Municipal Employees' Retirement System

Strategies to Modify Your Defined Benefit Plan Design

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AGENDA

- Motivations for Plan Design Changes
- Defined Benefit Provisions
- Plan Modifications to Control Cost
- Reopening a Defined Benefit Plan
- Benefit Enhancements
- Trends
- Employer Resources

Motivations for Plan Design Changes

Fiscal Objectives

- Predictable Costs
- Reduced Unfunded Liability
- Total Cost

Workforce Objectives

- Recruit
- Retain
- Retire

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Targeting Income Replacement

- A goal of any retirement plan design is the ability for employees to retire on time and have a comfortable retirement.

- An excellent way to do this: Set a target income replacement of 80% of preretirement income.

Defined Benefit Provisions

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Defined Benefit Formula

Final Average Compensation X **Service Credit** X **Benefit Multiplier** = **Annual Benefit**

Final Average Compensation (FAC)

The average of the highest consecutive wages over a period of time as determined by the employer. Typically, a shorter period will provide for a greater benefit.

Adopted Provisions

Comparison

35-Year-Old New Hire	5-Year FAC	3-Year FAC
FAC	**$77,329**	**$78,855**
Years of Service	25	25
Multiplier	2.00%	2.00%
Monthly DB (FAC x Years of Service x Multiplier)/12	**$3,222**	**$3,286**

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Definition of Compensation

Standard Definitions *Standard definitions are non-modifiable*	**Base Wages**	**Box 1 Wages (from W-2)**	**Gross Wages**	**Custom Definition**
Types of Compensation				
Regular Wages Salary or hourly wage X hours PTO used (sick, vacation, personal, bereavement, holiday leave, or unclassified) On-call pay	All Regular Wages included	All Regular Wages included	All Regular Wages included	TBD
Other Wages Shift differentials Overtime Severance issued over time (weekly/bi-weekly)	Excluded	All Other Wages included	All Other Wages included	TBD
Lump Sum Payments PTO cash-out Longevity Bonuses Merit pay Job certifications Educational degrees Moving expenses Sick payouts Severance (if issued as lump sum)	Excluded	All Lump Sum Payments included	All Lump Sum Payments included	TBD
Taxable Payments Travel through a non-accountable plan (i.e. mileage not tracked for reimbursement) Prizes, gift cards Personal use of a company car Car allowance	Excluded	All Taxable Payments included	All Taxable Payments included	TBD
Reimbursement of Nontaxable Expenses (as defined by the IRS) Gun, tools, equipment, uniform Phone Fitness Mileage reimbursement Travel through an accountable plan (i.e. tracking mileage for reimbursement)	Excluded	Excluded	Excluded	TBD

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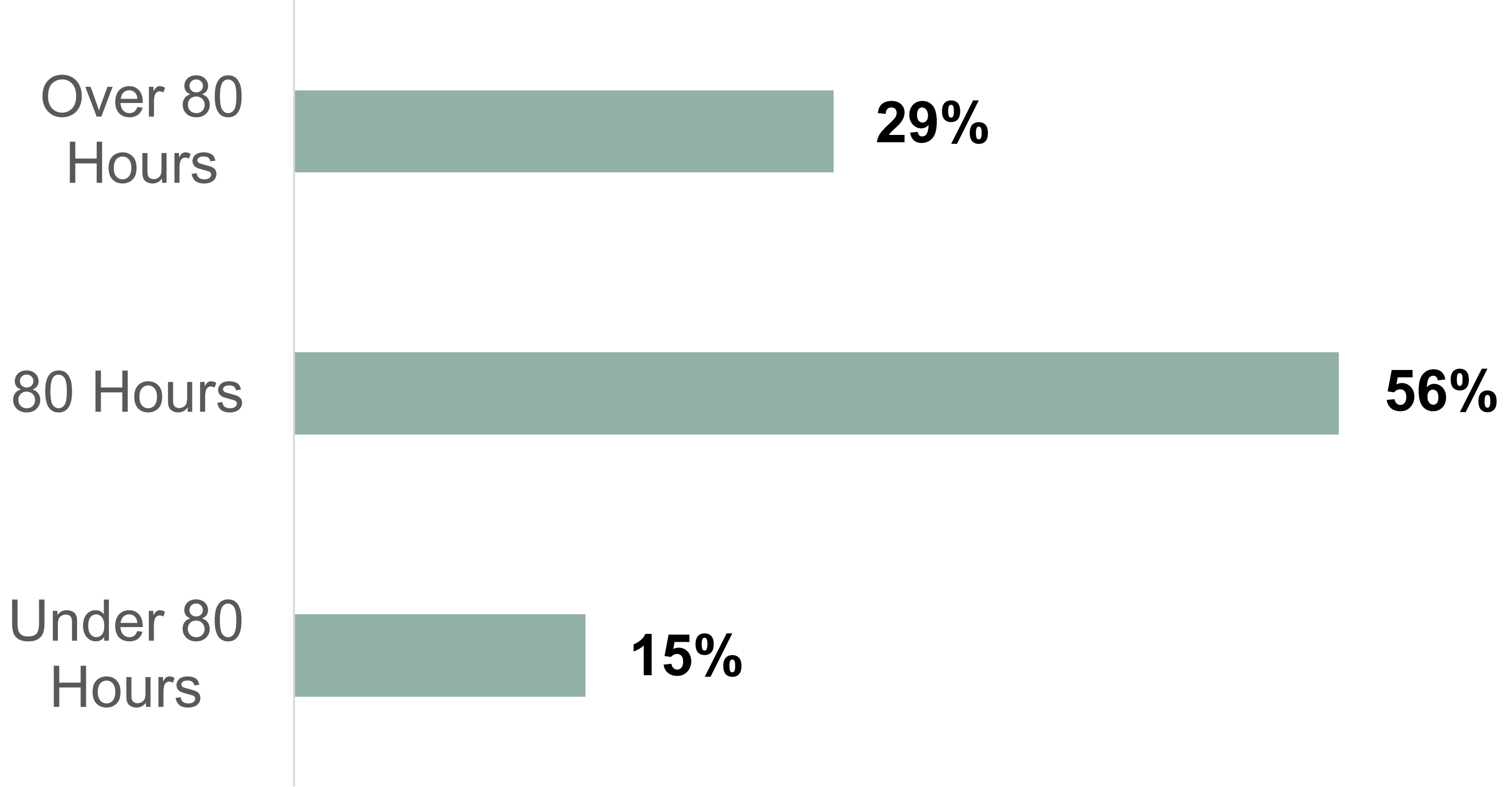
Service Credit Qualification

Defines the number of hours an eligible employee needs to work in a month to earn service credit. Typically, the lower number of hours, the more service is granted.

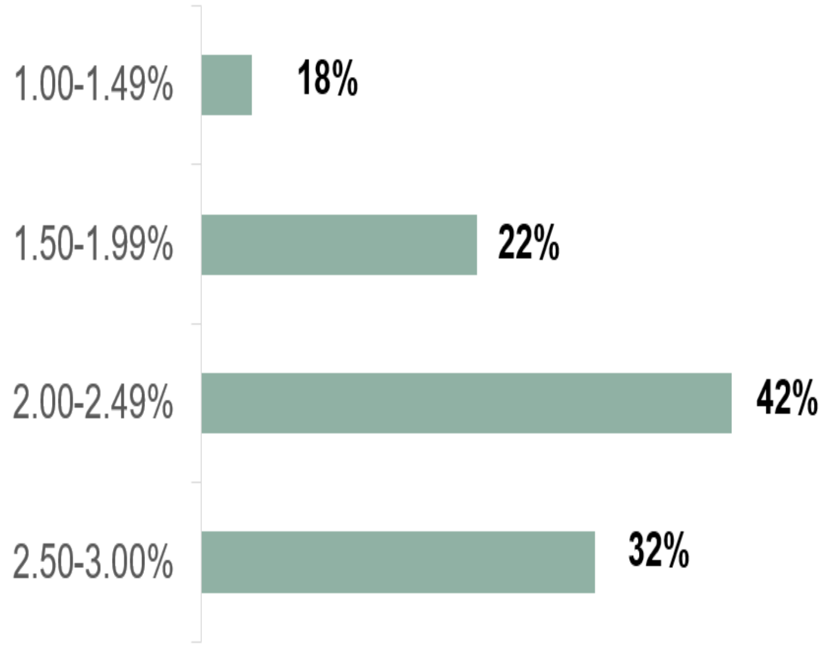
Adopted Provisions



Benefit Multiplier

The benefit multiplier is chosen by the employer. Multipliers of 2.25% and higher have a maximum benefit of 80% of FAC.

Adopted Provisions



Comparison

35-Year-Old New Hire	2.50% Multiplier	2.00% Multiplier
Final Average Compensation (FAC-3)	$78,855	$78,855
Years of Service	25	25
Multiplier	2.50%	2.00%
Monthly DB (FAC x Years of Service x Multiplier)/12	**$4,107**	**$3,286**

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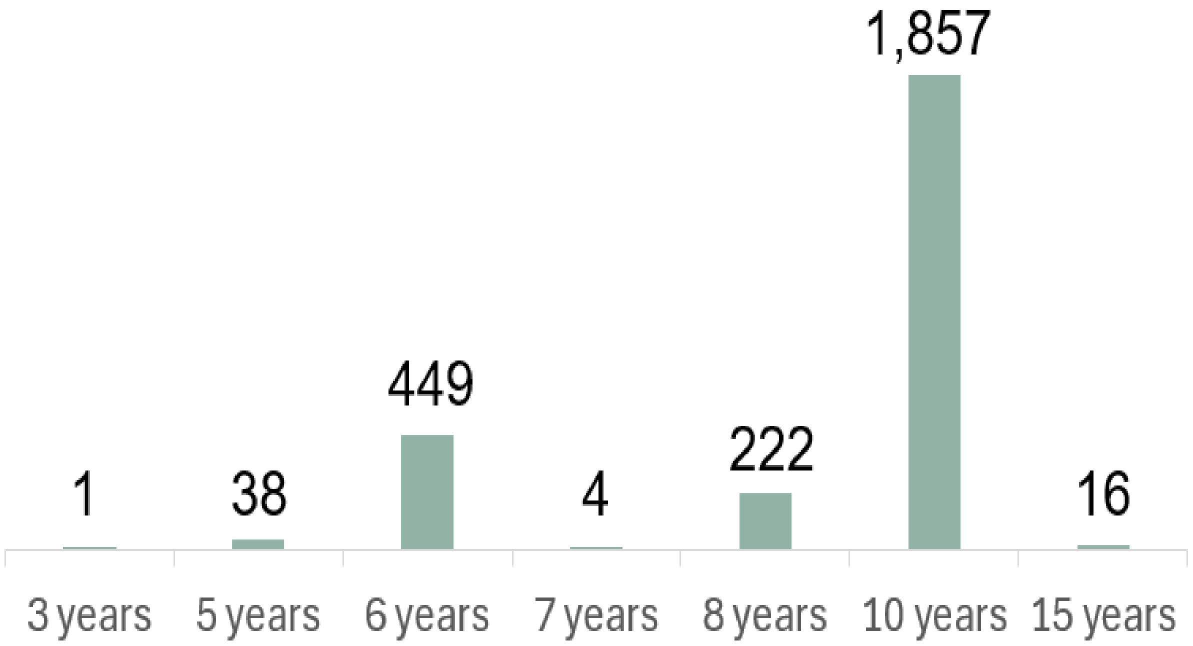
Vesting Schedules

Longer schedules help employers retain employees by rewarding them for their loyalty and encouraging them to stay longer. They can also result in cost savings if the employee leaves before becoming fully vested.

Adopted Provisions



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Retirement Eligibility

Standard retirement age is 60 years

If adopted by the plan, employees can retire:

- At age 50 with 25 or 30 years of service
- At age 55 with 15, 20, 25, or 30 years of service
- Any age with a minimum of 20-30 years of service, in whole numbers

Reduced Retirement Benefits
Permanently reduces an employee’s benefit by 0.5% per month if they are younger than the retirement age

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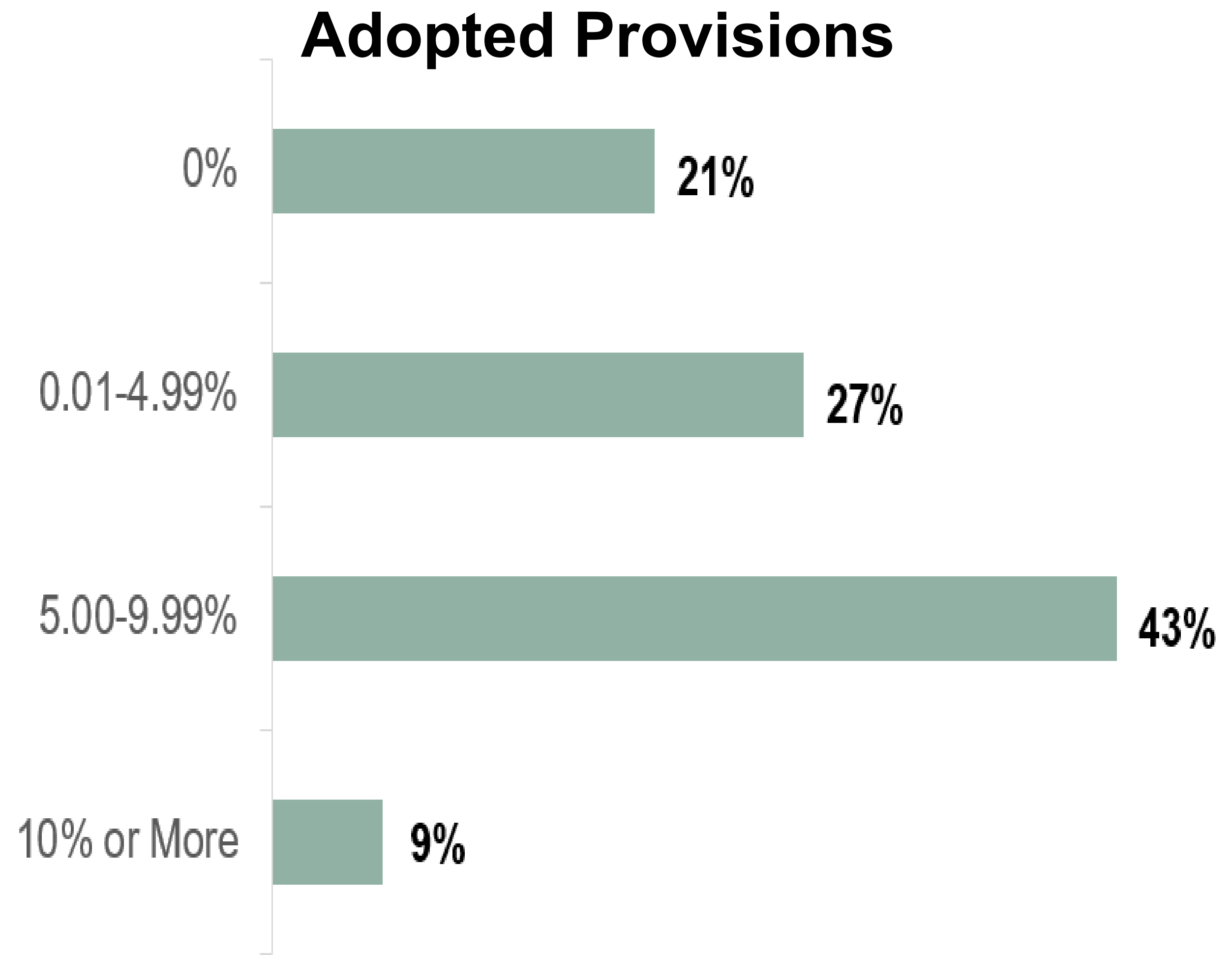
Employee Contributions

The employer may require employee contributions to the plan to help offset the cost of Defined Benefit. This *<u>does not</u>* increase the employee's pension.



Other Common Provisions

Enhanced Death and Disability Benefit (D-2)

Enhances the retirement benefit in the event of a duty-related disability or death.

When adopted, this benefit adds up to ten additional years of service credit, not to exceed a maximum of 30 years.

Cost of Living Adjustment (COLA)

An annual increase that may be applied to the retirement benefit.

The COLA can either be an automatic increase or something that is annually adopted by the employer.

Reciprocal Retirement (Act 88)

May be adopted by the employer to help employees that have worked in more than one Michigan governmental employer, to satisfy vesting and any early retirement eligibility requirements.

More Options to Consider

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Deferred Retirement Option Plan (DROP)

A Defined Benefit retirement payment option

Allows employees to work past retirement eligibility

Pension payments are put in a separate, notional, account accessible upon final termination date

How Does DROP Work?

1

Employee selects a final day of work six to 60 months past their original retirement eligibility date

This date is irrevocable, and on that date, the employee must leave employment.

2

Calculated payment is accumulated each month in a notional DROP account

The employee continues to pay their employee contribution

3

When employment ends the participant begins receiving the monthly pension benefit.

The DROP account balance is transferred to a qualified account or taxed and paid directly to the retiree.

Employer DROP Options

- Percentage of elected monthly pension payment the participant will have allocated to their account

- An interest rate of 0% to 3% to be applied to the account balance monthly

- If the annual cost of living adjustment (COLA) will be applied

DROP Benefit Example

- Credits 80% of the pension benefit to the DROP account
- Has a 3% interest rate
- Does not have a COLA

Benefit Example

Benefit to the Employee

FAC $75,000 **X** Service Credit 25 years **X** Benefit Multiplier 2.5% **=** Straight Life Benefit $46,875

Straight Life Benefit $46,875 **X** DROP Credit 80% **=** **DROP $37,500**

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Benefit Example – Accumulation

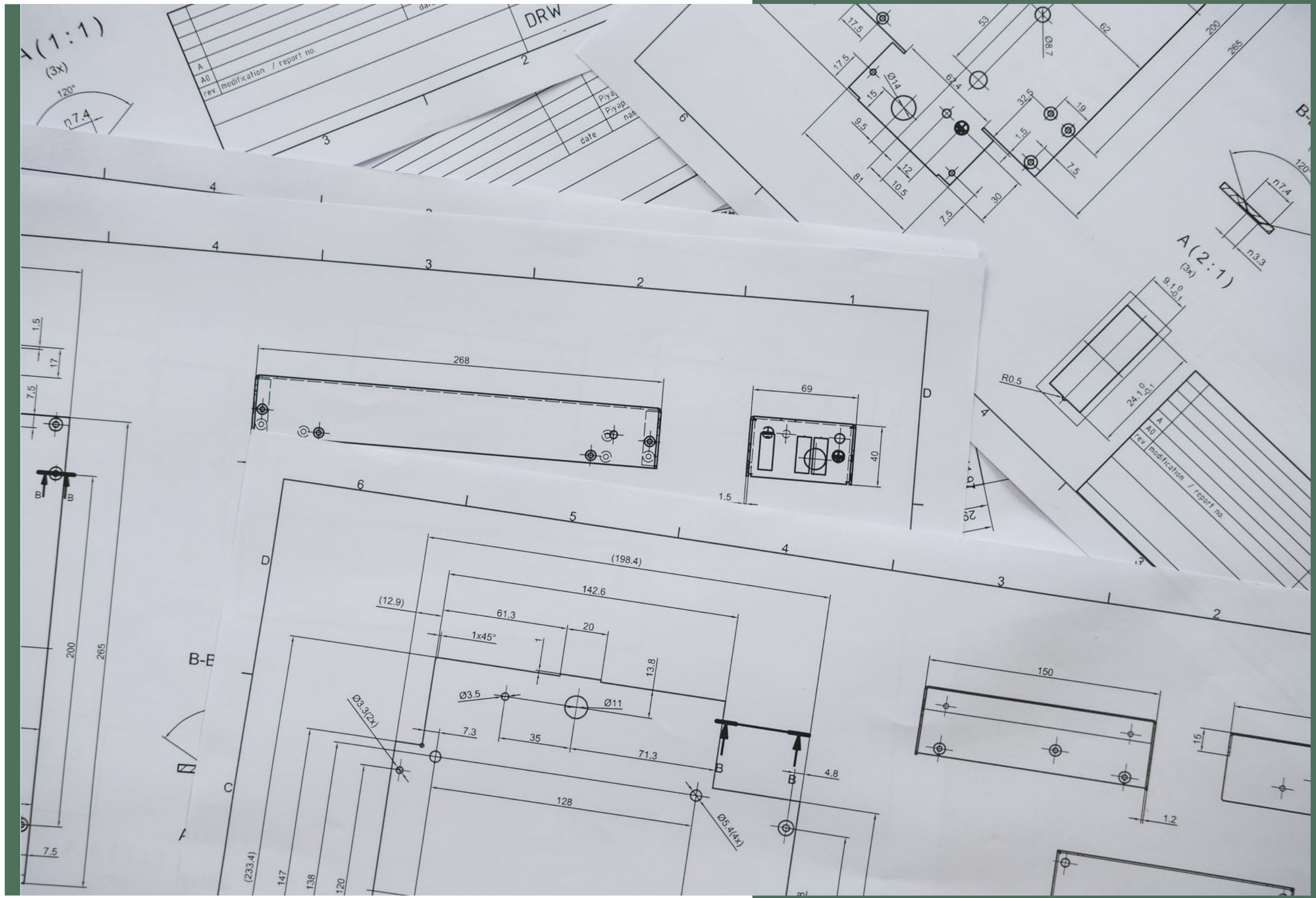
- Individual has elected to work 60 more months
- End of the DROP period, the participant will have $201,830.12 in their DROP account
- $187,500 in DROP payments + $14,330.12 in interest

Benefit to the Employee

- The DROP account balance can be:
  - **Rolled into a retirement account** as directed by the participant,
  - **Paid directly to the employee** at taxable income, or
  - Defaulted into a MERS **IRA**

- Following the DROP period completion, the retiree will receive their retirement amount as a pension benefit

Plan Modifications to Control Cost



Managing Unfunded Accrued Liability

Funding Strategies

(Increase assets)

Plan Design Strategies

(Reduce or eliminate liability moving forward)

Plan Design Strategies

Reduce Future Liability for New Hires

- Defined Benefit Plan with lower provisions
- Hybrid Plan
- Defined Contribution Plan

Reduce Future Liability for Existing Employees

- Lower multiplier going forward
- Eliminate COLA on future service
- Plan freeze

Lump Sum Buyout Option

- Offer terminated-vested participants a lump sum payment instead of future monthly benefit payments
- Adopted for all participants in one or more divisions for a limited time window (6-24 months)
- Actuaries calculate the dollar value of the earned pension benefit for each participant
- May reduce or eliminate DB liability, depending on options chosen

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Reopening a Defined Benefit Plan

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Important Considerations

Employer Goals

Are you struggling with attracting or retaining employees? Are you looking to diversify benefits for participants?

Plan Provisions

What is the plan design you are considering? Do you want to allow long-term employees to have the opportunity to retire at an earlier age?

Conversion/Freeze

Are you wanting to stop accrual in your current plan and start a new DB plan, and/or are you considering offering conversion for the existing participants to the new DB plan?

Reopening a DB Plan: Considerations

<u>Pros</u>

- DB may help hire and retain employees depending on average tenure and vesting requirements

<u>Other Considerations</u>

- Cost to fund liability changes each year and could go up in the future

Benefit Enhancements

Enhancement Requirements

Plans must meet funding requirements

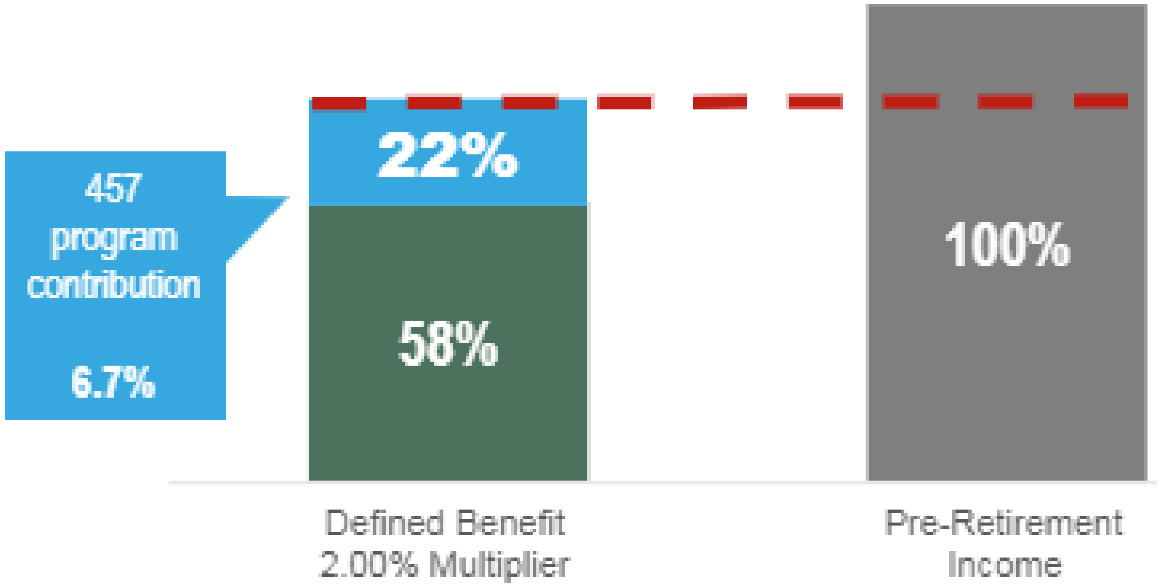
Requires actuarial analysis to illustrate financial impacts

Beyond Pension: Option to Consider

- Blend existing defined benefit plan with matching employer contribution to 457
  - Encourages employee participation
  - Does not add to pension liability
  - Contributions are flexible and can be started, stopped, or changed at any time
- Helps participants reach income replacement goals

Blending Programs

Adding a 457 Program to Reach an 80% Desired Income Replacement Rate



Projection assumes a 30-year-old employee earns 30 years of service credit , retires at age 60 and lives until age 90. Assumed wage inflation is 2%.

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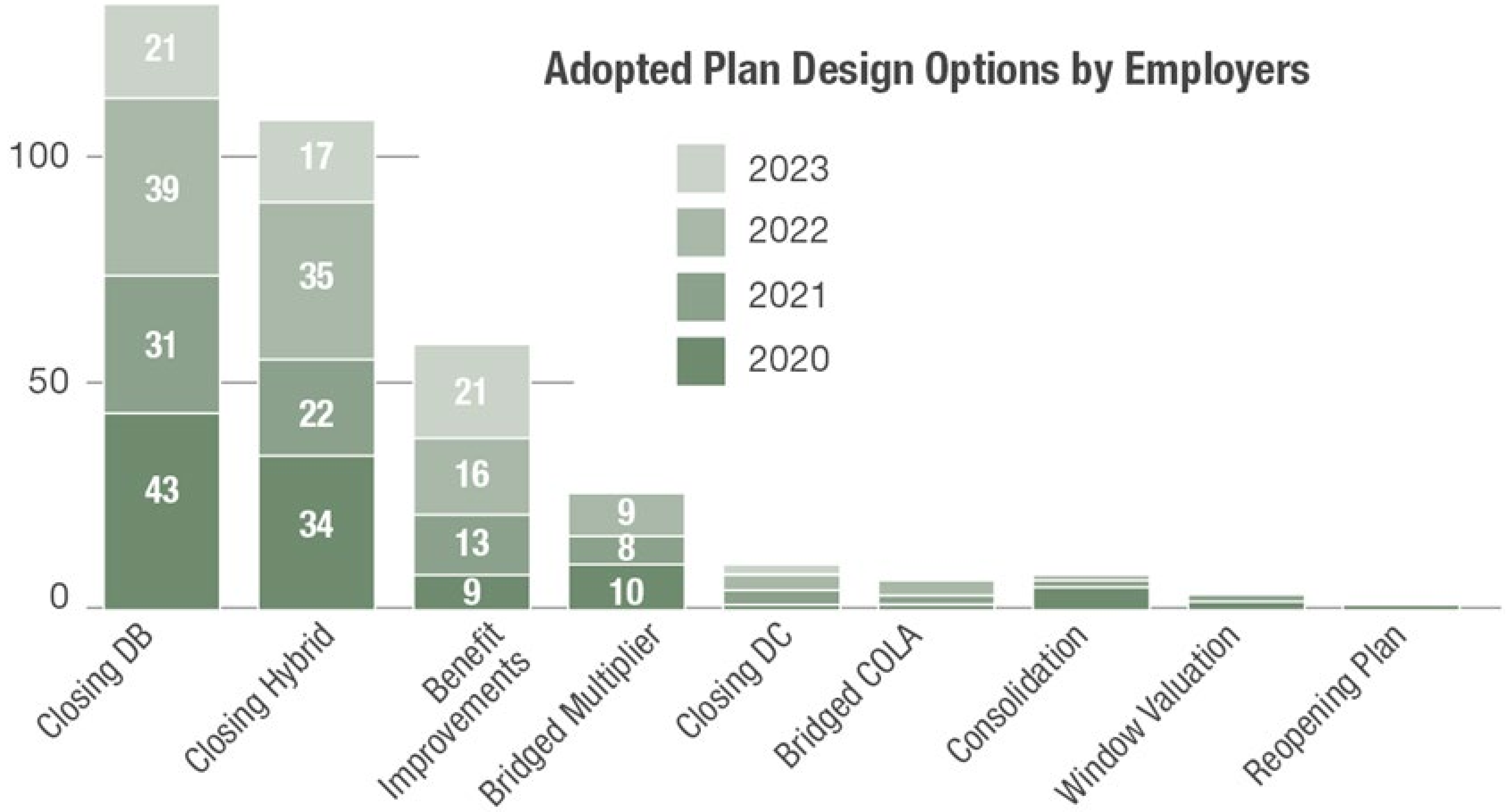
Trends

Meeting Your Workforce and Fiscal Needs



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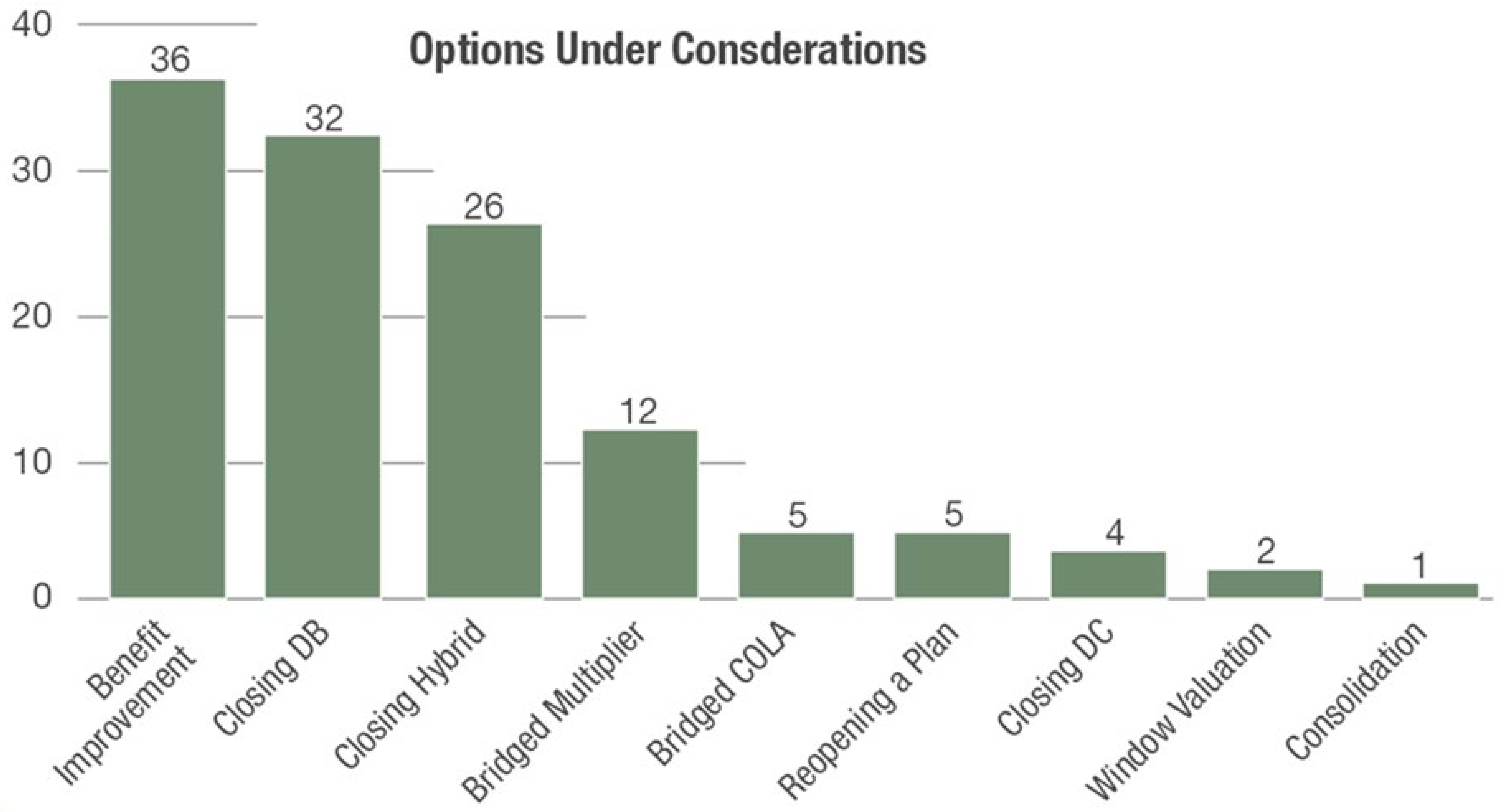
Meeting Your Workforce and Fiscal Needs



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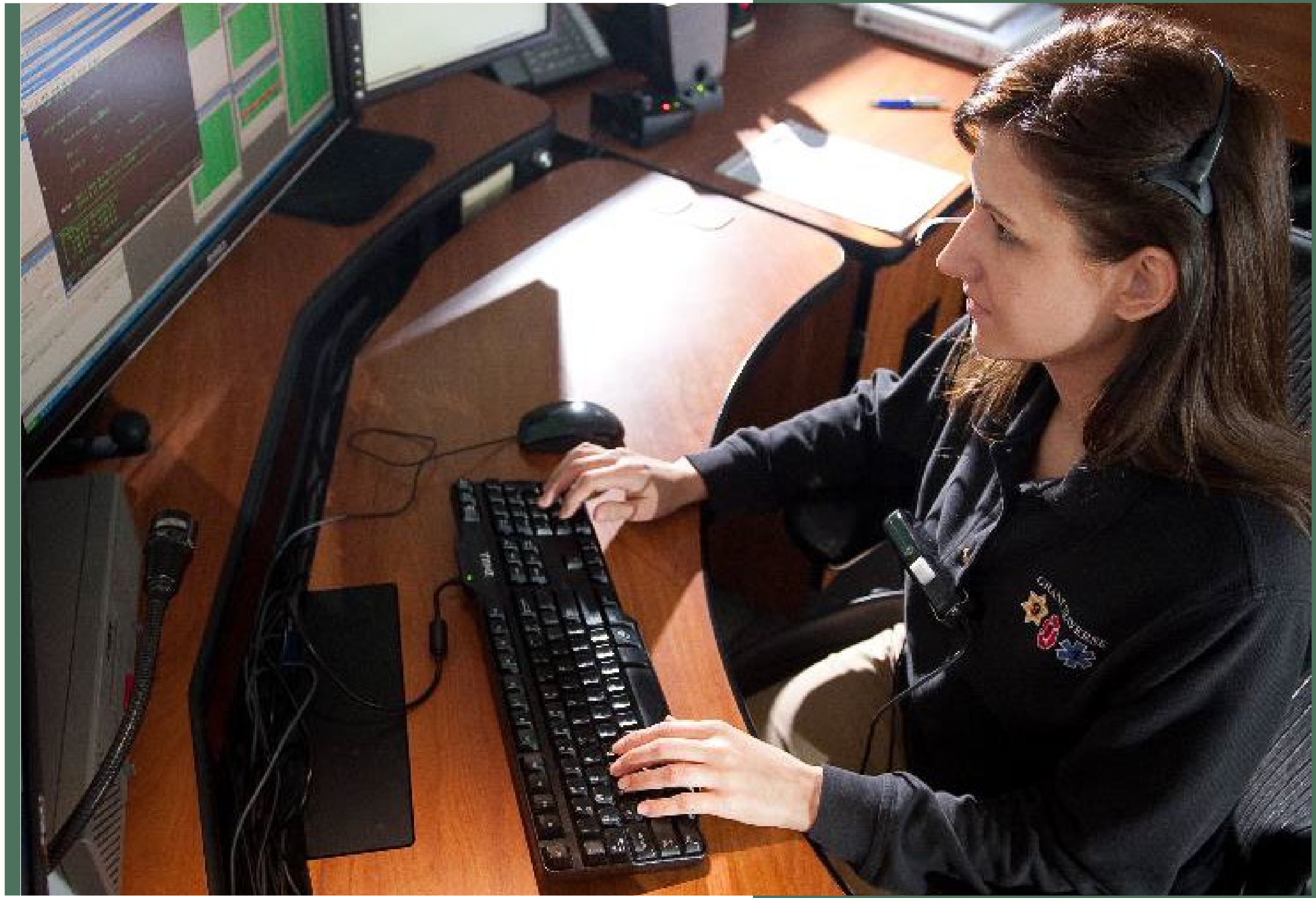
Key Takeaways and Resources



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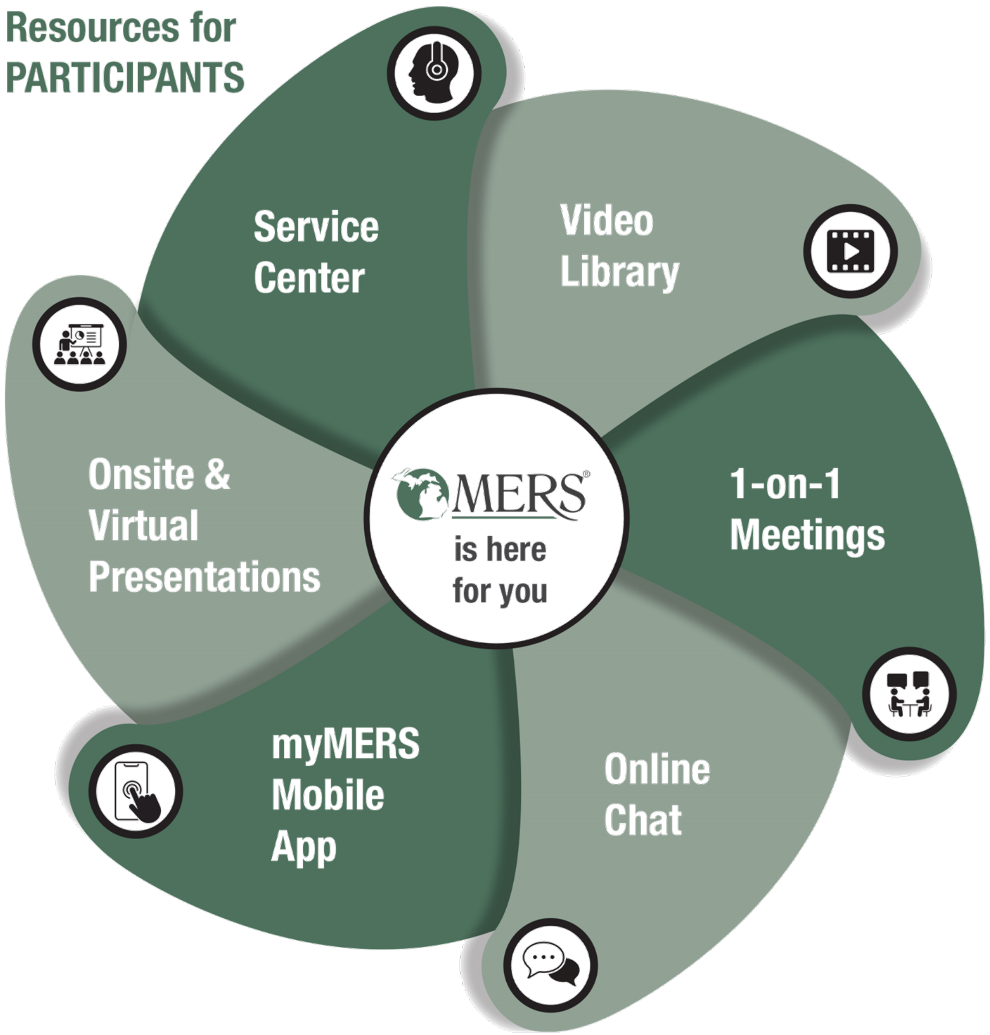
Key Takeaways

- A comprehensive benefits package can help you **recruit and retain** employees
- There is **no one-size-fits-all** retirement plan
- Design a plan to **maximize your employees' retirement income**
- Take advantage of **MERS resources** to manage your retirement benefits package

Resources



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