

AGENDA
Fiscal Committee

Tuesday, May 1, 2012

4:00 PM
Carnegie Town
235 West 10th

Hall
Street

1. Call To Order
2. Approval of Minutes
- A. Monday, April 2, 2012
3. Reports and Updates
- A. Discussion on the Pension Design Study by Bill O'Toole, Human Resources Director; Angie Uthe, Human Resources Manager; Tracy Turbak, Finance Director; and Tom Huber, Assistant Finance Director
- B. Discussion on how to spend remaining CIP Budget Funds by David Bixler, Budget Analyst; Rich Oksol, Lead Internal Auditor; and Tracy Turbak, Finance Director
4. Adjournment

Date: 2012-05-01
SIRE Meeting ID: 1699
Meeting Type: Committee Meeting
Subtype: Fiscal Committee
YouTube:https://youtu.be/GlVPfYEJL_8
Agenda Item: Not Assigned
Item ID: 62693

The following document(s) are public records obtained from the
City of Sioux Falls.

South Dakota Retirement System

Funded Status, Plan Provisions, and Operations Summary

May 1, 2012 – City of Sioux Falls

The South Dakota Retirement System (SDRS) is a cost-sharing multiple employer hybrid public employee retirement system. Most public employees in South Dakota are together in this retirement plan that shares the cost of retirement, survivor and disability benefits. All participating public employers and their full-time employees make matching contributions to the plan. SDRS is designed to provide a quality retirement plan as effectively and efficiently as possible.

SDRS MISSION STATEMENT

To plan, implement, and administer income replacement programs, and to encourage additional savings for retirement, all of which offer SDRS members and their families the resources and the opportunity to achieve financial security at retirement, death or disability by providing an outstanding, appropriate and equitable level of benefits.

The Board of Trustees believes this mission is achievable with the resources available in a progressive working environment, by sound and efficient management, through superior investment performance and by exercising the fiduciary responsibility associated with the proper stewardship of member assets.

LONG-TERM INCOME REPLACEMENT GOALS

SDRS Income Replacement Goal is to provide lifetime income replacement from SDRS resources of at least 55% of final average compensation for career employees in each membership class. (Class A – 30 years / Class B PS - 25years)

Recommended Member Total Income Replacement Goal is to provide lifetime income replacement of at least 85% of final average compensation, including income from SDRS, Social Security, and personal retirement savings of at least one-time annual compensation at retirement.

Funded Status Summary:

The SDRS measures of actuarial soundness substantially exceed funding standards and exceed virtually all statewide systems. SDRS has maintained this status because of conservative fiscal policies, prudent benefit designs, and outstanding investment performance. *(Over 100% funded in 22 of the last 25 years – Current Market Value Funded Ratio - 103%.)*

Total Membership (as of 6-30-2011)

	<u>Total Membership</u>
Total Members	74,148
Active Members	38,490
Inactive Members	14,201
Benefit Recipients	21,457
Annualized Benefits	\$359,385,526

South Dakota Retirement System

PO Box 1098

Pierre, South Dakota 57501-1098

Plan Provisions:

- Hybrid Benefit Plan
 - Retirement Benefits – Benefit Multiplier X Salary X Years of Service
 - Benefit Multiplier
 - Class A General Employees (1.55% of Final Average Compensation – Limited Alternate Benefit)
 - Class B Public Safety Employees (2.0% of Final Average Compensation)
 - Joint and 60% Survivor
 - Guaranteed Contribution Payouts
 - Deferred Vested Benefits
 - Automatic COLA (2.1% to 3.1% depending on plan funding and CPI)
 - Family Benefits – 40% of Salary plus 10% per child under age 19
 - Disability Benefits – 50% of Salary plus 10% per child under age 19
- Supplemental Savings Plans
 - Governmental Deferred Compensation (Employee Voluntary Election) – Supplemental Retirement Plan (SRP)
 - Termination Pay Plan (Employer Voluntary Election) – Special Pay Plan

Employer and Employee Contributions Based on Compensation:

- Definition of Compensation - gross wages paid to a member by the employer for personal services rendered during the period considered as credited service.
 - Includes W-2 wages, plus contributions to section 401, 403, 408, or 457 plan and any amounts contributed to a section 125 plan. *(More complete definition)*
 - Compensation does not include travel, meals, lodging, moving or any expenses reimbursed by the employer and lump sum termination payments for sick leave, annual leave and retirement incentives. *(More complete definition)*
- Rate of Matching Contributions
 - Class A General Employees
 - Employee – 6% of compensation
 - Employer – 6% of compensation
 - Class B Public Safety
 - Employee – 8% of compensation
 - Employer – 8% of compensation

Employer Responsibilities

- Monthly Electronic Reporting – Required by the 15th of the following month
- Monthly Transmission of Contributions – Required by the 15th of the following month
- In-house Authorized Agents
 - SDRS Training Provided

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Cavanaugh Macdonald
CONSULTING, LLC

The experience and dedication you deserve



Pension Plan Design Study Presentation

March 26, 2012

Tom Cavanaugh, FSA, FCA, EA, MAAA

Eric Gary, FSA, FCA, MAAA

Patrice Beckham, FSA, FCA, EA, MAAA



Today's Meeting



- Scope of Project
- Pension Plan Design Study
 - Goals/Objectives
 - Background
 - Alternatives considered
 - Recommended changes
 - Cost impact of proposed changes

Scope of Project



- RFP issued jointly by both Boards in April, 2011

- Services requested in RFP
 - Actuarial audit of the 12/31/10 actuarial valuations
 - Plan design study
 - Facilitate discussion and analysis on system alternatives and plan design changes necessary to reduce and stabilize City pension contribution rates.

 - Identify options and/or benefit structure changes, provide cost analysis, and recommend system modifications for Board consideration.

Background Information



- Two broad categories of retirement plans
 - Defined benefit (DB) plans: benefit security
 - Defined contribution (DC) plans: wealth accumulation

- Hybrid plan contain features of both DB and DC plans
 - Combination DB/DC plan
 - Cash balance plan

- City offers retiree healthcare benefits which were also considered in this study

Plan Design Study



- Recent market downturn has put upward pressure on employer contribution rates at a time when revenue growth is uncertain

- Significant activity in this area
 - From 2009 to 2011, 43 states enacted major pension changes
 - Restructured benefits and contribution provisions. Changes are dependent on legal provisions.
 - Typically have revised rather than replaced traditional defined benefit plan, often with new tier.
 - Costs shifted to employees through higher contributions and lower benefits

Employer Cost



$$C^{ER} = B + E - I - C^{EE}$$

C = Contributions

I = Investment Income

B = Benefits Paid

E = Expenses

Retirement Benefits



- Retirement programs are part of the overall compensation package
- Impact recruitment and retention of employees
- Any changes made should be designed to help the City attain its overall goals regarding City employment

City's Compensation and Benefit Objectives



- Attract qualified applicants for employment by City in all categories of work
- Retain experienced and qualified employees in all categories of work
- Provide incentives for employees to pursue career advancement opportunities as they arise within the City
- Accomplish these objectives within responsible economic parameters



Current Pension Benefit Plans

- Plans are well funded (around 90%)
 - ARC has always been contributed
 - Closed amortization period (13 for pension)
 - No benefit improvements for many years
- City cost of current retirement benefits

	General	Police	Fire
Normal Cost Rate	11.62%	19.30%	21.01%
UAAL Contribution Rate	<u>4.24%</u>	<u>9.42%</u>	<u>12.20%</u>
ARC Rate	15.86%	28.72%	33.21%
Employee Contribution Rate	<u>3.00%</u>	<u>8.00%</u>	<u>8.00%</u>
Employer ARC Rate	12.86%	20.72%	25.21%

Unfunded Actuarial Accrued Liability



- Existing UAAL cannot be reduced without reducing benefits for current retirees or actives
 - No desire to change the benefits of retirees
 - Difficult to change pension benefits for current active members since subject to vote of active employees
 - Only option for City cost reduction is to have current active employees contribute more toward their pension benefits.
- UAAL is a “legacy” cost that must be paid regardless of changes for new hires
- Change in the benefit structure for new hires (future actives) will generate additional savings



Alternatives Considered

- South Dakota State Retirement System
- Defined Contribution Plan
- Hybrid Plans
- Retain current Defined Benefit Plan
 - Increase contribution rate for current active members
 - Change benefits for new hires (create a new tier)
- Healthcare Benefits
 - Change eligibility requirements
 - Change subsidy amount
 - Discontinue access to active employee plan
 - Discontinue healthcare benefit

New hires go into South Dakota Retirement System (SDRS)



- Would require legislation
- Current retirees and actives continue to earn benefits in the current City plans – no change
- New hires are covered by SDRS
- Cost impact of closing the plan – impact of changing cash flows on asset allocation
- Loss of City control – No real influence on decisions driving costs or benefits

New Hires Participate in SDRS



- City will have to continue paying for unfunded liability of current plans
- May need to evaluate different payment schedules for UAAL
- Will impact asset allocation at some point which will increase costs
- Potential variability of SDRS employer contribution although relatively stable in past and history of being well funded
- Potential variability of SDRS benefit levels for new and existing members as exhibited recently

New Hires Participate in DC Plan



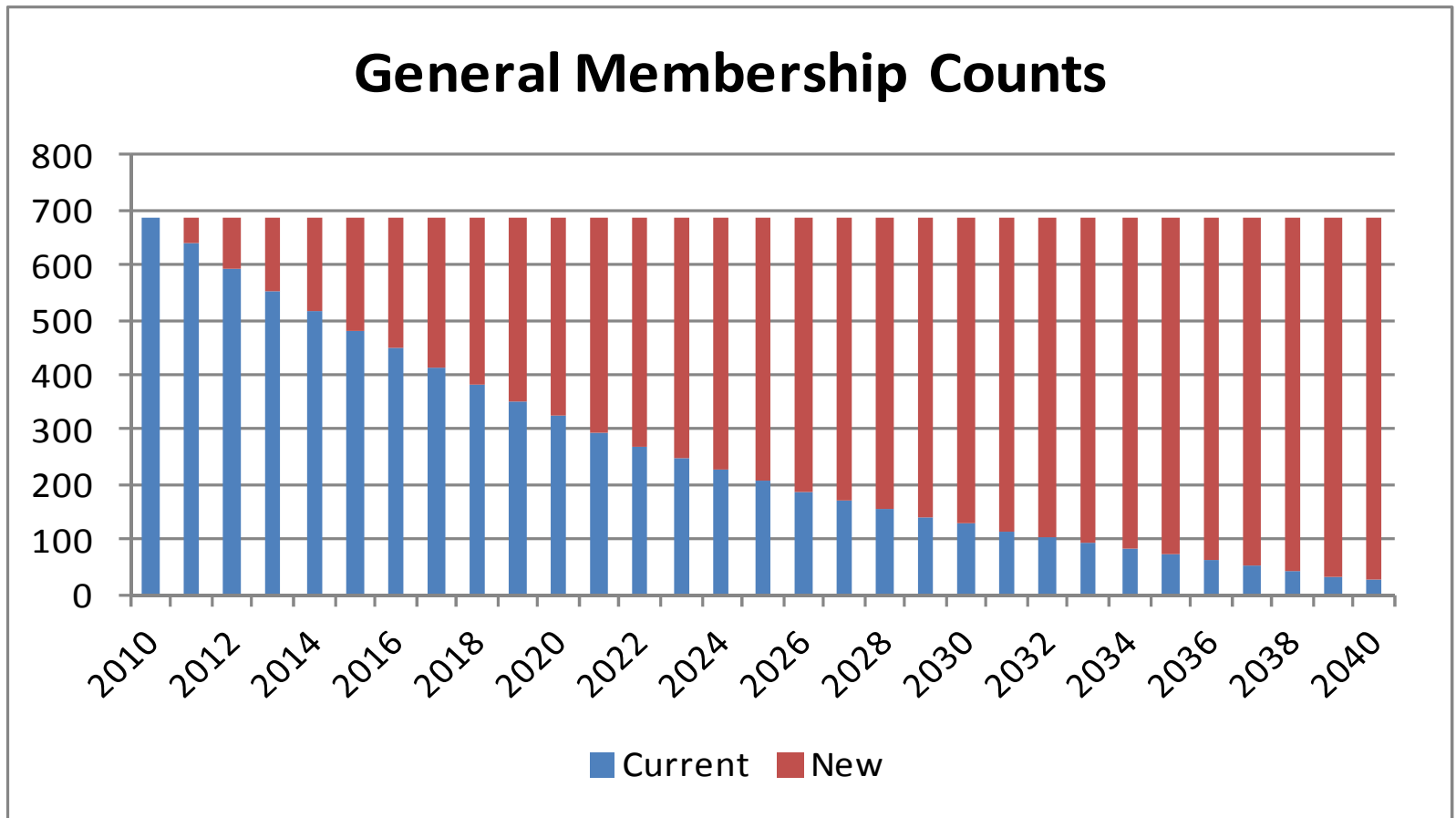
- City will have to continue paying for unfunded liability of current plans
- May need to evaluate different payment schedules for UAAL
- Will impact asset allocation at some point which will increase costs
- More benefits paid to those who leave City employment than under DB Plan
- Question of benefit security and ability of employees to successfully manage the various retirement risks

New Hires in New Tier in Existing DB Plan

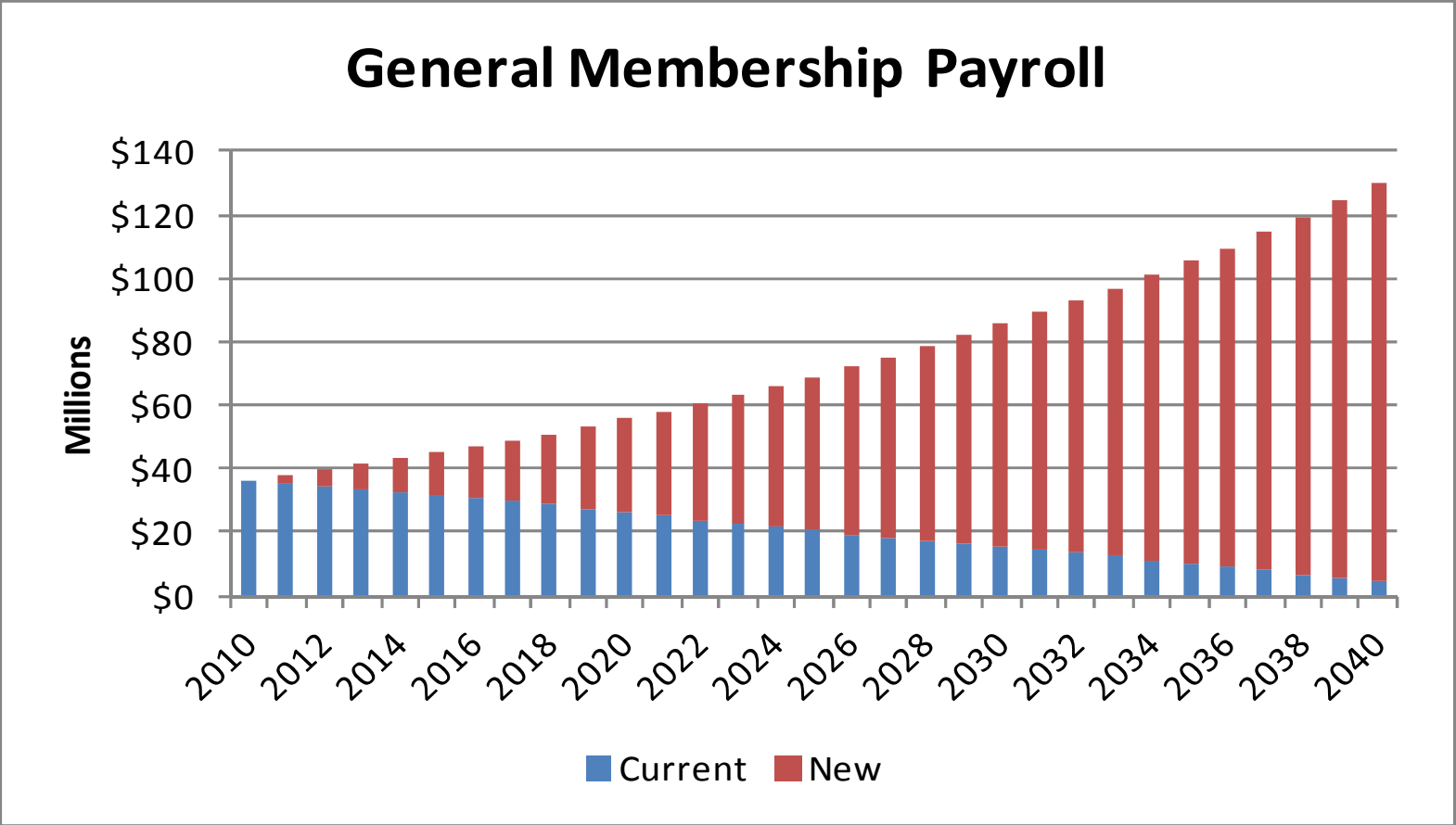


- Design new tier to have a lower cost than current plan.
- Cost savings unfolds over time as current actives are replaced by new hires
 - Savings quantified by modeling the difference in estimated employer contributions over the projection period (30 years for study)
 - Most significant savings later in projection period
 - Payroll growth creates very large payrolls farther out in projection period – can distort comparison of savings
- Projections are based on many different assumptions. Actual experience will vary which will impact the actual costs in future years.

Change in Active Membership



Change in Payroll Over Time



Relative Impact of Plan Changes



- Numerous changes that could reduce costs, but where is greatest potential savings?
- Relative cost of current pension benefit structure:

Normal Cost	General	Police	Fire
Retirement	9.67%	16.71%	18.51%
Death/disability	0.99%	1.26%	1.75%
Deferred Vested	0.49%	0.23%	0.18%
Refund of EE contributions	<u>0.47%</u>	<u>1.10%</u>	<u>0.57%</u>
Total	11.62%	19.30%	21.01%

Cost Impact of Pension Changes



- **Greatest savings**
 - Benefit multiplier
 - Retirement eligibility
 - COLAs
 - Eliminate lump sum pay in final average salary
- **Large savings**
 - Final average pay: longer period
 - Reduce disability benefits (public safety)
- **Small savings**
 - Longer period to vest
 - Lower interest on employee contributions
 - Reduce pre-retirement death and disability benefits (General)
 - More severe reduction in benefits for early retirement

Current Retiree Healthcare Plans



- Plans are about 40% funded
 - ARC has always been contributed
 - Closed amortization period (25 years)
 - Funding within the pension plan is limited by IRC §401(h)
- City cost of current retiree health benefits

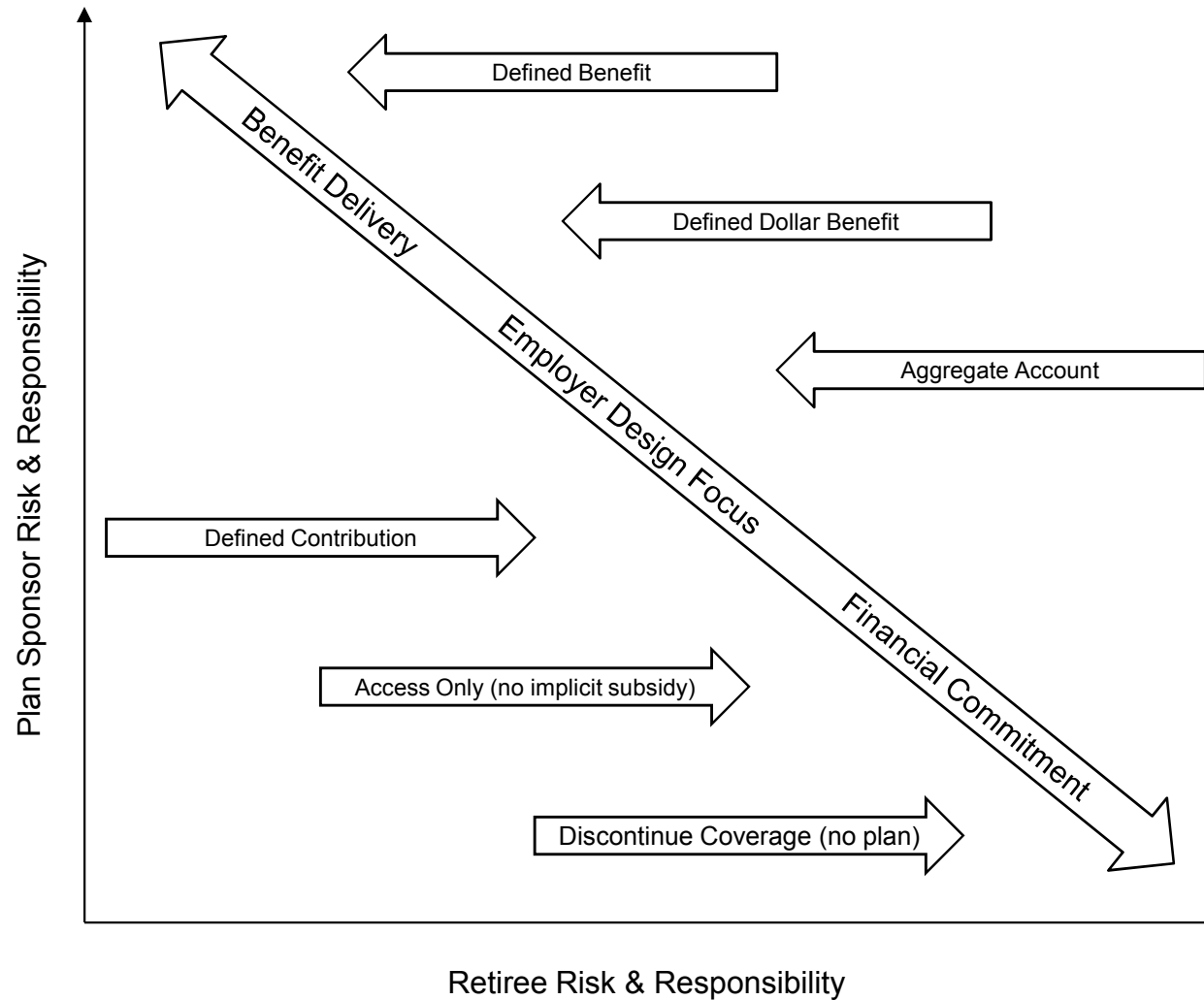
Normal Cost	General	Police	Fire
Retirement	2.74%	4.75%	5.23%
Death/disability	0.44%	0.32%	0.42%
Deferred Vested	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>
Total Normal Cost Rate	3.18%	5.07%	5.65%
UAAL Contribution Rate	<u>2.21%</u>	<u>4.10%</u>	<u>4.10%</u>
ARC Rate	5.39%	9.17%	9.75%
Employee Contribution Rate	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>
Employer ARC Rate	5.39%	9.17%	9.75%

Challenges Unique to Health Plan



- Current health plan costs and funding linked to external influences
 - Level of current benefit linked to health care inflation
 - Health plan cost trends continue to be significantly higher than price and wage inflation
 - Unpredictable
 - Retiree contributions not keeping pace (leveraging)
 - Level of current benefit linked to active employee health plan
 - Benefits (e.g., copays, deductibles, coinsurance)
 - Level of health plan funding linked to pension plan
 - 401(h) subordination limit

Continuum of Retiree Healthcare Plan Designs



Challenges Unique to Health Plan Plan Design Considerations



- Change healthcare plan for retirees
 - Increase cost sharing (e.g., co-pays, deductibles, coinsurance)
 - Change retiree contributions/subsidy amount
 - Cap subsidy
 - Defined dollar subsidy
 - Eliminate dependent subsidies
 - Eliminate implicit subsidy
 - Additional administrative efforts
 - Flight of healthier retirees with increase in cost

Challenges Unique to Health Plan Plan Design Considerations



- Tighten retiree healthcare benefit eligibility
 - Require a certain number of years of service to be eligible for healthcare benefit (e.g., 15 years of service)
- Plan access only
 - No explicit or implicit subsidies
- Discontinue retiree healthcare benefit
- Impact of pension changes
 - Pension eligibility
 - Will retiree healthcare be offered if DC or SDRS is elected for the pension plan?

Challenges Unique to Health Plan Alternative Plan Design Considerations



- Level of health plan funding linked to pension plan
 - Trust contribution limits may drive the design of the health benefits plan
 - Explore all qualifying funding options available
 - Need to consider requirements and limitations

Projected Value of Healthcare Benefit (\$) Year of Retirement - 2025



Age and YOS	Current Plan*		Proposed Changes	
	Retiree**	Spouse**	Current Employees	Future Employees
50/25	822	769	1,384	0
55/20	1,324	1,070	1,107	0
55/30	1,324	1,070	1,661	0
60/15	1,872	1,438	831	0
60/20	1,872	1,438	1,107	0
60/30	1,872	1,438	1,661	0
64/30	2,312	1,747	1,661	0

*Year 2025 net benefit cost projected using the assumptions of the 12/31/2010 valuation.

**Assumes a male retiree and a female spouse three years younger.

Proposed Changes: Current Members



- Current retirees: no changes
- Current employees
 - Increase employee contributions by 2% over a 2 year period beginning in 2014 for all groups
 - Eliminate access to the City's health plan effective January 1, 2014 and provide stipend to employees to purchase their own health insurance
 - \$40 per month per year of service until Medicare eligible (age 65)
 - Annual inflationary adjustment but not more than 3% per year
 - Benefit payable ONLY to employee/retiree (except for death while actively employed where surviving spouse is covered)
 - Need to determine status of benefit
 - Taxation
 - Administrative effort
 - Pension or OPEB
 - Trust/401(h) implications

Proposed Changes: Future Employees



- Future employees (hired on/after 1/1/13)
 - Increase employee contributions by 2% for all groups
 - Remove lump sum payments from the calculation of Final Average Salary for all groups
 - Increase normal retirement age for General Employees from current provisions of Rule of 85 (age plus service is at least 85) or age 60 with 5 years of service to age 60 with 30 years of service or age 65 with 5 years of service
 - Discontinue retiree healthcare benefits

Estimated Retiree Healthcare Savings in Over 30 Year Projection Period (\$M)



	General EEs	Firefighters	Police Officers	Total
Current Employees: eliminate access to City health plan and provide stipend of \$40 per month per year of service (to age 65)	\$43.8	\$25.9	\$31.0	\$100.7
Current Employees: provide a 3% inflationary adjustment to the \$40 stipend	(8.3)	(5.1)	(6.7)	(20.1)
Future Employees: eliminate retiree healthcare	51.1	23.4	27.5	102.0
All Proposed Changes Combined	86.6	44.2	51.8	182.6

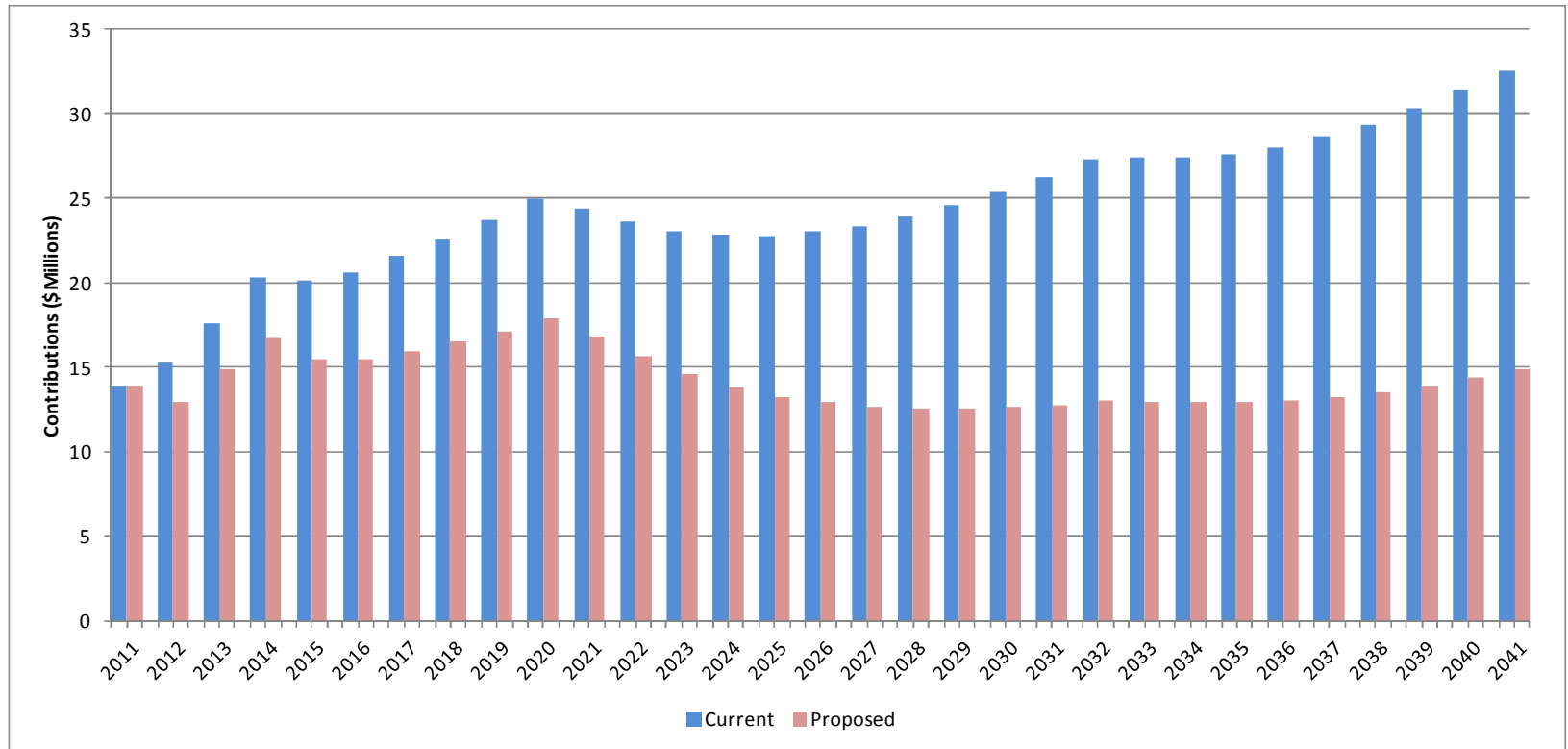
Estimated Pension Savings (\$M) Over 30 Year Projection Period



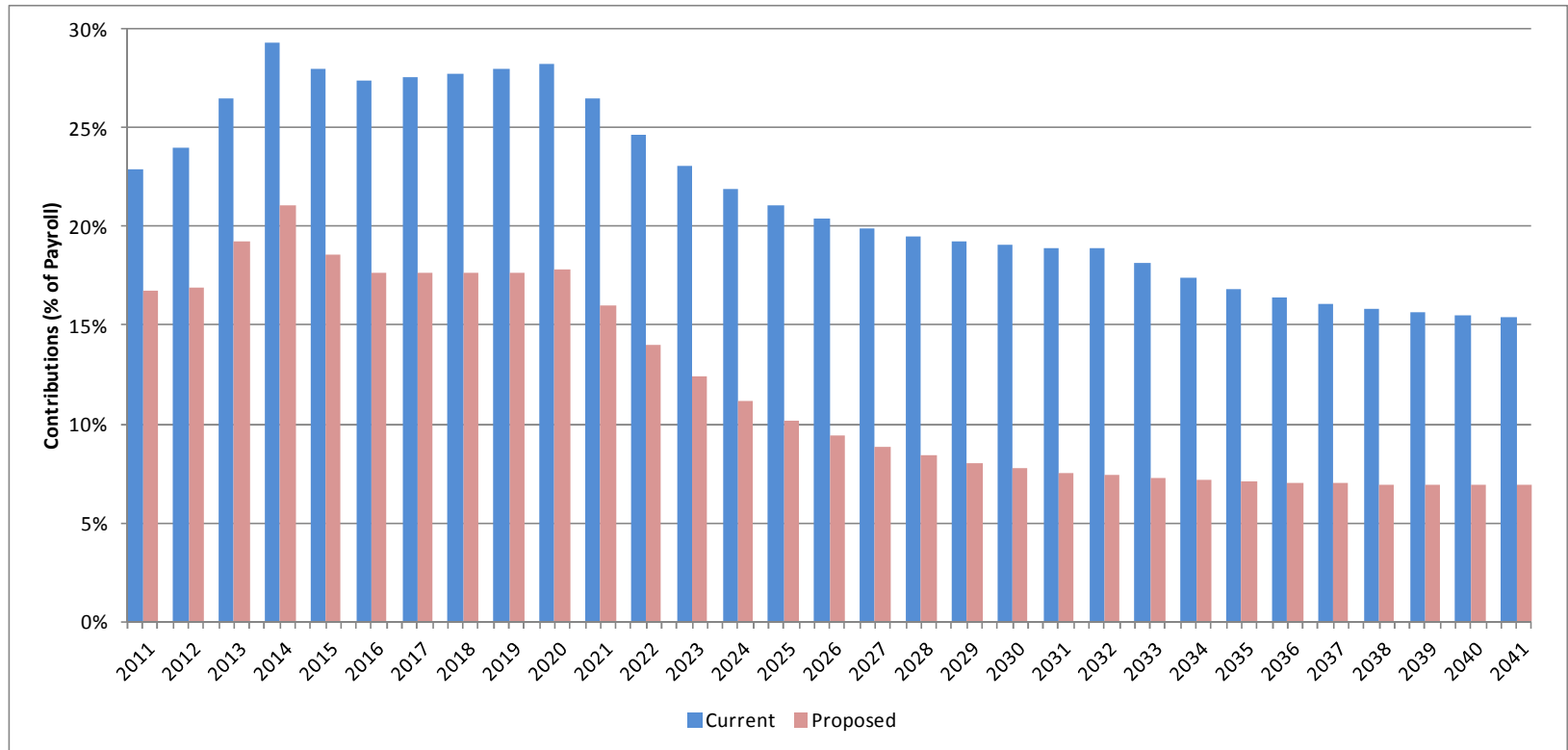
	General EEs	Firefighters	Police Officers	Total
Current Employees: increase contributions 2%	\$13.1	\$4.9	\$5.6	\$23.6
Future Employees:				
Increase contributions 2%	\$26.6	\$6.7	\$8.7	\$42.0
Remove lump sum from final average pay calculation	22.2	10.0	11.2	43.4
Increase normal retirement age to age 60 and 30 years of service or age 65 and 5 years	19.6	N/A	N/A	19.6
All Proposed Changes*	82.1	21.6	25.5	129.2

*Total savings are not necessarily additive.

Cost Impact of Proposed Changes over 30 Year Projection Period



Cost Impact of Proposed Changes over 30 Year Projection Period



Estimated Total Cost Savings Over 30 Year Projection Period (\$M)



	General EEs	Firefighters	Police Officers	Total
Current Retirees	\$0	\$0	\$0	\$0
Current Employees	48.6	25.7	29.9	104.2
Future Employees	120.1	40.1	47.4	207.6
All Employees	168.7	65.8	77.3	311.8



Appendix

Assumptions



- The projected cost savings provided are based primarily upon:
 - The 12/31/2010 replication valuation results prepared by CMC.
 - The actuarial assumptions used in the valuation.
 - The projection model prepared by CMC for the plan design study.
 - The membership data provided by the City for the December 31, 2010 actuarial valuation.
- To the extent actual experience deviates significantly from the assumptions, results may be significantly better or significantly worse than indicated. Significant items are noted on the following slides.



Assumptions

- 7.75% investment return in all future years.
- All demographic assumptions regarding mortality, disability, retirement, salary increases, and termination of employment are based upon the assumptions of the 12/31/2010 valuations and are assumed to hold true in the future.
- Estimates based upon an open group projection assuming the active member count remains the same (no increase or decrease).
- Plan provisions for future employees are modified as described. No other benefit changes are reflected in future years.



Assumptions

- The funding methods including the entry age normal cost method, the asset smoothing method and the amortization method remain unchanged.
 - Exception: Implementation of a five year floor on the amortization period in 2019 (pension) and 2031 (healthcare).
- The full actuarial contribution rate will be contributed in each future year.
- To maintain the comparability of scenarios, all retiree healthcare results have been prepared using total payroll (including new hire pay) and level percent of payroll amortization.



Assumptions

- As the proposed changes close the retiree healthcare plan to new entrants, the impact to savings may be altered by any changes to asset allocation or amortization methodology.
- The cost savings determined by the Systems' retained actuary may differ from those presented as different actuarial software will be used to perform the projections.

Retirement Design Strategy



- Determine goals and objectives
 - Reduce costs (what level?)
 - Stabilize costs (how much variation is acceptable?)
 - Is funded ratio a consideration?
- Retirement philosophy
 - Who should bear risk?
 - Importance of income security?
 - Career employee – how defined?
 - Which employees will be impacted by change?
 - Current retirees
 - Current actives(future service only)
 - Future hires

Retirement Design Strategy



- Attraction and retention of employees
 - Are retirement benefits important in attracting employees?
 - Are retirement benefits important in retaining employees?
 - Local marketplace competition for talent and importance of benefits
 - Future hires – what type of workers will be needed and what retirement program will attract and retain those employees
- Total compensation
 - Salary, retirement, health, life and other fringe benefits



Definition of Risks

➤ Investment Risk

- Rate of return on assets
- In DB plans, employer usually bears risk unless contribution increases are shared with employees
- In DC plans, employee bears all the investment risk

➤ Inflation Risk

- Cost of living before/after retirement
- DB plans are usually based on final average pay so employee has limited cost of living risk before retirement
- If post-retirement increases (COLA) are provided, employee has some protection against inflation in retirement



Definition of Risks

➤ Contribution Risk

- Level and volatility of annual contributions
- In DB plans, employer often bears this risk. At best, it is shared with employees
- In DC plans, contributions are a fixed percentage of salary. No volatility.
- If investment returns are low, employees have to make additional contributions to reach retirement goals.

➤ Longevity Risk

- Outliving your retirement assets
- DB: benefits paid as life annuity so plan bears risk
- DC: benefits based on account balance, so employee bears all risk.

EE/ER Risk Features of Different Plan Designs



Economic Risk	Current Defined Benefit		Pure Defined Contribution		Hybrid Plans	
	ER	EE	ER	EE	ER	EE
Investment Risk	High	Low	None	High	Medium	Medium
Inflation Risk – wage (pre-retirement)	High	None	None	High	Medium	Medium
Inflation Risk – price (post-retirement)	Medium	Medium	None	High	Low	Medium
Contribution Risk	High	Low	None	High	Medium	Medium
Longevity Risk	Medium	None	None	High	Low	Medium
Features						
Rewards older/longer service employees	High		Low		Medium	
Provides retirement security	High		Low		Medium	
Attract employees	Medium		High		High	
Retain employees	High		Low		Medium	
Provides systematic retirement of employees	High		Low		Medium	

Plan Design Considerations



- Risk components
 - Is it in the right place?
 - Can it be managed by the person bearing it?
 - Short term vs. long term risk (don't solve the short term problem and create a long term problem)
- Retirement Philosophy
 - Adequacy of benefits
 - Importance of benefit security
 - Purchasing power after retirement
- Funding Policy
 - Level of contributions
 - Stability
- Balance stakeholder concerns
 - Employer
 - Employee
 - Taxpayer

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Year-end Surplus Capital Strategies:

Task:

Investigate other municipalities and ascertain the policy or method of appropriating funds to specific city needs.

Lead Internal Auditor and Budget Analyst investigated separately. We found limited resources to tap regarding the subject. Of what we did find, opinions ranged from paying down debt, building reserves or addressing needs.

There was no common thread, policy or approach. Our research identified two reasons causing the limited information we were able to find. First, Capital Surplus is not common or at least unplanned Capital surpluses. Secondly, the economic climate, the financial strength of the city, capital needs can all play a role in determining the best use of the funds.

Our recommendations:

Finance

1. Finance provides a pro forma report estimating / forecasting any potential surplus or deficit.
2. Determine what month finance should begin presenting this view. (Earlier in the year does not make much sense.)

Mayor/Directors

1. If there is a high probability (?) a surplus is expected the Mayor enlists the Directors to provide a list of (?) projects that could/should be considered for funding.
2. The Director who champions the project could either:
 - a. Provide a synopsis of the project highlighting the need and benefits.
 - b. Present the project to the Council in a working session – this would allow dialogue and clear up misunderstandings and provide the knowledge to the council to make a well informed decision.

Council / Lead Internal Auditor/Budget Analyst

1. Establish a list of criteria that enables the council to rate projects in a standardized format.
2. The criteria scale will be weighted and standardized so all projects are measured similarly.
3. Each council member would rate the projects criteria factors using a scale of 1-4.
4. All council's scores would be consolidated and tallied resulting in each project having an overall weighted score.