MERS

Municipal Employees' Retirement System

2017 RETIREMENT CONFERENCE

Pension Funding & Plan Design

Part 3 – A Panel Discussion

Moderated by:

Marne Daggett

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Agenda

- Options for Managing/Reducing UAL
- Evaluating Adequacy and the Associated Risks
- Building a Successful Plan
- Plan Design Considerations for Recruitment

Strategies for Managing UAL

Plan Design Strategies to Manage UAL

Strategy	Description	Trend 2012	2013	2014	2015	2016	2017	Impact
Lower Benefit to New Hires	New hires receive a lower tier of Defined Benefit provisions	49	53	43	52	34	20	Existing employees are not affected Reduces the liability for new hires
Bridged Benefits for Existing Employees	Benefits are offered in parts to existing employees Multiplier is lower going forward	17	19	29	16	45	14	Leaves earned benefits unchanged Reduces the liability for new hires and existing employees
Hybrid for New Hires	New hires receive a Hybrid Plan	67	31	43	21	15	6	Existing employees are not affected Reduces liability for new hires
Defined Contribution for New Hires	New hires receive a Defined Contribution Plan	20	45	30	37	39	26	Existing employees are not affected Eliminates liability for new hires
Defined Benefit Plan Freeze	Plan is frozen and all employees move to a new plan	n/a	n/a	n/a	n/a	8	1	Existing employees do not accrue additional service credit and FAC is frozen

Divisions that have adopted these strategies as of 6/30/2017.

Funding Strategies to Manage UAL

Strategy	Description	Trend 2012	2013	2014	2015	2016	2017	Impact
Cost Sharing for Existing Employees[1]	Employees contribute to help fund the overall cost of the plan	149	280	143	97	136	87	Reduces the employer cost, but does not affect total cost or the plan's unfunded liability
Voluntary Contributions[2]	Additional payments made into plan toward unfunded liability	180	211	210	277	…	269	Reduces existing liability Extra dollars are invested and recognize market returns
Bonding[3]	Municipalities may bond for all or a portion of their unfunded accrued liabilities—pension or OPEB	n/a	n/a	4	1	2	2	Proceeds of the bond are deposited and potentially will fully fund the UAL No guarantee that future unfunded liabilities may not occur

[1]Divisions that have adopted this strategy as of 6/30/2017.

[2]Municipalities that have adopted this strategy as of 5/31/2017.

[3]Municipalities that have adopted this strategy as of 6/30/2017.

Adequacy Options

Risks of Not Providing an Adequate Retirement Plan

Recruit

Decreased ability to compete with other employers to attract talented employees

Retain

Talented employees may not be engaged in their current position and seek future opportunities

Retire

Potential employer costs if employees have inadequate savings to retire:

- Higher health care costs than younger employees
- Higher absenteeism and lower productivity while at work
- Decreased engagement for other workers unable to advance in their career

Evaluating Adequacy

Understanding the target income replacement rate for your plan

- Age at Hire: 25
- Starting Salary: $45,000
- Annual Salary Increase: 4%
- Highest 5-year Avg. Salary: $129,951
- Benefit Multiplier: 2.5%
- Retirement Age: 55
- Age of Death: 90
- Investment Return While Working: 5%
- Investment Return in Retirement: 4%
- National Average Wage Index: 3.55%
- Inflation in Retirement: 2%

	Defined Benefit Plan	Defined Contribution Plan
Total Employer Contribution Normal Cost = 5.95% UAL = 9.15%	15.1%	15%
Employee Contribution	7.5%	10%
Total Cost of the Plan	22.6%	25%
Income Replacement	69.4%	35.6%

Building a Successful Plan

Plan Design Considerations

Plan Type
- Is the plan intended solely for retirement income or specific to health care costs in retirement?
- Is its purpose to supplement a pension or be the primary retirement plan?

Participation
- Is the plan mandatory or voluntary?
- Would an automatic enrollment design enhance the plan?

Contribution Structure
- Fixed employee contribution amount or are employee contributions voluntary and flexible?
- Are there employer contributions?
- Do the employer contributions incentivize increased participation and/or contributions from the employee?
- Would automatic escalation of contributions enhance the plan?

Vesting Schedule
- Longer vesting schedules reward longer term employees
- Unvested dollars that return to employer offset future contribution costs

Evaluating Retirement Plan Risks

Contribution Risk

The risk that there is insufficient money saved to adequately fund a retirement benefit

- The pooled nature of a defined benefit plan provides for more efficient use of assets to fund benefits over the long-term
- Defined contribution employees bear the risk of adequacy themselves
- In a hybrid plan the risk is lower since the defined benefit and defined contribution are smaller portions of the overall benefit

Defined Benefit Plan		Hybrid Plan		Defined Contribution Plan	
ER	EE	ER	EE	ER	EE
Mid	Low	Low	Low	None	High

ER = Employer
EE = Employee

Evaluating Retirement Plan Risks, Cont.

Investment Risk

The risk that the investments achieve a rate of return to adequately fund a retirement benefit. This includes the risk that the portfolio is diversified and invested appropriately for the timescale involved

- Defined benefit plans have institutionally invested assets that are governed by a board that has the fiduciary responsibility
- Defined contribution plans have a higher risk of underperformance primarily due to access to fewer asset classes, behavioral tendencies by individuals, and higher fees. Research also shows that most employees do not actively rebalance their portfolios to an appropriate asset allocation
- In a hybrid plan the risk is lower since the defined benefit and defined contribution are smaller portions of the overall benefit

Defined Benefit Plan		Hybrid Plan		Defined Contribution Plan	
ER	EE	ER	EE	ER	EE
Mid	None	Low	Low	None	High

ER = Employer
EE = Employee

Evaluating Retirement Plan Risks, Cont.

Economic Risk

The risk that there is a major reversal and loss in the market on the onset of retirement or during a distribution

- A defined benefit plan can hold distressed assets until they rebound and can effectively manage market risk by investing for the long-term of a more significant pool of members, capturing higher returns
- Defined contribution employees have only their career span to save for retirement and bear this risk alone. A major loss in the market at the onset of retirement, may require a defined contribution employee to realize an immediate loss to meet income needs
- To manage inflation a defined contribution employee must shift the allocation of their portfolio as they approach and move through retirement, lowering their expected return as the proportion of equity in their portfolio decreases

Defined Benefit Plan		Hybrid Plan		Defined Contribution Plan	
ER	EE	ER	EE	ER	EE
Mid	None	Low	Low	None	High

ER = Employer
EE = Employee

Evaluating Retirement Plan Risks, Cont.

Longevity Risk

The risk of outliving retirement resources

- Defined benefit plans can effectively manage longevity risk by using actuarial assumptions on a more significant pool of members
- Defined contribution employees must attempt to estimate their longevity and bears this risk alone
- In a hybrid the risk is lower to the employer since the defined benefit is a smaller portion of the overall benefit

Defined Benefit Plan		Hybrid Plan		Defined Contribution Plan	
ER	EE	ER	EE	ER	EE
Mid	None	Low	Low	None	High

ER = Employer
EE = Employee

Recruitment Considerations

What Employees Value Most

- Retirement program can be a compelling reason to stay on the job
- Plan design can create efficient retention management
  - Turnover
  - Succession Planning
  - Retirement Decisions

Towers Watson, Attraction and Retention: What Employees Value Most

An Introduction to our Panelists

Patricia Denig
Director of Human Resources
Pittsfield Charter Township

Cindy Catanach
Finance Director
Livingston County

Wendy Trumbull
Finance and Budget Director
Canton Township

Patricia Denig
Director of Human Resources
Pittsfield Charter Township

Pittsfield Charter Township Demographics

- Full Service Township
  - Gold Standard of Public Service culture
  - Police, fire, dispatch, utilities, building inspections/permitting, parks & recreation, assessing, elections, finance, etc.
  - Population of 38,435
  - Located in southeast Michigan
- Approximately 140 benefited employees, with five union groups (four are public safety)
- Average age of employee is 43, average age of retiree is 63
- Seven different employee groups for benefits
  - Elected officials, non-union, police command, police, fire, dispatch, clerical/maintenance/utilities staff
- Post-employment benefits include pension and retiree health insurance
- Considered "young" as it relates to number receiving retiree benefits

Pittsfield Township Culture

- **Commitment to the Gold Standard of Public Service**
  - Residents and Businesses – stellar customer service, good stewards of taxpayer dollars and ensure we meet our obligations
  - Employees – wages & salaries that attract talent, and ensure we meet the promise of retirement benefits.

- **Knowledge and Action to Ensure Gold Standard**
  - 2008 – New administration at Elected Official level (currently in place/on 3rd term)
    - Focused on addressing the impact of **Recession**
    - Wage freeze through 2012, commitment to no layoffs but took advantage of vacancies through attrition
  - 2013 – Focused shift to long term financial stability
    - Post-employment legacy costs
    - Union negotiations – first opportunity for raises since 2008 but trade-off for changes to retirement benefits

Retiree Health Insurance History

- **1991** (Full-Time benefited employees = 35)
  - Age 62 or older with 10 years of continuous service
  - Age 60 or older with 15 years of continuous service
  - Age 55 or older with 25 years of continuous service

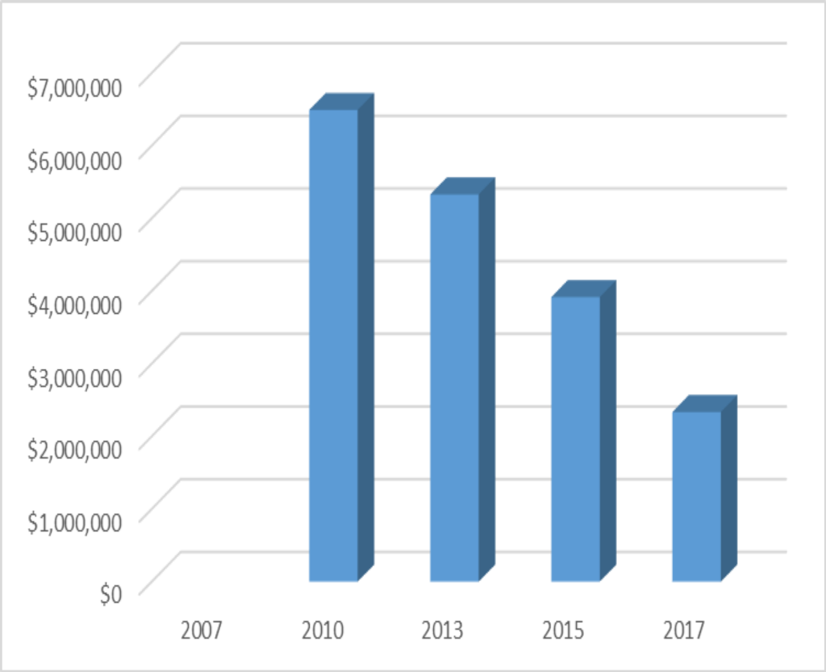
- **2006/2007** (Full-Time benefited employees = 124)
  - OPEB Valuation
  - MERS Retiree Health Funding Vehicle – April 2007
  - Negotiated Retiree Health Insurance benefit changes
    - Hired pre 2007 = EE & Spouse, 25 yrs. service, plan design you retired under
    - Hired 1/1/2007 & after = EE only, 25 yrs. service, up to $600/mo. stipend toward premium cost
  - MERS Health Care Savings Program – EE=1%/ER=1% (help defray cost of above changes)

- **2012/2013** (Full-Time benefited employees = 128)
  - Retiree Health Insurance Mirrors Existing health insurance plan design

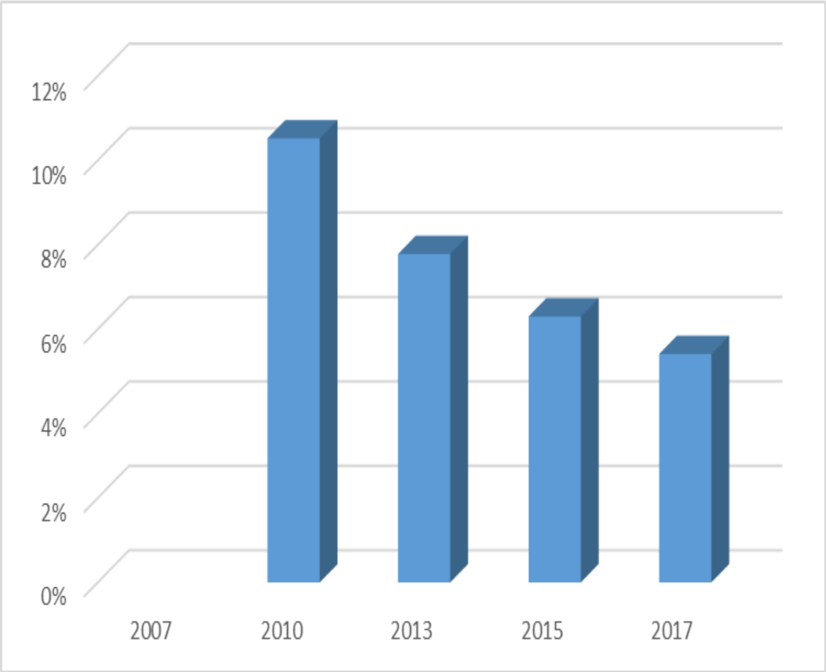
Retiree Health Insurance Legacy Costs

Progress Made

Unfunded Liability



ARC as % of Payroll



NOTE: Currently have 8 Retirees on Health Insurance and 3 Deferrals

Retiree Pension Plan History

- **Pre-1991** -- 401K Pension Plan and 457 Deferred Compensation Program

- **1991-1992** (Full-Time benefited employees = 55)
  - Established MERS Defined Benefit Pension Plans for Elected Officials and Non-union in June 1991
  - Negotiated MERS Defined Benefit Pension Plan for five union groups April – September, 1992
  - Fund Impact Issues (in hindsight)
    - Allowed employees to go back to date of hire for years of service calculation
    - Allowed employees to keep their existing 401K funds (did not require rolling into MERS program)

- **2000 – 2006** (Full-Time benefited employees = 99 - 124)
  - Times are good, increases made to pension benefits (higher multipliers, reduced employee contribution, E-2 COLA riders for police & elected officials, etc.)

Retiree Pension Plan History, Cont.

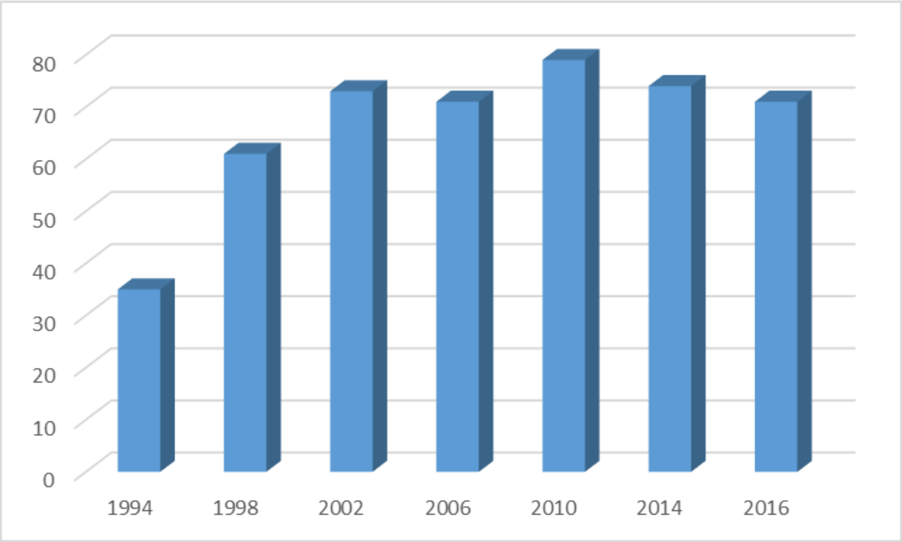
- **2013 - 2014** (Full-Time benefited employees = 128, 126 respectively)
  - Pension Plans modified
    - EE's hired before 12/31/2014 = Existing Defined Benefit Pension Plan
    - EE's hired after 12/31/2014 = Hybrid Pension Plan (part Defined Benefit/part Defined Contribution)
    - Eliminated E-2 COLA rider for police, police command and elected officials
  - 457 Deferred Compensation Program
    - Added MERS 457 Program as second option (previously only available through ICMA)
    - Added employer contribution of 1% If employee contributed 3% or more

- **2016-2017** (Full-Time benefited employees = 134, 138 respectively)
  - Began paying extra lump sum into fund, pro-rated across seven employee groups
  - No "Phase-In" on impact of Experience study (i.e., pay in more upfront to continue reducing unfunded liability)

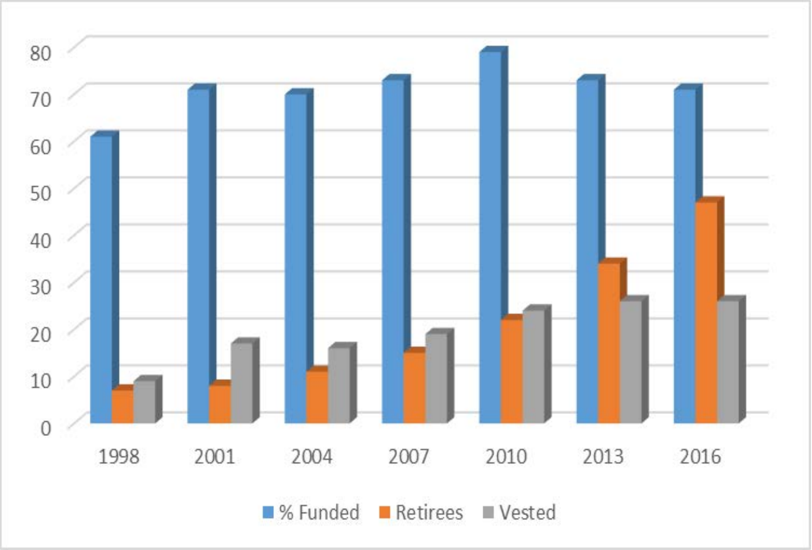
Retiree Pension Plan Legacy Costs

Progress Made

Percent Funded



% Funded with # Retirees and Vested Members



Budget Costs/Savings

Results of changes in benefit plans made in 2013–2014

WAGES			
	Prior CBA Cost	2015	2016
IAFF	$0 Wage Increase	$0 Wage Increase	$0 Wage Increase
POAM	$1,560,963	$1,706,672	$1,761,872
POLC-Command	$576,445	$629,428	$646,726
POLC-Dispatch	$143,570	$307,583	$316,146
TPOAM	$725,046	$814,606	$896,189
Total	$3,006,024	$3,458,289	$3,620,933
Difference		$452,265	$162,644
Percentage		15.05%	4.70%
BENEFITS			
	Prior CBA Cost	New CBA Cost	
IAFF	$956,479	$785,853	
POAM	$1,011,202	$802,476	
POLC-Command	$846,567	$608,288	
POLC-Dispatch	$366,788	$225,629	
TPOAM	$570,104	$485,376	
Total	$3,751,140	$2,907,622	
Difference		($843,518)	
Percentage		-22.49%	

Lessons Learned

- Keeping elected officials (decision makers) informed on the cost of decisions
  - Changing to Defined Benefit in 1991/1992
  - Increasing benefits in good times without ensuring funding in the future
  - Long-range view
- Cost of closing Defined Benefit Plans and opening Hybrid Plans
  - Move from % of payroll to flat fee
  - Good in long run—no longer amortizing liability
- Stay informed … use MERS staff for assistance, they are well-informed

Lessons Learned, Cont.

Balancing fiscal responsibility with benefits that attract and retain talent

- Gold Standard of services requires high quality employees
- Competitive wages and benefits to attract and retain quality employees
- Always a partnership with employees (as well as leadership)
    - Identifying needs, priorities and gaps
    - Providing continuous education (benefits and overall financial wellness, etc.)
    - Meeting the promise of retirement benefits through ongoing review/analysis/commitment to fiscal responsibility

Cindy Catanach

Finance Director

Livingston County

Livingston County, Michigan

September 2017

- Population: 188,624
- County Seat: Howell

- Total GF 2017 Budget: $45,434,361
- Total Authorized FTE's: 649.68 (582 FT, 67.68 PT)
- 7 Employee groups

Livingston County, Michigan

Pension Plans and Benefit Designs

Prior to 2002

- Defined Benefit Plans for all groups ranging from 2% (B2) to 2.25% (B3) depending on employee group
- No employee contribution for majority of that time
- 2% COLA adopted annually
- 2002 info:

– Active members	573
– Vested former members	70
– Retirees	147
Total	**790**

– Total liability of $52.4 million and 77% funded

Livingston County, Michigan

Pension Plan Design Changes

Subtle Changes beginning in 2002 & 2003

- Closed Defined Benefit Plan for two union groups & offer Defined Contribution Plan to new hires
- Change prompted by challenges faced in retaining employees long term
  - Defined Contribution benefit was portable so employee could have something to take with them
  - Defined Contribution benefit eliminated the ongoing long term liability to the employer

Livingston County, Michigan

Pension Plan Design Changes

Major Changes in 2009 and after

- Prompted by:
  - Rapidly decreasing revenues
  - Slowing economy
  - Increasing pension and OPEB liabilities
  - Rapidly increasing annual costs for pension and healthcare

	2007	2008	2009	2010	2011	2012	2013
Revenues	$47,840,540	$46,432,921	$45,250,257	$43,237,150	$41,404,406	$40,330,696	$40,813,095
Expenses	$46,126,146	$44,816,588	$42,619,585	$40,915,515	$40,389,246	$40,038,145	$39,557,263

Livingston County, Michigan

Implementation of Pension Plan Changes

- Implemented changes with non-union groups first in 2009
  - Multiple supplemental valuations were prepared by MERS
  - Closed Defined Benefit plan to new hires – require 5% contribution from those remaining
  - Open Hybrid Plan
    - Defined Benefit 1.25% multiplier, 0% Employee Contribution required
    - Defined Contribution - up to a 3% employer match
    - FAC 3 and 6 year vesting
    - Option for those enrolled in Defined Benefit plan to convert (83 of 249 converted)
    - All new hires enrolled in Hybrid plan
- Followed in 2011 with courts union and 2014 with sheriff unions
  - Defined Benefit plan closed to new hires
  - All new hires enrolled in Hybrid
  - Same Hybrid plan as offered to Non Union

Livingston County, Michigan

Pension Outcomes / Results

- 2009 info before changes
  - Active: 448
  - Vested: 87
  - Retiree: 251

    Total: 786
  - Total Liability $95.1 million and 73% Funded
- 2016 info (current)
  - Active: 488 (234 Defined Benefit/254 Hybrid)
  - Vested: 123 (97 Defined Benefit/26 Hybrid)
  - Retiree: 368 (356 Defined Benefit/12 Hybrid)

    Total: 979
  - Total Liability $142.6 million and 71% Funded

Pension Outcomes / Results, Cont.

Continued focus on reduction of long term liability

- Ensuring employees receive the retirement benefit they have earned is top priority of the Board
- Since 2011, Livingston County has made over $9.3 million in additional contributions
- Identification of one time revenues or excess reserves targeted for reduction of unfunded liabilities
- Continuous brainstorming on cost containment/cost reduction strategies
- Meet with MERS representatives to discuss options

Livingston County, Michigan

Pension Lessons Learned

Communication Is Key

- Educate employees on the financial value of their benefit package
  - Currently offering one-on-one meetings with employees to educate and answer questions on benefits
  - Creating a one page snapshot to mail out to employees that would show them the total value of their wage and benefit package
  - Promote numerous educational opportunities for employees to meet with representatives at MERS sponsored events

Other Post-Employment Benefits (OPEB)

- Created a Retiree Healthcare Trust in 2003
  - Paid full annual ARC into Trust from 2003-2014
  - Paid retiree claims from Benefit Fund
- Worked on ways to reduce OPEB liabilities
  - In 2003 closed the Defined Benefit program to new hires.
  - Offered a cash opt-out to NU employees to convert to a RHC Savings Program
    - Employees could receive cash, transfer to their RHC savings account, or their 457 plans
  - In 2009 converted all NU employees not eligible to retiree to the RHC savings plan.
    - Those who converted received a deposit into their RHC savings account based on years of service
    - Those remaining in the Defined Benefit plan stopped earning service credit
  - In 2009 stopped offering RHC Savings to NU new hires

OPEB Unions

- In 2014 the Sheriff's unions were offered a incentive to opt out of the Defined Benefit program
  - $20,000 cash to those who opted out
  - Those who switched and all new hires receive an equivalent of 4% of their annual base salary deposited into a RHC savings plan
  - 52 of 107 members accepted the incentive

- 2015 - Current
  - Continue to offer a cash incentive – lower amount than initial offering at $18,000
  - 47 actives remain in Defined Benefit plan as of the 12/31/14 Actuarial

Livingston County, Michigan

OPEB Results

- 2010 Actuarial
  - Unfunded Liability: $21.5 million
  - 34.3% Funded
  - 111 Active Participants
  - $2.3 million Annual Required Contribution
- 2014 Actuarial
  - Unfunded Liability: $4.0 million
  - 78.7% Funded
  - 47 Active Participants
  - $847,364 Annual Require Contribution
- Currently paying all retiree healthcare claims from the Trust

Wendy Trumbull

Finance and Budget Director

Canton Township

Previous Plans & Benefit Designs

- The Defined Benefit Plan has been closed to new members since 2007
  - Multipliers ranged from 2.5% – 2.8%, depending on union group
  - Employee contributions ranged from 5% – 6%, depending on union group
  - Approximately 230 active members
- Employees hired after 2007 were enrolled in a Defined Contribution Plan with a 5% employer contribution
  - Some employees received a 15% employer contribution
  - Approximately 110 active members
- The Township's actuarial liability was approximately $90 million and 71% funded

Previous Plans & Benefit Designs, Cont.

- Retiree health care
  - A plan was offered to all full-time employees at no cost
  - No deductible
- The Township’s actuarial liability for retiree health care was approximately $78 million and 7% funded

Strategies & Action Steps

- What prompted the action?
  - Goal was to offer fair benefits to our employees while reducing our legacy costs
- Some considerations:
  - Recruiting new employees
  - Retaining our great existing employees
- The Township's process:
  - Incorporated through union negotiations
  - Transparency was key
    - The Township prepared 5-year financial projections
    - Supplemental valuations prepared by MERS

Current Plans & Benefit Designs

- Defined Benefit Plan changes
  - 6 out of the 8 employee groups modified their benefit structure
  - Multipliers previously 2.8% bridged down to 2.5%
  - Multipliers previously 2.5% bridged down to 2.25%
  - Final Average Compensation was frozen at time of multiplier bridge down
  - Employees contributions ultimately increased to 10%

Current Plans & Benefit Designs, Cont.

- Introduction of Hybrid Plans with 1.5% multiplier
  - Employees contribute 5% into the Defined Contribution portion of the plan
  - Employer ONLY contributions into the Defined Benefit portion of the plan
    - Employer contributes 10%—even if the Annual Actuarial Valuation calls for less than 10%—until the plan is 100% funded
    - If the Annual Required Contribution exceeds 10%
      - Employees pick up additional required contribution into the Defined Benefit portion
      - Employees' contribution into the Defined Contribution portion of the plan is reduced accordingly

Current Plans & Benefit Designs, Cont.

- Retiree Health Care
  - Eliminated for all employees hired after 1/1/2013
    - $50/pay is deposited into the Health Care Savings Program, with vesting requirements
  - Incorporated Public Act 152 requirements for those future retirees who were hired prior to 1/1/2013
    - Currently offer a low-cost health plan with deductibles, which is below the hard cap
    - This plan is free to the employees
    - Employees have the option to purchase, at their own expense, the higher cost insurance

Outcome/Financial Results

- Defined Benefit

	Asset Value	Actuarial Accrued Liability Before	After	Difference	Annual Employer Contribution Change*	Funded Percentage Change
Full-Time Elected	$ 1,122,344	$ 1,437,079	$ 1,404,224	$ (32,855)	$ (5,880)	1.80%
Non-Union	$ 14,082,056	$ 18,627,491	$ 17,663,380	$ (964,111)	$ (87,725)	4.10%
Firefighters	$ 17,637,788	$ 27,860,937	$ 25,581,304	$ (2,279,633)	$ (193,440)	5.60%
AFSCME	$ 4,104,389	$ 4,469,872	$ 3,816,389	$ (653,483)	$ (56,713)	15.70%
TPOAM	$ 2,718,606	$ 3,560,321	$ 3,365,978	$ (194,343)	$ (22,213)	4.40%
POAM	$ 14,488,750	$ 18,490,035	$ 15,202,161	$ (3,287,874)	$ (261,408)	16.90%
	$ 54,153,933	$ 74,445,735	$ 67,033,436	$ (7,412,299)	**$ (627,379)**	
Percentage Funded		**72.74%**	**80.79%**			**8.04%**

* Before factoring in Employee Contribution increase

Outcome/Financial Results, Cont.

- Defined Contribution/Hybrid

	Defined Contribution		Hybrid
	2011	2012	2013
Total Costs	$ 788,619	$ 807,222	$ 587,418
Total Savings			**$ 219,804**

Outcome/Financial Results, Cont.

- Retiree Health Care

	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded AAL	Funded Ratio
December 31, 2012	$ 5,202,401	$ 77,830,022	$ 72,627,621	6.68%
December 31, 2014	$ 7,117,313	$ 65,454,539	$ 58,337,226	10.87%
Decrease in Unfunded AAL			**$ 14,290,395**	

  – Township has committed to prefund $1,000,000 per year

- Employee impact

Contacting MERS of Michigan

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