

**Discussion of a Retirement Plan Model for
the City of Burlington
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I am suggesting two sets of retirement plan designs for newly hired workers of the City of Burlington. The plans could also be applied, to a degree determined by the city through its collective bargaining process, to current workers.

These suggested plans are intended to achieve the following objectives:

1. Restore and maintain a healthy pension plan funding level.
2. Restore and maintain taxpayer costs at a level that is predictable and sustainable.
3. Reduce the plan's unfunded liability.
4. Establish a retirement plan that voters understand and support
5. Establish a plan whose cost and benefit levels are in line with national norms.
6. Establish a retirement plan that enables the city to attract and retain qualified workers needed to provide essential public services.

Restore and maintain a healthy pension plan funding level

The funding level of the BERP is approximately 69 percent, below the national median of approximately 73 percent. Importantly, the plan's funding level has fallen sharply—greater than most other public pension plans—from well above 100 percent in 2001.

There is no single figure or threshold that indicates a “healthy” public pension plan funding level, although 80 percent is often referenced as such a benchmark. Arguably a more important indicator is whether or not the plan is causing fiscal stress for the plan sponsor, in this case the City of Burlington. The Burlington pension plan indeed appears to be causing fiscal anxiety for the city: the weighted average employer contribution rate is approximately 18.8 percent—two-thirds of which is the cost to amortize the unfunded liability—a figure that has risen steadily over the past 10+ years, despite efforts by the city to reform its pension plan by adjusting benefit levels. Anecdotally, the cost, instability, and uncertainty of the plan appear also to be causing strained relationships within the city and its employees.

The plan designs I am suggesting the city consider, including a temporary suspension of the COLA, would reduce the pension plan's unfunded liability and improve the plan's funding level. Also, by incorporating self-correcting mechanisms, such as a flexible COLA and capacity for increased employee contributions, the plan design I am suggesting also would reduce the volatility of the funding level, and guard against sharp declines in the funding level.

Restore and maintain taxpayer costs at a level that is predictable and sustainable

With the increase in the unfunded pension liability, the cost to taxpayers of the Burlington plan has grown steadily since after the market decline that ended in 2002. This increase has occurred despite changes in the plan's design that were made around 2006 and 2007. Employer (taxpayer) costs of the plan are now more than 32 percent of pay for Class A workers and nearly 15 percent of pay for Class B. These costs have grown continuously for more than a decade.

The plan designs I am suggesting the city consider would reduce the volatility of the required employer (taxpayer) contribution rate. This reduced volatility (and increased predictability) would result from the flexible COLA and flexible employee contribution rate features.

If the plan design I am suggesting were applied to new hires only, taxpayer costs would slowly decline as current employees leave the plan and they are replaced by new hires who participate in the new plan design.

If the city applies new plan design provisions to current plan participants, the taxpayer cost of the plan would drop immediately, and the extent of the reduction would depend on the extent to which elements of the new plan design are applied to current plan participants.

Reduce the plan's unfunded liability

As of the latest actuarial valuation, dated 6/30/13, the BERP unfunded liability (UAL), which is the difference between pension obligations accumulated to-date and assets on hand, was \$63.4 million. This is equal to 1.4 times the city's annual payroll. The cost to the city of amortizing the current UAL is approximately \$6 million annually, projected to continue through 2035, when it is projected to decline steadily to zero by 2044.

Reducing the UAL also reduces its cost. The plan design I am suggesting the city consider would reduce the UAL only to the extent that changes to the plan design are applied to current plan participants. Applying plan design changes to new hires only would reduce the cost of the plan in future years.

I am not an actuary and I am not qualified to measure the reduction in the UAL as a result of changes to the plan design applied to current plan participants. Following are some examples of the effect a reduction in a COLA can have:

- The Colorado Legislature approved changes in its pension plan design in 2010 that included a reduction in the COLA from automatic 3.5 percent to the CPI up to 2.0 percent. With relatively minor adjustments in retirement eligibility criteria for plan participants, the plan's unfunded liability was reduced by approximately 30 percent.
- The Oklahoma Legislature in 2011 approved a bill requiring that any future COLAs must be funded in advance. This change was calculated by the plans' actuary to have reduced their combined UAL by approximately 30 percent.
- The Maine Legislature in 2011 suspended the state's automatic COLA for three years; when the COLA returns, it will apply to the first \$20,000 in pension benefit (indexed for inflation) rather than the full pension benefit. This change reduced the Maine PERS unfunded liability by approximately 10 percent.
- Relatively large reductions were also achieved in Rhode Island, Maine, New Jersey, and other states that made changes in their retirement plan design that affected current plan participants, chiefly via suspension or reduction in COLAs.

Establish a retirement plan that voters understand and support

The current retirement plan in place for Burlington employees is divided into numerous tiers within each class, based on hire date and other factors. For some Class A workers, the plan

contains features that are unconventional, if not unique to Burlington. Without the benefit of city code or reference sources, understanding the Burlington retirement plan's benefit design is a nearly insurmountable task.

Since most taxpayers have, at best, a 401k plan as their primary retirement benefit, their ability to comprehend the Burlington plan is likely quite limited. Naturally, no matter how virtuous or well-intended, something that is incomprehensible is also difficult to support or appreciate.

Also, the potential replacement rate (pension benefit relative to salary) for some Burlington workers is far greater than what typical taxpayers would receive as an employer-sponsored retirement benefit. Moreover, some Burlington employees are able to retire at an age that is much lower than the age when a typical taxpayer can afford to retire.

These factors that distinguish Burlington's retirement plans from those available to other city taxpayers, likely challenge the ability of city taxpayers to understand and appreciate the retirement plan in place for the city's workers.

In 2006-07, the city made progress toward simplifying its retirement plan benefit structure by closing the plan design feature to new hires that permits retiring members to select their retirement multiplier. The retirement plan designs I am submitting for consideration are intended to further simplify the retirement plans in place for city workers.

Establish a plan whose cost and benefit levels are in line with national norms

The proportionate cost of the Burlington retirement plan to taxpayers is greater than the cost to average taxpayers, and the benefit levels for Class A workers exceed those for most like (public safety) workers among states and cities around the country.

The plan designs I am suggesting the city consider would bring the city-sponsored retirement benefits into closer alignment with retirement benefit levels for employees around the country.

I am proposing one possible plan design scenario for Class B workers that actually would provide a higher initial replacement ratio than the current plan does. This proposed plan would increase the retirement multiplier from 1.4 percent to 1.5 percent, with an increase in the employee contribution rate from 3.05 percent to 4 percent. These changes would bring this plan closer to national norms for like workers, while also providing a higher initial retirement benefit.

Establish a retirement plan that enables the city to attract and retain qualified workers needed to provide essential public services

I suggest that the city consider reducing the vesting period, from seven years to five, for Class B workers. The city may also wish to consider increasing the amount of the employer contribution that is paid to workers who terminate employment prior to vesting. This change could enhance the city's ability to attract shorter-term workers.

The hybrid plan I am proposing includes a defined contribution component that would be entirely portable. This may increase the appeal of coming to work for the city for older workers and others who believe they may not spend an entire career working for the city.

The plan designs I am suggesting for consideration for Class A workers would provide a competitive retirement benefit for those employees. These changes are not likely to diminish the city's ability to attract and retain qualified workers.

Explanation of proposed plan designs

I have submitted for the committee's consideration two plan design models each for Class A and Class B workers. One model retains the defined benefit plan, and the other introduces a hybrid, defined-benefit defined contribution plan.

Common Elements

COLA changes

In the case of each proposed plan, I am suggesting the establishment of a cost-of-living adjustment that is based on the rate of inflation and that is tied to the plan's funding level.

I suggest the committee consider suspending the COLA until either a) the plan's funding level reaches 80 percent; or b) for a designated period of time, such as three years. This will accomplish two important objectives: a) it will immediately reduce the city's unfunded liability; and b) by reducing the UAL, suspending the COLA will relieve the current cost pressure on the plan, enabling the city to take advantage of some combination of maintaining current payments to the plan, which will reduce the UAL in future years; and providing immediate fiscal relief to taxpayers.

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.

Early Retirement

The benefit level for all plan participants who retire early should be based on an actuarial reduction, so there is no actuarial incentive to retire before normal retirement eligibility.

Proposed models for new hires:

Class A, Option A: DB Plan

Because Burlington Class A workers do not participate in Social Security, their employer-sponsored retirement should differ from Class B workers, to make up for the absence of Social Security. To this end, the committee may wish to consider establishing a retirement plan for new hires that incorporates some or all of the following elements:

- Normal (unreduced) retirement eligibility at age of 55 or age 52 with at least 25 years of service
- A benefit multiplier of 2.5 percent per year of service

- Employee contribution rate of 10 percent
- A cost-of-living adjustment that is based on the rate of inflation and that is tied to the plan's funding level. For example, no COLA would be paid if the plan is funded below 70 percent; a COLA of up to two percent would be paid if the plan is funded more than 70 percent but less than 80 percent; up to three percent if the plan is funded above 80 percent and less than 90 percent; and up to four percent if the plan is funded above 90 percent.
- Normal cost estimate: 8 percent

Class A, Option B: Hybrid Plan

- A minimum normal retirement age of 55 or age 52 with at least 25 years of service
- A benefit multiplier of 1.75 percent per year of service
- An employee contribution rate of 8 percent.
- A defined contribution plan into which the employer contributes five percent of pay into an employee's individual account.
- A cost-of-living adjustment that is based on the rate of inflation and that is tied to the plan's funding level. For example, no COLA would be paid if the plan is funded below 70 percent; a COLA of up to two percent would be paid if the plan is funded more than 70 percent but less than 80 percent; up to three percent if the plan is funded above 80 percent and less than 90 percent; and up to four percent if the plan is funded above 90 percent.
- No COLA payable until age 55
- Normal cost estimate: 8 percent

Class B, Option A: DB Plan

- Normal (unreduced) retirement eligibility at age of 65 with five years of service or age 62 with at least 20 years of service
- A benefit multiplier of 1.5 percent per year of service
- Employee contribution rate of 4 percent
- COLA based on inflation and tied to plan funding level: up to 3% when funding level is >90%; up to 2% when funding level is 80% to 90%; up to 1% when funding level is 70% to 80%; zero when funding level is <70%
- No COLA payable until age 65
- Normal cost estimate: 4 percent

Class B, Option B: Hybrid Plan

- A minimum normal retirement age of 65 with five years of service or age 62 with at least 20 years of service
- A benefit multiplier of 1.0 percent per year of service
- An employee contribution rate of 3 percent
- A defined contribution plan into which the employer and employee each contribute three percent of pay, and the employer matches an additional two percent of pay by the employee, for a possible total contribution to the employee's individual account of 10 percent.

- COLA based on inflation and tied to plan funding level: up to 3% when funding level is >90%; up to 2% when funding level is 80% to 90%; up to 1% when funding level is 70% to 80%; zero when funding level is <70%
- No COLA payable until age 65
- Normal cost estimate: 5 percent

Future Triggers

As described in the paper on the New Brunswick plan, it is helpful to establish mechanisms for adjusting elements of the plan design in case the plan's funding condition falls below a targeted threshold. I would recommend that if the actuarial funding level is used as the basis for determining whether adjustments are needed, that the key elements of the plan's funding policy also be agreed upon, to avoid disputes in how the actuarial funding level is determined.

The key elements of a funding policy include the plan's actuarial cost method, amortization policy, actuarial assumptions, and asset smoothing method. Agreeing on these elements is important, as a plan's funding level can differ, potentially significantly, based on which parameters are used.

Suggested Triggers

- I am suggesting that the committee incorporate a cost-of-living adjustment policy, at least for new hires, and potentially applied to all plan participants, that ties the provision of COLAs to the plan's funding level. Because the COLA is a fairly expensive plan provision, implementing a flexible COLA will create a self-adjusting mechanism that will minimize the effects on plan costs of a declining funding condition.
- In addition to the flexible COLA policy, the committee may wish to also consider increasing employee contribution rates when the plan's funding level drops below designated thresholds. One suggested example might be an increase in worker contributions of one percent when the funding level drops below 80 percent, and by two percent when the plan's funding level drops below 70 percent.

Applying the plan design to current workers

The city may wish to consider applying elements of the proposed plan designs to current plan participants. The alternative, limiting the proposed plan design to new hires only, would leave the city's unfunded pension liability—and its associated cost—intact, resulting in lower retirement plan costs materializing slowly, over a number of years, as current plan participants gradually are replaced by new hires. Absent higher expected investment returns or other changes to the plan's actuarial assumptions, and assuming there is no new revenue source available to reduce the UAL, the only way to reduce the UAL more quickly is to reduce benefit levels for existing plan participants, either retired, active, or both.

I have suggested that the city consider suspending the COLA, either for a designated timeframe or until the plan reaches a funding level of 80 percent. This change would reduce the UAL but I cannot determine by how much.

If the city wishes to apply a new plan design to current active plan participants, such changes should take into account the fact that participants have been anticipating and planning for their

date of retirement. Thus, any changes that might be applied to existing plan participants should be commensurate with each active member's proximity to retirement.

For example, the city may wish to make no changes to retirement plan provisions for workers who already are eligible to retire and those who are within five years of normal (unreduced) eligibility. Under such scenarios, there would be changes to their retirement eligibility.

For those who are further than five years away from normal retirement, their normal retirement eligibility (age and years of service) could be changed gradually. For example, normal retirement eligibility could be extended by two months for each year greater than five an employee is currently from normal retirement eligibility. Using this scenario, an employee who currently is 8 years from qualifying for normal retirement eligibility would have their eligibility extended by 9 months (3 years x 3 months), up to the new plan retirement eligibility criteria.