BURLINGTON RETIREMENT COMMITTEE
Summary Paper
September 28, 2014

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I.   **Introduction**:

This summary paper outlines several central findings of the Burlington Retirement Committee (the Committee) in the Introduction before providing the relevant historical context to the Committee's work, outlining problem statements and associated reform principles discussed by the Committee, and offering recommendations of relevant solutions with precedent in different communities in the sections that follow.

The 16-member Committee was established by the City Council to explore the challenges of the City's retirement system, develop goals and principles for the system, and develop proposals and implementation strategies to carry out those goals and principles while meeting the values of participants and informing all retirement system stakeholders – specifically employees both union and non-union. These goals and principles, along with possible options, will then be further explored through the City's Human Resources and collective bargaining processes.

With the assistance of an outside consultant contracted by the Committee, the group has identified a number of important characteristics, challenges, and opportunities connected with the Burlington Employee Retirement System (BERS):

- **The relative funding level of BERS has deteriorated both more rapidly and more substantially than the national average**. In fiscal year (FY) 2001, public pension plans' were funded at roughly 101 percent and lost about 28 percent on average by FY13. The City of Burlington's plan, by contrast, has fallen from about 112 percent funded in FY01 to 69 percent funded across the same timeframe, a drop of about 43 percent.

- **Burlington is out of line with several national norms, contributing to increasing fiscal anxiety and a growing unfunded liability**. Burlington taxpayers pay substantially more to finance the retirement system than the national average, while Class B employee (or general employee) contributions are below the national average and Class A employee (or public safety employee) benefit levels exceed the benefit levels of other Class A workers nationally.

- **The City currently bears a disproportionate share of mortality, market, and inflation risks within BERS**. If the system requires additional revenue, taxpayers make up that difference but for any changes later negotiated at the bargaining table.

- **Committee participants share the view that uncertainty generated by steadily increasing taxpayer contributions – and repeated negotiations to address the issue – is unhealthy and could be improved by instituting a system of automatic adjustments**. Establishing agreed upon, automatic adjustments of elements of the plan design if, for example, the BERS funding condition falls or remains below a specified threshold could stabilize the system and eliminate the need for negotiations by sharing risk beyond the employer contribution payable by taxpayers.

- **Nationally, public pension plans have experienced the most significant period of reform since the 2008 – 2009 market collapse**. These changes have generally included establishing hybrid plans, higher employee contributions, reduced cost-of-living adjustments (COLAs), higher vesting periods, a higher age or greater number of years of service (or both) needed to qualify for normal, unreduced retirement, and others. BERS and the City's unions have agreed upon some reforms, but the cumulative effect of these reforms has not slowed the rising taxpayer contributions or the growing unfunded liability.

During its discussions, the Committee considered the idea of converting the City's current defined benefit (DB) plan to a purely defined contribution (DC) plan. Though DC plans are comparatively simpler to administer and would reduce uncertainty about future City liabilities, there was not consensus among members of the Committee that a DC plan alone would provide reliable retirement income. Further, Burlington has the benefit of observing the many other public retirement system reforms that have taken place across the country since 2008. Relatively few cities made the conversion from a DB to a DC plan, the experience of some cities, like Phoenix, AZ, suggests that meaningful reform of the current DB system could actually result in greater taxpayer savings (see Appendix, "*How Other Municipalities Have Addressed Pension Reform*," p. 10).

Given the difficulties associated with such a conversion, and the uncertain benefits for taxpayers, the Committee is not recommending such a course at this time. The Committee did, however, envision the possible range of plan designs as a spectrum anchored at one end by a pure DC system and at the other by a pure DB plan and discussed hybrid options integrating both DC and DB components as described in later sections of this report.

II.   <u>Historical Context</u>:

A public Pension Summit in November of 2013 identified a number of issues about BERS that warranted further discussion, such as an unfunded liability that has grown despite dramatically-increased taxpayer contributions and discussions about how to recruit and retain good employees. There was widespread agreement that the challenge should be approached collaboratively with the involvement of many different stakeholders in a jointly-designed process.

To design such a process and ensure the long-term viability of BERS consistent with the parameters established by the August 12, 2013 City Council Resolution "Convening of a Summit to Discuss the Underfunding of the City's Pension Plan and to Explore Options to Address Unfunded Liability," the City Council and the Mayor established the Committee with representatives from each stakeholder group in the BERS system to facilitate discussion about the challenges our community faces.

This Committee and its discussions do not replace the Human Resources and collective bargaining processes or impose any Committee-recommended modifications about the City's retirement fund. Rather, the 16-member Committee's work is meant to inform the Mayor, the City Council, retirement system stakeholders, and the public at large about the challenges the system faces and to identify possible paths forward. The Committee's goals are as follows:

- Define the root cause challenge(s) facing our current pension system
- Define goals consistent with the identified challenges
    - These goals should be specific, measurable and achievable within a defined time frame
    - Suggestions from the City Council on potential goals would be welcome at the outset of the process
- Develop principles by which to guide goals
- Identify the value for all stakeholders impacted by the pension system of developing solution goals
- Develop proposals with associated costs and implementation strategies

The Committee membership is as follows:

- Each of the four bargaining units (Police, Fire, IBEW, and AFSCME) has a representative selected by the union (4)
- A non-union, non-management employee, selected by the City Council President and approved by the City Council, is on the Committee (1)
- The City Council has four representatives selected by the Council President with input from the caucuses (4)
- The BERS Board has two non-City-employee representatives selected by BERS (2)
- The Administration has representatives from the Human Resources Department, City Attorney's Office, Clerk/Treasurer's Office, and Mayor's Office (4)
- The Mayor is on the Committee (1)

III.   Problem Statements and Reform Principles:

Problem statements within this section are divided into two types – challenges related to system design and challenges related to actuarial assumptions. *[Ed. Note: Recommendations on changes to actuarial assumptions will follow BERS report; this summary paper contains placeholders until that time.]*

System Design

1. **Taxpayer contributions have risen rapidly since the early 2000s at the same time the retirement system's unfunded liability has grown substantially.** This trajectory, with taxpayer contributions rising from $274,878 in FY01 to $8,175,505 in FY13 even as a $12.5 funding surplus in FY01 became to a $63.4 million unfunded liability by FY13, calls the system's long-term sustainability into question.

   Principles:
   1. Restore, and subsequently maintain, the taxpayer contribution to a sustainable level
   2. Reduce the plan's unfunded liability to increase confidence in the system

2. **BERS is out of line with several national norms, and some of these factors contribute to the fiscal concerns**. In Burlington, taxpayers pay a greater cost for the retirement system than the average national taxpayer because of some specific elements of the plan:

   i. In FY15, the City is contributing about $9 million to BERS while employees are contributing about $2.3 million. This means the City is paying approximately 80 percent of total contributions. This is about 10 percentage points (or 14 percent) higher than the national average of public employers who pay approximately 70 percent of all pension contributions.
   ii. About 7.9 percent of the City's FY15 General Fund is to be spent on retirement contributions. Comparisons across comparable municipalities are difficult to make reliably, but the City's contribution appears somewhat higher than the national average.
   iii. Burlington's Class B employees contribute 3.05 percent, compared with a national average of about 5.7 percent. (For reference, Class A workers contribute 10.8 percent, roughly commensurate with Class A workers nationally; the higher contribution is because they do not participate in Social Security).

     iv.   In Burlington, there are different tiers within employee classes. The benefit level for some Class A workers exceeds benefit levels for most other Class A employees nationally; further, because Class A workers can retire at a relatively young age, this benefit has a substantial effect on the City's unfunded liability.

     v.   Burlington's seven-year full vesting period is somewhat longer than typical (5 years)

     vi.   The Class B retirement multiplier is below national average, which effectively undercompensates Class B employees relative to their peers.

     vii.   The 6 percent COLA ceiling for Class A employees and 4 percent COLA ceiling for Class B employees is substantially higher than comparable plans; most plans reviewed by the City's consultant fell in the 2-3 percent range.

Principle:
1. Establish a plan whose cost and benefit levels are in line with national norms

3. **The City currently bears a disproportionate share of mortality, market, and inflation risks within BERS**. When investment returns are not realized, for example, the system's current arrangement puts a disproportionate share of risk on the City. As currently established, active employees pay a fixed percentage of income and retirees make no contributions, altered benefit levels, or adjustments, so any increases are made up entirely by the taxpayers' share. For example, in the FY13 valuation, the City was expected to pay $5.9 million in past service payments. In FY14, that figure is estimated at $6.1 million, and the City alone (through ratepayers and taxpayers) bears the cost of this difference.

Principle:
1. Establish a more equitable means to share risk

4. **BERS is an unusually complex system**. As a result of repeated "tinkering" with plan design (which itself has contributed to some of the uncertainty about BERS's sustainability) and a unique arrangement with each of the four unions representing City employees (and numerous tiers within each class based on hiring dates or other factors), administration of BERS has become complex, and the possibility of administrative error is non-trivial. In the words of the Committee's consultant, "Without the benefit of city code or reference sources, understanding the Burlington retirement plan's benefit design is a nearly insurmountable task."

Principles:
1. No reforms should further complicate the system
2. Simplify BERS where possible and appropriate

5. **BERS stakeholders have experienced repeated negotiation and a lack of predictability that erodes trust, diminishes confidence, contributes to the systems complexity, and lacks flexibility.** Burlington needs a system all stakeholders have confidence in if the City is going to be able to continue to recruit and retain talented employees and maintain broad voter support for the retirement system.

Principles:
1. Establish a system that is predictable, self-correcting, and no longer requires frequent renegotiation

2. Develop a system that inspires public confidence
3. Prioritize a system that contributes to the effective recruiting and retaining talented employees
4. Modify system to ensure long-term solvency and voter support

Actuarial Assumptions

[placeholder pending BERS report]

IV.   Possible Solutions and Recommendations:

Across the country, public pension plans have experienced the most significant period of reform since the 2008 – 2009 market collapse. The consultant hired by the Committee has examined many of these reforms in light of the challenges outlined above, and offered the following recommendations to changes in system design. *[Ed. Note: Recommendations on changes to actuarial assumptions will follow BERS report.]*

System Design

5. **Direct the actuarial evaluation of the impact of the reforms proposed by the consultant on BERS to better understand their implications.** To address increasing taxpayer costs concurrent with a growing unfunded liability, and after reviewing the experience of other communities across the country, the consultant has recommended considering suspending the COLA until the BERS reaches a certain threshold (i.e., 80 percent funded) or for a designated period of time (i.e., three years). In the consultant's assessment: "Given recent market gains, combined with the completion of recognizing the investment losses from 2008-09, the plan's funding level should be positioned to begin to improve beginning with the plan's next actuarial valuation. Combined with suspension of the COLA, assuming the city continues to make its full required contributions, the plan is likely to return to an 80-percent funding level in fewer than five years."

6. **Bring Burlington back into line with national norms to reduce fiscal anxiety about BERS and reduce the BERS's unfunded liability**. Moving to national norms would mean a reduction in the City's percentage of total contribution, an increase in Class B contributions, a reduction in Class A benefits, and increase in the Class B retirement multiplier, a shorter vesting period, and a lower COLA ceiling.

7. **Share of mortality, market, and inflation risks more equitably within BERS,** with unexpected costs stemming from mortality, market, and inflation risks split __ percent to __ percent between the City and employees. Or alternatively, plan components like benefit levels, actuarial assumptions, or employee contribution rates could be adjusted based on actuarial and investment performance.

8. **Institute a system of agreed upon adjustments triggered automatically by changes in system health to address the lack of predictability in BERS**. Establishing agreed upon, automatic adjustments of elements of the plan design (such as employee or employer contribution rates) in the event BERS funding condition falls or remains below a specified threshold would stabilize the system naturally. An example of one such possible adjustment would be suspending COLAs for a pre-determined period of time should the

plan fall below, for example, 70 percent funded or the unfunded liability reach a threshold percentage of the City's payroll.

Actuarial Assumptions

[placeholder pending BERS report]