Legislative Department
Seattle City Council
Memorandum

Date: September 10, 2014

To: Councilmember Nick Licata, Chair
Councilmember Jean Godden, Vice Chair
Councilmember Tim Burgess, Member
Finance and Culture Committee

From: Erik Sund, Council Central Staff

Subject: Retirement Office request legislation

The Seattle City Employees' Retirement System (SCERS) Board of Administration (Board) has submitted four pieces of legislation to the Council for its consideration: two Council Bills that would reorganize the sections of the Seattle Municipal Code (SMC) that govern SCERS and two Council Resolutions that would approve actions taken by the Board to adopt contribution and interest rates for the system. Summaries of the individual pieces of legislation follow.

Council Bills 188199 and 118200 - Seattle Municipal Code (SMC) Revisions

Council Bills 118199 and 118200 are both products of an effort by the SCERS Board and the Retirement Office to update and organize the sections of the SMC that govern SCERS. The first of these proposed ordinances, Council Bill 118199, is an attempt to clarify those sections of code pertaining to SCERS that are difficult to read but for which there are no identified differences of interpretation and application. The changes included in Council Bill 118199 include:

- Consolidating and reordering sections in a more intuitive way, including grouping sections addressing the same subjects together;
- Removal of outdated sections that have no application to current or future members;
- Rewriting SMC 4.36.100, which establishes membership criteria for SCERS, to improve clarity; and
- Other improvements, such as replacement of gender-specific pronouns such as "he".

None of the code changes included in Council Bill 118199 will have any impact on the benefits of current or future members or on the way in which SCERS is administered.

The second ordinance requested by the SCERS Board is Council Bill 118200, which would revise the methods used to calculate a SCERS member's service credit and Final Average Compensation (FAC, also referred to as Final Average Salary or FAS) in the system. The formula for calculating the basic retirement benefit of a member who is eligible to retire in SCERS is as follows:

$$[Final\ Average\ Compensation] * [Years\ of\ Service] * 2\% = Basic\ Retirement\ Benefit$$

Under current law, there are two methods used for calculating each of the main factors (FAC and years of service) used in the SCERS benefit formula.

The Seattle Municipal Code (SMC) describes two methods for calculating the FAC:

- <u>Highest Consecutive 4,176 Hours Method</u> – used for members retiring from temporary, interim, intermittent or part-time positions, under this method the average hourly pay rate during a member's highest-compensated consecutive 4,176 hours of service is multiplied by 2,088 hours.
- <u>Highest Consecutive 24 Months Method</u> – used for all other members, under this method a member's "average annual compensation earnable by a member during his 24 highest consecutive months prior to termination of employment with the City" is used as the FAC.

There are two issues with current provisions for FAC calculation. First, the Highest Consecutive 24 Month Method is not clearly defined in the SMC. Additionally, the longstanding practice at SCERS has been to apply the two methods opposite to the way specified by the code. In other words, the FAC of members retiring from temporary, interim, provisional, intermittent or part-time positions is calculated using a reasonable interpretation of the 24 month method, and the FAC of all other members is calculated using the 4,176 hour method.

Council Bill 118200 would adopt a single new method for the calculation of FAC to be used for all members. Under this method, FAC would be defined as "the average annual compensation earned during a member's 52 highest consecutive biweekly pay periods prior to termination of employment with the City." For most employees the FAC produced by the new method would not differ significantly from the FAC produced by current methods. A relatively small number of employees would be expected to receive a larger retirement allowance; however this increased benefit is not large enough to materially affect SCERS' actuarial liability.

As with the calculation of the FAC, the SMC currently specifies two methods for calculating service credit: one for members in temporary, intermittent or part-time positions, and another for members in regular full-time positions. While the code's descriptions of the two methods are clear, they are incomplete. The SMC does not provide clear instructions for how service credit is to be calculated for full-time, permanent employees who take unpaid leave at some point and therefore have a break in credited service. Such "time loss" is a common occurrence. Retirement Office staff found that out of 2,027 members currently in full-time positions with service going back to 1992, more than 90% have two or more days of time loss. This forces Retirement Office staff to perform time consuming manual calculations of members' service credit in an attempt to determine how many individual days of service a member had worked in a given pay period, month, and year. Council Bill 118200 would amend SMC 41.36.125 as follows:

A. A member <u>who has served continuously in a full-time position and not realized any time loss</u> ~~in an eligible full-time position, with creditable service for every day,~~ will accrue a creditable year of service for 12 months' service. No additional credit is given for Leap Year's Day.
B. For <u>all other members</u> ~~a member in a temporary, intermittent or part-time position, eight hours constitutes one day; and~~ a creditable year of service is measured as ~~261 credited days or~~ 2,088 hours of compensated service at straight-time pay

This proposal would eliminate the requirement for Retirement Office staff to count individual days of service. Instead, for any year in which a member experienced time loss, the member's service would be calculated by dividing the member's service hours by 2,088 hours/year. The impact of the proposed method is estimated to be less than 0.03 years of service credit over a 20-year period for any individual employee, with some members receiving slightly more credit and other members receiving slightly less. The change is not expected to impact contribution rate requirements for SCERS.

<u>Resolution 31540 – 2015 SCERS Contribution Rate</u>

Council Resolution 31540 would approve the Board's adoption of revised SCERS contribution rates for 2015. The proposed rate, which would be incorporated in the 2015 budget if approved, reflect the results of January 1, 2014 Actuarial Valuation. Resolution 31540 would adopt a total contribution rate equal to 25.76% of payroll, an increase of 1.42% from the current rate of 24.34%. Under the terms of the current agreements with the labor unions representing City employees, 10.03% of this total contribution rate would be paid by employees, while the City would contribute 15.73% of payroll, up from 14.31% in 2014.

The proposed increase in the SCERS contribution rate is primarily caused by a decrease in the assumed long-term rate of return for the pension fund from 7.75% to 7.50%. This change was recommended in the 2010-2013 experience study conducted by Milliman, SCERS' contracted actuarial firm, and was consistent with the analysis of NEPC, SCERS' investment consultant.

<u>Resolution 31542 – 2015 SCERS Credited Interest Rate</u>

The second Resolution requested by the SCERS Board is Resolution 31542, which would approve the Board's adopted interest rates for SCERS members' 2015 plan contributions. SCERS members' contributions are maintained in individual accounts that earn interest. The balances of these individual member accounts are tracked for three reasons. First, a member's contributions and interest earnings are refundable in the event that the member separates from City employment without meeting the five-year vesting requirement for SCERS or separates after vesting but requests a refund instead of collecting a retirement allowance. Second, the member's contributions and interest may be paid to the member's beneficiary or estate in the event that the member dies prior to retirement. Finally, the account balance of a member who retires from SCERS is used in the calculation of a retirement annuity option that is an alternative to the basic retirement benefit formula described above.

Previously, interest was credited to member accounts at a fixed rate of 5.75% per year. This fixed rate, which was established in 1975, is effective on all member contributions made prior to December 31, 2011. Under a new policy adopted by the Board and approved by the Council in 2011, contributions made after 2011 earn interest at a variable rate established each year by the Board (subject to Council approval). The Board's stated policy is to set the interest rate for any given year "with a view toward the market returns of other low-risk or risk-free investments", with a target rate of 0.25% above the average yield on 30-year United States Treasury Bonds for the 12-month period ending May 31st of the prior year.

In practice, the Board's policy target was met only once, in 2012, when the adopted interest rate for member contributions was 4.47%. The Board adopted and Council approved interest rates for 2013 and 2014 were both set equal to the average yield on 30-year Treasury Bonds, without the additional 0.25% interest called for under the Board's policy target. The Board's adopted 2015 interest rate for member contributions is 3.66%, which is equal to the average 30-year Treasury yield for the 12 months ending May 31st of this year.

Interest Rates Earned by SCERS Members' Contributions

Contribution Year	30-Year Bond Average Yield*	Policy Target Rate	Actual Rate
Before 2012	-	5.75%	5.75%
2012	4.22%	4.47%	4.47%
2013	3.33%	3.58%	3.33%
2014	2.91%	3.16%	2.91%
2015	3.66%	3.91%	3.66% (Proposed)

**For US Treasuries in the 12 month period ending May 31 of prior year.*

Next Steps

If the Committee takes action on the proposed legislation at its September 10th meeting, the bill would be eligible for full Council vote on Monday, September 15th.

If the Committee would prefer additional time to deliberate any of the proposed measures, the next opportunity for a vote in Committee would be Wednesday, September 24th, in which case the Council could consider the bill at its meeting on Monday, September 29th.