Benefits Advisory Group
Enhancing Sustainability
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RISK MANAGEMENT

A. Reduce Employer Contribution Rate Volatility - Amortization Period
A short amortization period provides rapid paying down of the unfunded liability but volatile contribution rates. A long amortization period provides smoother funding but also delays paying off pension debt. If we adopt a formal pension funding policy that pays the greater of the actuarially determined amount using a long amortization period and a preset minimum then we will have the best of both worlds. For example, the Fire & Police Plan could use a thirty year amortization with minimum payment of $4 million annually (the current level of the amortization payment).

B. Share the Gain, Share the Pain – Employee & employer share both gains and losses
Currently in the Fire & Police plan there is a contribution rate sharing but there is no risk sharing. If the required contribution rate goes up or down the amount of change is absorbed in full by the City.

As of June 15th the City contribution rate for the pension component is about three times as high for the employer as the employee (21.65% vs. 7.2%). We might consider locking in this ratio at 3:1. This means future gains and losses would be shared by the employer and employee in a ratio of 3:1. If the required contribution rate increase or decreases then both the employer and employee contribution rates are changed proportionately. If combined rate goes from 32% (24% + 8%) to 36% then new rates are 27% & 9%. If rates move in the other direction to 28% total 21% City and 7% Employee. The precise ratio of 3:1 is convenient for illustration. The actual ratio might be different and subject to (negotiation, discussion, review).

C. Investment Protection Brings Benefit Protection - Investment Allocation
The City has taken steps to diversify the major plans for which it has investment authority. In the last six or seven years the plans (boards, administrators) have added international developed markets, emerging markets, timber, private equity, and real estate. This is a good beginning. The work needs to continue. Staff does not suggest any ***one*** particular investment instead a number of investments that in aggregate will enhance diversification and limit the probability and severity of a significant downturn. A list of potential candidates follows:

Asset backed securities	Bank loans	Commodities
Convertible bonds	Covered calls	Distressed debt
Emerging market bonds	Farmland	High dividend equities
High yield bonds	Increase real estate exposure	Increase timber exposure
International bonds (EAFE)	Laddered bonds	Long short funds
Managed futures	Market neutral	Master limited partnerships
Preferred stock	Private Placement bonds	Risk arbitrage
Short term bonds	Tactical Asset Allocation Funds	
TIPS (US & International)	Variable Rate Notes	

D. Benefit Accruals Function of Funding Status
Lower the benefit accruals in years the plan's funding status changes for the worse. Example: The Fire & Police Officers benefit accrual is 2.5% for the first twenty years and then 3.2% per annum for the next ten years. If the stock market drops 20% in a year the accrual rate for the next year is 2.5% for plan members, regardless of whether or not they have 0 -20 or 20 -30 years. If the stock market recovers in a few years then we resume the 3.2% accrual rate to future years of employment. This is an administrative nightmare and least favorite of the four. Last resort if the prior three fail.

BENEFIT REFINEMENTS

E. Supplemental Retirement Plan –
The Supplemental Retirement Plan has a Lump Sum Option. In lieu of the monthly benefit a retiree may elect to receive the present value in a single payment. The lump sum payment is not calculated at the long term actuarially assumed rate in the plan (7 ½%) but instead at a going market rate. This market rate is usually below the assumed rate, and recently it has been significantly below. This leads to significant losses to the pension plan. The provision could be either eliminated or changed to use the long term actuarial assumption.

The Supplemental Plan vests any **full time** employee over age **sixty**. So, a person hired at age 59 years old only has to work one year to become eligible for monthly retirement benefits. This provision is an expense, an administrative burden, and inconsistent with the City's other vesting standards. It could be eliminated.

Similarly, the Supplemental Plan vests any **part time** employee over age **sixty five**. So, a person hired at age 64 years old only has to work one year to become eligible for monthly retirement benefits. This provision is an expense, an administrative burden, and inconsistent with the City's other vesting standards. This could also be eliminated.

Eliminate Supplemental Retirement Benefits for part time employees for new hires. Replace this with a provision for those becoming full time to purchase service credit for their prior part time service with the City.

F. Reduced Benefit for New Fire & Police New Hires

For new hires into the police and fire plan set the benefit accrual rate at a fixed 2.5% per year with no cap at thirty years and no bump to 3.2% at twenty years. An alternative is to increase the benefit multiplier to 3.2% after the 25^{th} year for new hires.

Cap the Difference between New and Old Hires

There is a significant difference in retirement benefits provided to new and old hires. Short term this is not an issue. People who are on the job one or two years do not raise a fuss over their retirement benefits. Also, there are not many of them and they are not placed in paramount positions. However, not too many years down the road these things will all change. Then there will be a groundswell of discontent among the second class workers. A small disparity (between the new and old benefits) can be tolerated forever. However, a large disparity cannot.

Narrow the spread in benefits between the new & old hires. A fundamental difference between the two is that General Schedule new hires contribute 4% of pay to VRS. The old hires (pre 7/1/2010) pay nothing to VRS. To accomplish this there must be state legislation to allow the City to charge all employees a modest percentage of pay (1% or 2%).

I also recommend we drop the employee contribution to the Supplemental Plan for new hires.

Continue the Efforts on Workers Compensation and Disability

Disability and Workers Compensation costs are too high. Wellness programs, benefit levels, recertification of disability status, tax efficiency, and structure of the trust fund are all under review. While the nuts and bolts of these efforts are outside the scope of the

Benefits Advisory Group the committee can lend credibility to the effort and call for a sense of urgency to those persons, departments, or groups working on these projects.

Virginia Department of Health (VDH)

VDH employees working in the City's Health Department receive a City pension benefit. This is too expensive and should be terminated.

GOVERNANCE

Create one (single, unitary, non-trivial integer less than two) Board for all retirement plans. This would help in several ways. All employees would have a voice. There would be a single place to go for all issues. There would be a group of focused, experienced, educated board members that have both depth and breath. The voting structure need not materially change.

Create and Adopt a Formal Funding Policy and a Benefits Policy.

ADMINISTRATION

Combine the Supplemental and Fire & Police trust funds for investment purposes and for compliance and IRS determination letter rulings. There would be no changes in benefits.

Combine the Fire & Police pension and disability components. Disability and workers compensation are discussed above. That focus is benefits related. This focus is administrative and reducing annual fees to Comerica.

NO CHANGES

Make No Changes to Actuarial Assumptions

Make no changes to the Actuarial Methods

Make no changes…except the amortization method mentioned above