline in the S&P 500.

It is important to note that the "trigger mechanism" chosen should, as much as possible, be an objective, independent measurement directly related to the City and its pensions, bond rating, etc. and consistent with existing pension and investment policy. These characteristics would bolster employee confidence that the triggered cost-reduction is neither arbitrary nor capricious. The "trigger mechanism" should also be relatively easy to administer and powerful enough that no further City Council action would be required in a future downturn.

The "trigger mechanism" for increased contribution rates could establish FY 2013 contribution rates as the benchmark. (The actuary's recommended contribution rates for FY 2013 represent the latest data available from the actuary and will be the high water mark to date for contribution rates.) If the actuary's recommended contribution rate for a given year were to exceed those for FY 2013, the costs of the increase could be shared by the City and employees. Each employee group will decide what risk sharing ratios are appropriate but options include employees contributing a flat amount, such as one percent, or a specific portion of the increase, such as one half.

The third step would be to establish the benchmark for what a return to "normal" would mean. This benchmark would be directly related to the original "trigger mechanism". So, for instance, if the trigger mechanism was the FY 2013 actuary's recommended contribution rate, contribution rates or benefit accruals would return to normal for future years once the actuary's recommended contribution rate returned to or fell below the FY 2013 rate. If the benefit reduction option is chosen, another benchmark could potentially trigger a full or partial retroactive restoration of benefits reduced during the downturn.

Choosing between the options available for each step will require a careful cost-benefit analysis of each option. However, ideally, the ultimate plan would have certain characteristics:

- The "trigger mechanism" would be an objective, independent measurement directly related to the City and its pensions, bond rating, etc. and consistent with existing pension and investment policy.
- The "trigger mechanism" would be powerful enough that City Council wouldn't need to take further action to control pension costs during a downturn.
- The plan would be relatively simple to administer.
- There would be some consistency among plans.
- There would be no disparate impact or a very limited disparate impact on employee subgroups, such as younger v. older employees.
- The plan would be effective in both the short and long term.
- The plan would have only a short lag from the triggering event to measurement to implementation.

As indicated above, these options can be discussed and debated in full. The answers may vary from plan to plan. In summary, City staff favor a trigger mechanism pegged to the actuarially recommended contribution rate, and that the cost-sharing approach be used to promote financial sustainability by increasing the employee contribution rate by some amount.