CITY OF SEATTLE
RESOLUTION 31474

A RESOLUTION amending Resolution 31334; clarifying the City's approach toward amortizing the unfunded liability of the Seattle City Employees' Retirement System (SCERS); and requesting that the SCERS Board of Administration and its actuary deliver to the City Council in 2014 an analysis of other potential assumption and policy changes designed to further strengthen the retirement system.

WHEREAS, the City provides and manages a defined-benefit pension for its non-uniformed employees to serve as a source of retirement income, along with Social Security; and

WHEREAS, the City Council previously declared, in Resolution 31334, its intention to fully fund the actuarially required contribution amounts into the pension system, including a plan to amortize the system's unfunded liability in 30 or fewer years; and

WHEREAS, on the advice of the SCERS actuary, the City Council wishes to clarify that, going forward, this amortization process should occur over a closed, fixed period of 30 years rather than a rolling, new period with each actuarial valuation, a practice akin to re-financing a mortgage annually; and

WHEREAS, closing and fixing the amortization period will have several benefits, including providing stronger funding to SCERS, reducing the risks of underfunding the system, limiting negative amortization (in which the unfunded liabilities continue to rise, though more slowly than assets), preventing further harm to intergenerational equity by keeping taxpayer costs closer in time to the services provided, and finally, reducing total City costs by allowing investment returns to provide a greater share of the required funding; and

WHEREAS, closing the amortization period going forward will not affect the projected 2014 City contribution rate but may affect rates in future budget biennia; NOW, THEREFORE,

BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF SEATTLE THAT:

Section 1. Resolution 31334, adopted in November 2011, is modified as follows:

"Section 1. The City will fully fund its actuarially required contributions to SCERS in the 2012 Adopted Budget and thereafter. The City will base its contribution rate on a five-year smoothed asset valuation as described in the most recent actuarial report, and the rate will be sufficient to amortize the system's unfunded liabilities in 30 or fewer years.

Section 2. To that end, the ((~~2012~~))2014 Adopted Budget will include((~~s~~)) sufficient appropriation for the City to pay ((~~11.01~~))14.31% of regular (non-overtime) payroll into SCERS. This is greater than the employee contribution of 10.03%. It brings the combined contribution to ((~~21.04~~))24.34%, which is the actuarially required amount for ((~~2012~~))2014 as described in January 1, ((~~2011~~))2013 Actuarial Valuation. ((~~and the October 12, 2011 cost update letter from Milliman Actuaries.~~))

Section 3. The City endorses the actuarial assumptions and methods adopted by the SCERS Board of Administration and utilized beginning with ((~~in~~)) the January 1, 2011 valuation. These include:

A. The entry age normal actuarial cost method

B. An investment return rate of 7.75%

C. A five-year smoothed method for asset valuation

D. Generational mortality tables that take future life expectancy improvements into account

E. Expected average membership growth of 1% per year

F. Other economic and demographic assumptions as described in the valuation.

Section 4. Each year, and in the event the SCERS Board of Administration should wish to change its actuarial assumptions and methods, the City requests that the Board consult with the Mayor and the City Council by the tenth day of July regarding the impacts of such changes

on funding requirements, as described in SMC 4.36.180.A, to allow sufficient time to make budget preparations.

Section 5. The City will update its contribution rate to SCERS annually to a level not less than the actuarial required contribution for that year as determined by the most recent valuation. The City may elect to exceed the required contribution rate in any given year in the interest of funding stability or to amortize the system's unfunded liabilities in fewer than 30 years.

Section 6. Beginning with the January 1, 2013 Actuarial Valuation and thereafter, the amortization period is closed and fixed. That is to say, the amortization rate should be sufficient to retire the system's unfunded liability over the period 2013-2042. Since closed amortizations can generate excessive contribution rate volatility in the second half of the period, the Council may consider re-opening the amortization period after 15 years. At any time, the SCERS Board and its actuary may recommend additional amortization layers and/or separate amortization periods for any new unfunded liabilities or surpluses generated after January 1, 2013."

Section 2. The Council requests that, by May 15, 2014, the SCERS Board of Administration and its actuary deliver to the Mayor and Council an analysis of the factors described in Attachment A to this Resolution, along with the Board's recommendations for any further changes to the City's funding policy. The City, in response to the market events of 2008, has substantially increased contributions into SCERS, from 16.06% of payroll in 2010 to 24.34% of payroll by 2014. Under the five-year asset smoothing policy, the effects of the 2008 losses are now fully reflected in the actuarial valuation. At this juncture, and in preparation for the 2015-2016 Budget, the City Council would like to re-assess the retirement system's actuarial assumptions and the schedule for amortizing the system's approximately $1.1 billion in

unfunded liability. The Council desires to strengthen the system's funded status, to reduce the funding risks it faces, and to preserve intergenerational equity to the extent possible.

Adopted by the City Council the ____ day of _____, 2013, and signed by me in open session in authentication of its adoption this_____ day of _____, 2013.

_____

President _____of the City Council

Filed by me this ____ day of _____, 2013.

_____

Monica Martinez Simmons, City Clerk

(Seal)

Attachment A: Experience Study Analysis Plan, In Preparation for the 2015-2016 Budget

John McCoy

Experience Study Analysis Plan, In Preparation for the 2015-2016 Budget

The City Council requests that the SCERS Board of Administration and its actuary provide an analysis of the following assumption and policy changes by May 15, 2014, along with recommendations for the Council to consider as part of the 2015-2016 Budget. The actuary is encouraged to offer any additional variations or changes that, in his or her professional judgment, would be appropriate for SCERS. The effects of these choices should be illustrated with appropriate comparative payoff curves. Periods and amounts of any negative amortization should also be identified.

The actuary is also requested to provide his or her best recommendation for each of the assumptions and policies below. If the recommendations would result in a change to the required contribution rate of more than 2% of payroll, then the actuary is also requested to propose a transition path that would phase the change in over one to two biennial budget cycles (2-4 years).

Current Key Assumptions *(all percentages annual)*

Consumer Price Inflation (CPI)	3.5%
+ Real Return	4.25%
= Investment Return (net of fees)	7.75%

Consumer Price Inflation (CPI)	3.5%
+ Real Wage Inflation	0.5%
+ Membership Growth	1.0%
= Total Payroll Growth	5.0%

Amortization of Unfunded Liability: 30 years, level % of payroll

Option	Assumption / Policy Change		Change in Unfunded Liability / Funded Ratio	Change in Required Contribution Rate
1a	CPI to 3.25%	=> Invest. Return to 7.5% => Payroll Growth to 4.75%		
1b	CPI to 3.25% Real Return to 4.0%	=> Invest. Return to 7.25% => Payroll Growth to 4.75%		
1c	CPI to 3.25% Real Return to 3.75%	=> Invest. Return to 7.0% => Payroll Growth to 4.75%		
1d	CPI to 3.0% Real Return to 4.0%	=> Invest. Return to 7.0% => Payroll Growth to 4.5%		
2a	Membership growth to 0.75%	=> Payroll Growth to 4.75%		
2b	Membership growth to 0.5%	=> Payroll Growth to 4.5%		
2c	Membership growth to 0%	=> Payroll Growth to 4.0%		
3a	25 year, level % of payroll amortization, fixed (2013-2037)			
3b	20 year, level % of payroll amortization, fixed (2013-2032)			
3c	Period chosen so that there is ≥ $1 positive amortization in first year, level % of payroll, fixed (2013-20XX)			

Option	Assumption / Policy Change	Change in Unfunded Liability / Funded Ratio	Change in Required Contribution Rate
3d	Amortize over average remaining active service years, level % of payroll, fixed (2013-20XX)		
3e	20 year, level % of payroll amortization, open		
3f	30 year, level dollar amortization, fixed (2013-2042)		

Form revised: December 12, 2012

FISCAL NOTE FOR NON-CAPITAL PROJECTS

Department:	Contact Person/Phone:	CBO Analyst/Phone:
Legislative	John McCoy 615-0768	Jessica Wang 615-1759

Legislation Title: A RESOLUTION amending Resolution 31334; clarifying the City's approach toward amortizing the unfunded liability of the Seattle City Employees' Retirement System (SCERS); and requesting that the SCERS Board of Administration and its actuary deliver to the City Council in 2014 an analysis of other potential assumption and policy changes designed to further strengthen the retirement system.

Summary of the Legislation:

The proposed Resolution updates Resolution 31334, which was passed by the City Council in 2011 and declared the City's intent to fully fund SCERS by a specific set of actuarial policies and assumptions. The original Resolution was intended to be analogous to RCW 41.45.035, which mandates specific actuarial assumptions and methods for State pension systems.

The proposed update would further clarify the amortization schedule for SCERS' unfunded liabilities, specifying a closed, fixed period of 30 years (2013-2042) to complete the process. The resolution also updates contribution rates for 2014 to be consistent with the January 1, 2013 Actuarial Valuation. The total rate is set to rise to 24.34% of payroll, of which 10.03% will continue to come from employee contributions and 14.31% will come from the City. Finally, the resolution asks the SCERS Board of Administration and its actuary to re-visit its assumptions and amortization methods and deliver recommendations to the City Council and Mayor by May 15, 2014, in preparation for the 2015-2016 Budget.

Background:

SCERS' unfunded liability is currently estimated at an actuarial present value of $1.1 billion, largely due to investment losses in 2008, which affected pension plans nationally. Since then, the City has steadily increased its pension contributions to compensate, from a level of 16.06% of covered payroll to 24.34% of payroll by 2014. With Resolution 31334, the City committed to paying off the unfunded liability (amortizing it, in the parlance) over 30 or fewer years. However, in practice, the SCERS Board and its actuary, Milliman, have created a new, rolling 30-year period with each annual actuarial valuation, which is akin to refinancing a home mortgage annually. Milliman does not recommend continuing this rolling practice. If continued, a rolling amortization would spread the payoff over the indefinite future, with several undesirable effects, including:

- Allowing negative amortization, in which the unfunded liabilities grow during the intitial years of the payoff, to continue indefinitely;
- Increasing total City costs, as more of the benefit dollars would need to come from

contributions rather than investment returns;

- Further harming intergenerational equity, as taxpayers in the far future would be asked to finance benefits for service long past; and
- Increasing the risk of underfunding the system in the future, as SCERS' funded ratio would be expected to rise more slowly.

The Resolution ends the rolling amortization practice starting with the current January 1, 2013 valuation and sets a closed, fixed period of 2013-2042 for the amortization in future valuations. It also incorporates two elements of flexibility in this approach. In the first, the SCERS Board and its actuary are invited to propose separate amortization layers and periods for any new unfunded liabilities or surpluses that arise after January 1, 2013. In the second, the Council signals that it may consider re-opening the period in the second half of the amortization, if year-to-year valuation changes would result in excessive contribution rate volatility. This re-opening is not a given, however. Alternative approaches would include raising the contribution rate in response to volatility and then leaving it raised until the unfunded liability is paid off.

___ **This legislation does not have any financial implications.**
(Please skip to "Other Implications" section at the end of the document and answer questions a-h. Earlier sections that are left blank should be deleted. Please delete the instructions provided in parentheses at the end of each question.)

_X_ **This legislation has financial implications.**
(If the legislation has direct fiscal impacts (e.g., appropriations, revenue, positions), fill out the relevant sections below. If the financial implications are indirect or longer-term, describe them in narrative in the "Other Implications" Section. Please delete the instructions provided in parentheses at the end of each title and question.)

This resolution has only indirect financial implications.

Other Implications:

a) Does the legislation have indirect financial implications, or long-term implications?

This resolution has only indirect financial implications. It will not affect the 2014 contribution rate. All other things being equal, contribution rates would be expected to follow the path specified in the January 1, 2013 Actuarial Valuation for the next 30 years.

Year	Contribution Rate as a % of Covered (Non-Overtime) Payroll
2014	24.34%
2015	23.91%
2016	23.69%
2017	23.60%
2018	23.26%
2019 and after	23.08%

SOURCE: Milliman January 1, 2013 Actuarial Valuation, p. 32
Note: Rate changes in the first 5 years of the amortization are due to asset smoothing.

However, required contributions under a closed, fixed amortization will generally be a bit higher in 2015 and later than they would be in a rolling / open structure. How much higher would depend on future investment performance and other experience.

b) What is the financial cost of not implementing the legislation?

The City's total pension costs should be lower with the closed, fixed amortization than with a rolling amortization, in that dollars contributed earlier have more time to earn an investment return before being used for benefits. The investment return assumption of 7.75% is higher than any discount rate that the City typically uses for budget decisions, with the implication that dollars contributed earlier to SCERS would be expected to have a positive net present value. No specific estimates of this value have been attempted.

c) Does this legislation affect any departments besides the originating department?

Yes, this resolution affects the pension contribution rates paid by all City departments, including the utilities.

d) What are the possible alternatives to the legislation that could achieve the same or similar objectives?

A variety of other changes to SCERS' actuarial assumptions and amortization policies could achieve the same or additional benefits, with similar or higher future budget impacts. The SCERS Board intends to revisit all its assumptions with an Experience Study in 2014. In addition, the City and SCERS expect that various actuarial societies, bond rating agencies, and government finance standards bodies will be revisiting their guidance for pension funding in the coming years.

e) Is a public hearing required for this legislation?

No

f) Is publication of notice with *The Daily Journal of Commerce* and/or *The Seattle Times* required for this legislation?

No

g) Does this legislation affect a piece of property?

No

h) Other Issues:

List attachments to the fiscal note below:

None