

**2011 - 2012 Statement of Legislative Intent**

**Approved**

Tab	Action	Option	Version
108	2	A	2

**Budget Action Title:** Develop a Sustainable Retirement Benefit

**Councilmembers:** Budget Committee; Godden

**Staff Analyst:** John McCoy

**Budget Committee Vote:**

Date	Result	SB	BH	SC	TR	JG	NL	RC	TB	MO
11/12/2010	Pass 9-	Y	Y	Y	Y	Y	Y	Y	Y	Y

**Statement of Legislative Intent:**

The City of Seattle needs to find ways to make its employee retirement benefits more sustainable and affordable to the taxpayers and to employees themselves. The 2011-2012 Budget raises contributions from 16.06% of regular payroll to 20.06%, a dollar increase of nearly \$24 million per year across all City funds. Employees will pay half of this, contributing 10.03% of their pay. The increase, while necessary, is probably insufficient to amortize the Retirement Fund's long-term shortfall, and future budgets are likely to require further increases.

In 2011, the City Council wishes to develop alternative policy options for the Seattle City Employees' Retirement System (SCERS). These policies will involve benefit changes for new hires and other system improvements designed to bring down the cost of the retirement benefit while maintaining the City's competitiveness as an employer. To that end:

- Council requests the creation of an Inter-Departmental Team (IDT), with representation from Council Central Staff, the City Budget Office, the Retirement Office, Finance and Administrative Services, and the Personnel Department.
- The IDT is directed to consult with relevant stakeholders in 2011, including the Mayor, the City Council, employees, labor unions, the SCERS Board of Administration and taxpayers about the cost and features of the retirement benefit.
- The IDT is directed to deliver a report to the Mayor, City Council, and SCERS Board of Administration no later than February 15, 2012 outlining system improvements and possible policy changes for new hires, along with the potential cost savings they would bring.
- The SCERS Board of Administration is requested to deliver its recommendations for policy changes by March 15, 2012.

- The report's findings and Board policy recommendations will be considered for legislation in 2012 and implementation effective January 1, 2013.
- A related budget action adds \$250,000 of General Subfund appropriation to the Finance General Reserves Budget Control Level in 2011. These funds are for the IDT's costs of developing the report, including specialized consulting resources that may be required, such as actuarial scoring of alternate benefit designs. The Retirement Office is requested to devote whatever staff resources are necessary to participate actively in the process. A future budget supplemental may allocate these or additional costs to other City funds, such as the utilities, which have the largest share of SCERS enrollment.

## Background

SCERS provides retirement and disability benefits to most City employees who are not in a separate Police or Firefighter pension system. The Retirement Fund is supplied by City contributions and payroll deductions from City employees. These funds are invested by the SCERS Board of Administration in a variety of stock, bond, real estate and other instruments in order to grow and provide sufficient resources to pay the promised benefits. The Retirement Fund currently has about \$1.7 billion in assets invested.

Following the market dislocations of 2008 and the recent economic recession, state and local jurisdictions across the country are finding that their retirement funds are not as well capitalized as they should be. SCERS is no exception, having fallen from a 92% funding ratio at the beginning of 2008 to a 62% funding ratio at the beginning of 2010.<sup>1</sup> As a result of these market losses and longer employee lifespans, the system's unfunded liabilities for already-earned benefits total about \$1 billion. While there is no near-term risk of running out of money to pay promised benefits, the City must take steps to address these long-run liabilities. The 2011-2012 Proposed Budget raises contributions to the Retirement Fund from the current 16.06% of regular payroll to 20.06% over the biennium, an increase of nearly \$24 million per year over 2010 contribution rates. This contribution is currently paid in equal shares by employees and the City.

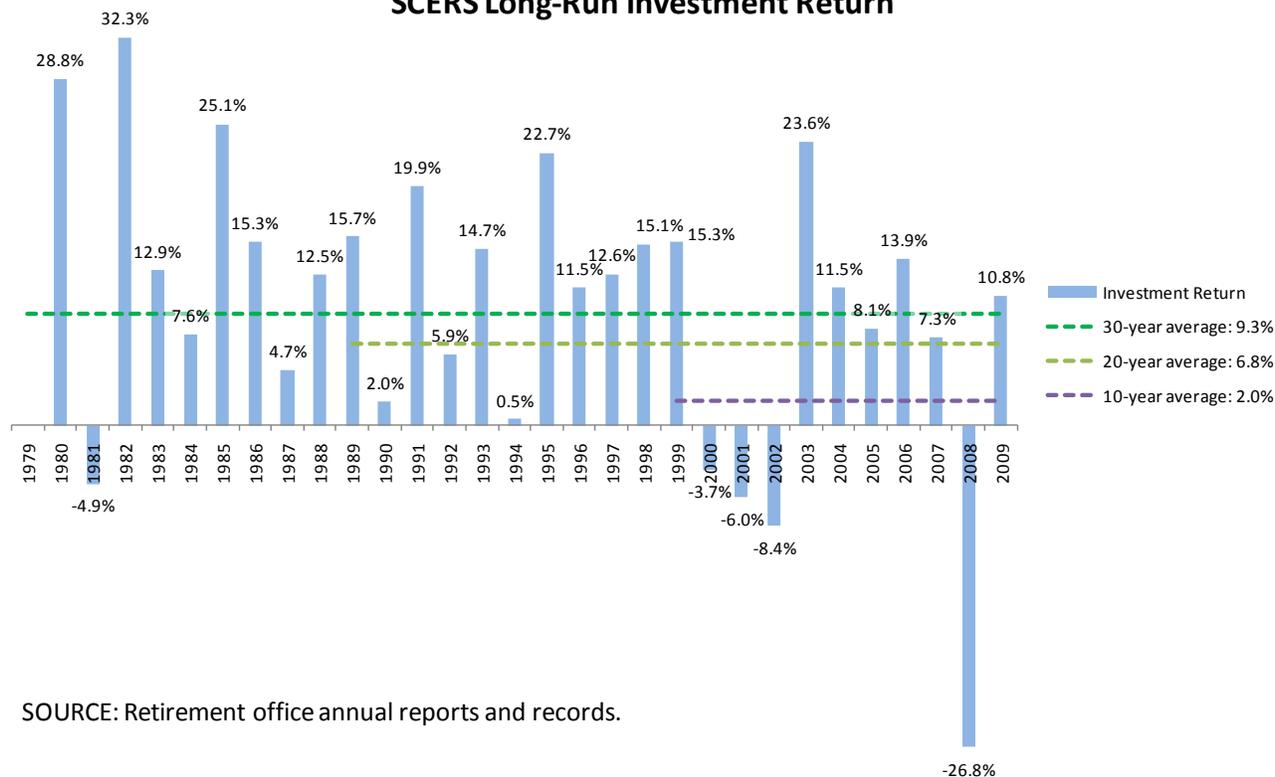
Actuarial projections show that this proposed increase will not amortize the system's unfunded liabilities over 30 years.<sup>2</sup> To do that, contributions would need to increase to over 25% of payroll. And even that calculation assumes that the SCERS investment portfolio will earn average annual returns of 7.75% going forward. Nationally, analysts are questioning the return rates that retirement systems can realistically achieve in the current market.

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<sup>1</sup> To put this statistic in context, retirement analysts regard a funding ratio above 80% and stable or improving as a "safe" level. SCERS is still better capitalized than many comparable major city systems. Also, SCERS faced a similar funding ratio coming out of the early 1980s recession. Contribution rates were increased at that time, and the funding ratio improved slowly over more than a decade, buoyed by strong investment performance, eventually surpassing 100%.

<sup>2</sup> A 30-year amortization is not a requirement. Rather, it is one possible accounting standard recommended by the SCERS Actuary.

## SCERS Long-Run Investment Return



SOURCE: Retirement office annual reports and records.

Over the past 30 years, the Retirement Fund has earned an annual average return of 9.3%. However, most of the strongest years were back in the 1980s. Over the past 20 years, the average return was just 6.8%, and over the past 10 years, which saw two major market downturns, the return has averaged just 2.0%, lower even than the inflation rate over the same period. In the wake of 2008, the SCERS Board of Administration is redesigning its investment allocation strategy to improve returns and reduce risk. It is noteworthy that all of the potential portfolios that the Board had to choose from at a recent Investment Committee meeting were projected to earn slightly less than the actuarial assumption of 7.75% on a 30-year compounded basis.

A sensitivity analysis in the 2010 Actuarial Report showed that the investment return is by far the most important factor driving the City's retirement costs. Should the investment portfolio continue to fall short of 7.75% to a significant degree and over a significant length of time, it is not unrealistic to expect that the SCERS pension contributions would rise to more than 25% of payroll. At today's staffing levels, each 1% of payroll requires about \$12 million per year in combined contributions from employees and the City.

**CONCLUSION:** The contribution rate increases in the 2011-2012 Proposed Budget take a significant step toward amortizing the City's unfunded pension liabilities, but they do not guarantee success. Significant risks remain that the City's unfunded retirement liabilities will increase, placing additional burden on City budgets. A new approach is needed.

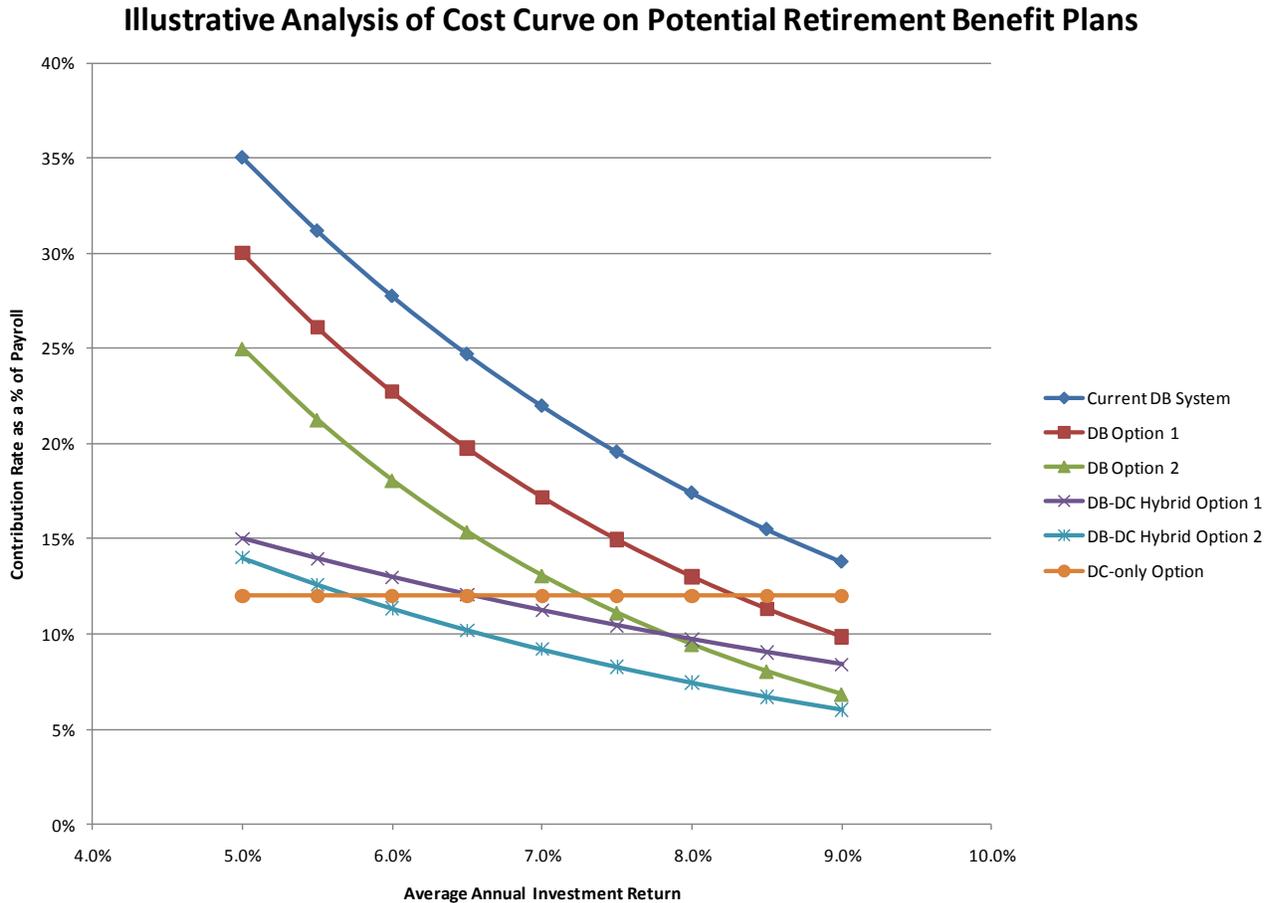
## Cost Containment Study Workplan

As the IDT conducts its research and consults with stakeholders, the City Council is interested in answering the following questions and generating the following analyses:

- How does Seattle’s retirement benefit compare to those offered by other public and private entities? What level of benefits is necessary to make the City competitive as an employer?
- What market return can SCERS reasonably expect to earn going forward, and what implications does that have for the affordability of retirement benefits? Essentially, how much are employees, the City, and the taxpayers willing to pay for retirement benefits?
- Since any changes made now are likely to endure for future generations, what employment patterns are young people entering the workforce today likely to experience, and what style of retirement benefit would serve them best? How can the City optimize any tradeoffs between flexibility/portability and retirement security?
- What percentage of pre-retirement income should the City’s retirement benefit aim to replace? Given increasing employee lifespans, what is a reasonable age to begin receiving retirement benefits?
- What alternate plan designs appear promising? The City Council would like to approach plan design holistically, taking into account the multiple sources of retirement income (pension, Social Security, and other retirement accounts) available to employees as part of a complete retirement package. Among the alternatives, Council would like see presented:
  1. An option with modest changes to the current SCERS defined benefit (DB) plan on such policy dimensions as:
    - The minimum retirement age and length-of-service combinations at which employees are eligible to begin receiving benefits, perhaps including incentives for later retirement;
    - The percentage of pay provided in retirement;
    - The interest rate paid on employee contributions;
    - Adjustments to annual cost-of-living updates.
  2. An option with more substantial policy changes to the SCERS defined benefit plan.
  3. One or more hybrid plans such as the one available to Federal employees. These would feature both a defined benefit pension and a defined contribution (DC) account, like the Thrift Savings Plan, possibly with a City match on employee contributions. The guaranteed pension component would replace a lower level of pre-retirement income than SCERS currently does, to be supplemented by the DC account, which would provide employees with more control over their savings level and desired retirement income.
  4. A defined contribution-only plan with a City match on employee contributions. The report should present the likely investment options that would be available to employees, a discussion of how this plan shifts the burden of investment performance

risk, and a discussion of the added portability/flexibility that such plans bring.

- What savings could be achieved by changing the retirement policy? What transition costs must be planned for? For each plan design, the report should present actuarial analyses that project the City's required total contribution rate as a percentage of regular payroll over a range of investment performance scenarios. The result would be a chart in the following style (the figures below are for illustrative purposes only):<sup>3</sup>



- Should some employees (particularly newer members of SCERS who are not yet vested) have the option to choose between the old and new systems?

The Council expects that the IDT will have convened stakeholders and selected its consultants for this report by June 1, 2011. The report to Mayor and Council is due February 15, 2012. The SCERS Board of Administration should make its recommendations to Mayor and Council by March 15, 2012. Mayor and Council will consider legislative proposals in Spring-Summer 2012, with a potential effective date on or about January 1, 2013.

<sup>3</sup> The chart is meant to represent the future “normal” cost of various retirement benefit designs over a range of investment performance scenarios. Such plan changes, if implemented for new hires, would not change the costs associated with unfunded liabilities on already-earned benefits for current SCERS members and retirees. Any overall savings to the City would be gradual and incremental, as a generation of employees cycles through the new benefit.

**Responsible Council Committee(s):** Finance and Budget

**Date Due to Council:** February 15, 2012