**How Other Municipalities Have Addressed Pension Reform**

**City of Burlington Retirement Committee**

**Prepared by Keith Brainard, July 12, 2014**

**Discussion**

Although public pension reform is not new, the scope and magnitude of changes made to public pension plans in recent years is unprecedented. Most states and many cities have made changes to their retirement benefits since the 2008-09 market decline, and many of the changes have been considerable.

Responses to pension funding challenges vary widely and depend on such factors as a) the extent of the funding problem; b) the framework of pension legal protections; c) the plan sponsor’s fiscal condition; d) the relative political strength of public employees; d) the political culture of the plan sponsor(s); and others. As a result, just as each public pension plan is unique, so is each case of pension reform also unique.

Below is a list of changes commonly made to public retirement plan designs:

* Higher employee contributions
* A higher age or greater number of years of service, or both, needed to qualify for a normal (unreduced), early retirement benefit, or both
* More years added to the Average Final Compensation (AFC) period
* Reduced cost-of-living adjustment
* Higher vesting period
* Restrictions on the definition of compensation that is included in the pension calculation
* Establishment of hybrid retirement plans, in lieu of traditional defined benefit plans

The group(s) of plan participants affected by these changes varies: in some cases, only new hires are affected; in others, current active workers have had their retirement benefit structure altered. In some cases, even members who are retired have had their benefits modified. Which groups have their benefits changed, and to what extent, is chiefly a function of the extent of the funding problem and the framework of pension legal protections in place.

The US Conference of Mayors has prepared two compendiums of municipal pension reform that together comprise some 90 pages in length. Below are selected excerpts from these accounts that are intended to briefly summarize the manner in which some cities addressed pension reform:

**Honolulu, HI**

The mayor of Honolulu said, ““We believe that a key factor in successful reform is communication and dialog early on with all stakeholders including the State, counties, and labor organizations.”

**Pleasanton, CA**

Pleasanton officials believe the successful outcomes were a result of several factors:

* Pleasanton and its employees have enjoyed a strong long-term relationship that formed the foundation for concession bargaining. Clear and consistent parameters focused on achieving sustainable benefits were established at the onset of negotiations and articulated publicly and regularly.
* In advance of negotiations, the City Manager and Assistant City Manager participated as members of a two-county Pension Reform Task Force that developed a “white paper” outlining recommendations for pension reform. Some of these were negotiated with the PPOA.
* Discussions at the table were candid and straightforward. Union leaders understood the impact of the present economy and public concerns for unsustainable retirement benefits. They worked collaboratively with City representatives to address the challenges.

**Providence, RI**

On April 30 [2011], with negotiations at an impasse, the Providence City Council approved unanimously, and Mayor Taveras signed, a pension reform ordinance built upon more than six months of actuarial analysis, public hearings, and expert testimony. The ordinance suspends all guaranteed annual raises (COLAs) for retirees until the pension system is 70 percent funded, and caps all future pensions at one-and-a-half times the median State household income. The ordinance also reduces the disability benefit from 66.6 percent of an employee’s final salary to 50 percent, and requires all employees to pay into the pension system for as long as they are earning credit toward a pension.

**Phoenix, AZ**

The Pension Reform Task Force was appointed by the Mayor and City Council in January 2011 to work with management, outside consultants, and other stakeholders to review and recommend changes to the COPERS. The Pension Reform Task Force recommended maintaining a defined benefit pension plan with reforms that include increasing the retirement age, establishing a 50/50 split of pension costs between the City and the employee and other reforms that make the system competitive with the Arizona State Retirement System (ASRS). The Task Force also recommended against moving to a defined contribution plan. Following a thorough review of the plan and actuarial and legal analysis, Task Force recommendations were presented to the City Council on February 14, 2012.

City Council adopted a pension reform timeline and directed staff to conduct an actuarial analysis of three reform models that apply only to new employees. The models are described below:

**Model 1**

Model 1 provides for the following changes to new hires:

* Change Rule of 80 provision to Rule of 87
* Change the pension multiplier to a graduated multiplier based on years of service, matching the Arizona State Retirement System (ASRS) schedule
* Increase time of service requirements and eliminate minimum pensions as recommended by the Pension Reform Task Force
* Employee contribution rate is based on 50/50 split of actuarially determined rate
* Allow new City hires with service on account with ASRS prior to 7/1/2011 to join COPERS under current provisions

Under Model 1, the City’s contribution rate is projected to decrease by 51 percent and estimated to yield approximately $596 million in cumulative savings by 2037. The highest employee contribution rate under this scenario is projected to be 13.6 percent of salary.

**Model 2**

Model 2 provides the same changes as Model 1 with a cap on City contribution rates at 10 percent (Model 2a), 7 percent (Model 2b) and 5 percent (Model 2c) of the actuarially required contribution. In a survey of other defined benefit plans, no other plans had an employer cap, although employee caps or fixed rates were more common. All of the cap options modeled place more than 50 percent of the cost on the new employees immediately upon implementation. This would result in greater volatility of employee net pay and decreases the City’s ability to attract and retain high quality employees.

Under Model 2a, the City’s contribution rate is projected to decrease by 52 percent and estimated to yield approximately $726 million in cumulative savings by 2037. The highest employee contribution rate under this option is projected to be 17.2 percent of salary.

Under Model 2b, the City’s contribution rate is projected to decrease by 64 percent and estimated to yield approximately $1,037 million in cumulative savings by 2037. The highest employee contribution rate under this option is projected to be 20.2 percent of salary.

Under Model 2c, the City’s contribution rate is projected to decrease by 73 percent and estimated to yield approximately $1,245 million in cumulative savings by 2037. The highest employee contribution rate under this option is projected to be 22.2 percent of salary.

**Model 3**

Model 3 provides for a mandatory 401(a) plan for all new hires with a 10% (Model 3a),

7% (Model 3b) and 5% (Model 3c) match by the City. In a survey of the 25 largest cities, only two cities, Washington, D.C. and San Diego, have a defined contribution only plan. All of the defined contribution options modeled substantially increase the City’s cost immediately and are more expensive than Model 1 over the next 25 years.

In addition, the defined contribution plans result in lower pension benefits to the employee than Model 1. In the very long run, after the current pension system is paid off, the City has no pension liability under a deferred contribution plan.

Under Model 3a, the City’s contribution rate is projected to increase immediately by 20 percent, then decrease by 55 percent by 2037. Model 3a is estimated to cumulatively cost approximately $415 million by 2037.

Under Model 3b, the City’s contribution rate is projected to increase immediately by 20 percent, then decrease by 68 percent by 2037. Model 3b is estimated cumulatively cost approximately $101 million by 2037.

Under Model 3c, the City’s contribution rate is projected to increase immediately by 20 percent, then decrease by 76 percent by 2037. Model 3c is estimated to cumulatively save approximately $109 million by 2037 with most of the savings occurring near the end of the 25 year projections.

**San Francisco, CA**

The City’s spring 2011 pension reform efforts proceeded on several fronts. Labor unions utilized actuaries funded by Mr. Hellman to research and identify reforms to consider, and Supervisor Elsbernd, Mayor Lee, and the City’s pension and labor negotiating teams did the same, aided by analysis from City Controller Ben Rosenfield. Although San Francisco’s Charter leaves the structure of its pension benefits to the City’s voters, state law requires negotiations with labor unions prior to the placement of such a measure on the City’s ballot by the Mayor or Board of Supervisors. In March 2011, therefore, the two processes coalesced in a series of large bargaining sessions convened by the City’s Employee Relations Division, under the direction of the Mayor, and attended by representatives of the City’s unions.

The City used an unconventional approach to bargaining on the pension initiative: Rather than presenting a draft proposal, and bargaining based on its specific terms, the City presented labor with a plethora of items and ideas it was considering including in the initiative. This brainstorming approach, borrowed from the “interest-based” model of collective bargaining, allowed the unions to have input as to the elements of the legislation from the very beginning. While the unions were initially upset that the City was considering controversial items such as defined contribution or “hybrid” plans for new hires and reductions in pension formulas for prospective service, they ultimately saw that the City was not wedded to any one solution. Over the next two months, subcommittees and the larger group met frequently to tackle tough issues regarding legal issues of vested rights, retiree health elements, new pension formulas, and cost-sharing models. Ultimately, the openness and participatory nature of this process

The voters adopted the City’s collaborative pension reform initiative, dubbed “Prop C,” despite the existence of a second, competing initiative put forth by Public Defender Adachi in the same election. The broad-based support of labor for Prop C was critical to its success in a town as union-friendly as San Francisco. Some of the most significant elements of Prop C include:

* new, less-expensive pension tiers for future employees that raise the retirement age by three years, cap pensionable salary based on IRS limits, base final compensation for pension calculation on three years rather than the single highest year, and cut retirement cash-out for non-service retirements in half;
* a mandate that supplemental COLAs to retirees will only be paid when the pension system is fully funded;
* comprehensive employee cost-sharing of the employer’s pension contributions, so that employees pay higher percentages when plan costs rise, and reduced percentages when plan costs drop;
* required employee contributions to the City’s Retiree Health Care Trust Fund, starting in 2016-17;
* restriction on retiree health benefits so that those who are not vested in benefit improvements that were implemented after the date they left service will not receive them; and
* provisions to increase the ability of the Health Service System, which controls City employee health plan design, to address rising costs.

**Barrington, IL**

Among Tier II changes were an increase in normal retirement age from 50 with 20 years of service to 55 with 10 years; a requirement that the 75 percent maximum salary benefit be based on 96-month salary averaging, rather than no averaging; a shift from a fixed 3 percent COLA to the lesser of 3 percent or one-half of the Consumer Price Index; and a reduction in the free Joint and Survivor Annuity from 100 percent to 66.7 percent. While this legislation was considered a move in the right direction, it was viewed as failing to address the primary cause of declining funding levels: benefits for current employees.

**Ft. Worth, TX**

Some major benefits for new police and General Employees have been reduced, as have future service benefits for current police and General Employees. Among these:

* Pension earnings will be based on the five highest salary years, rather than three.
* The multiplier that determines the percentage of pay a retiree receives was adjusted to 2.5 percent from 3 percent.
* Overtime will not be included in pension calculations.
* For employees who have selected to have an ad hoc cost of living adjustment (COLA) in retirement, the COLA will revert to 2 percent for future service accrual, with an option to revert to a guaranteed 2 percent for past accrued service.

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Fort Worth officials believe keys to their progress in resolving the City’s pension problems include: a City Council that was collectively committed to resolving the challenges while retaining a defined benefit plan; a supportive business community and supportive citizens; limited union power for police; and a significant educational campaign among employees, with a message of “Sustainability. Affordability. Security. Long-term Fiscal Accountability.”

**Pembroke Pines, FL**

The police pension was reformed by decreasing the benefit multiplier from 4 percent to 3.5 percent for any current member’s service time accrued after April 30, 2010. As of that date: the benefit multiplier for new hires decreased to 3 percent; the pension COLA changed from 3 percent to 2 percent per year, and for new hires the COLA was set at 1.5 percent; only accrued time earned before that date is included in the pension calculations, up to a maximum of 1,000 hours; the longevity pay percentage was frozen for current members; and a maximum of 300 hours of overtime may be included in pension calculations. Employees hired after October 1, 2006 have to pay the insurance equivalent (blended rate) to be covered under the retiree health insurance program.

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Under firefighter pension reforms, the pension COLA for current employees as of April 30, 2010 changed from 3 percent to 2 percent. The benefit multiplier changed as follows:

* For employees hired prior to June 18, 2003, service time accrued as of April 30, 2010 is calculated at 4 percent per year and for subsequent years it is calculated at 3.5 percent. Employees may remain active until such time that their creditable service would equal a multiplier of 80 percent.
* For employees hired on or after June 18, 2003, service time accrued as of April 30, 2010 is calculated at 4 percent per year and for subsequent years it is calculated at 3.5 percent.
* Employees are eligible to remain active until such time as the accumulated total multiplier under the new plan would equal the amount he/she would have received under the terms of the plan in effect on April 30, 2010.

# **Atlanta Pulls Off A Major Pension Overhaul**

Governing Magazine | July 14, 2011

Hailed as the most sweeping overhaul of public employee retirement benefits by a large U.S. city in recent years, Atlanta's Mayor Kasim Reed and the City Council reformed their public pension plan with an eye toward sharing investment risk with employees.

Most private companies did a harsher version of this years ago. They shifted their employees out of defined-benefit (DB) pension plans and into 401(k)-style defined-contribution (DC) plans. Their mantra was simple: Let workers take all of the investment risk.

Recently, eight new governors and numerous legislators supported similar moves. But not much has come of it, and 401(k) fever seems to have petered out for now -- at least among states.

The localities are something else. Atlanta's plan is a clear break from the past. However, the city takes the middle road by offering a hybrid plan, which targets the newly hired, who are eligible for a small DB component *plus* a DC plan.

Employees and their unions don't usually like DC plans since they don't provide the same guarantee of retirement income that a defined-benefit plan does. Keeping a small DB plan as part of the package helped assuage Atlanta employees misgivings, but the DB piece will provide only a small income. The rest of a retiree's annual payment will have to come from a DC, often referred to as a 401(k)-style plan.

While most people see 401(k)s as a means of accumulating assets -- a high-risk proposition -- the plans can be tailored to focus on future income. "No one has to lose in this thing as long as sound risk management principles are followed," says Richard Hiller of TIAA-CREF, a financial services organization. "You can provide lifetime income adequacy to government employees while at same time not subjecting yourself as a government employer to the risk of unfunded liabilities and unpredictable budgets. But you've got to design the DC part right."

One way to do that, Hiller suggests, is to give employees with a DC plan a variety of annuity investment options -- ones that the employee would contribute to during his or her work years, thereby mitigating the risk of buying an annuity at an unfavorable time. The other important component is to educate employees on investment objectives and how to achieve them.

But there's more to Atlanta's overhaul than just a DC plan for newbies. The reform also extended the retirement age for new employees, and created a minimum retirement age as well as a cap on the city's annual contribution to the pension funds. Current employees will continue in their DB plan, but they will have to contribute 5 percent more of their paycheck. According to the mayor's office, the comprehensive pension reform plan creates $22 million in savings the first year, reduces the city's exposure to market risk and allows the city to pay off a $1.5 billion unfunded pension liability. Looking further out, the measure saves the city more than $270 million over the next 10 years, and more than $500 million over 30 years.

Meanwhile, the not-for-profit [National Institute on Retirement Security has a new report](http://www.nirsonline.org/index.php?option=content&task=view&id=610) that offers lessons learned from six public defined-benefit pension plans that weathered market turmoil and remained well funded despite two economic downturns.

Anyone who reads [Girard Miller's columns](http://www.governing.com/columns/public-money) will recognize these six pointers for success:

* keep up with annual required contributions and maintain that stability in the rate over time;
* use employee contributions to share in the cost of the plan;
* actuarially evaluate benefit improvements (such as multiplier increases) before adoption, and then fund them properly;
* grant cost-of-living adjustments responsibly;
* adopt anti-spiking measures;
* and set economic actuarial assumptions that are achievable over the long term.