CITY OF BROOKSVILLE
201 Howell Avenue
Brooksville, FL 34601

WORKSHOP AGENDA

December 11, 2012 **6:30 P.M.**

A. CALL TO ORDER

B. PENSIONS & RETIREMENT PLANS

Presentation on Pensions, providing an overview of pension plans, benefit levels, sustainability, and options. Discussion by Council on City Pension/Retirement plans, benefits and funding.

Presentation:	City Manager
Action:	Review & Direction to staff
Attachment:	General articles on Pensions/Pension Issues

C. ADJOURNMENT

WORKSHOP ITEM
MEMORANDUM

TO: HONORABLE MAYOR AND CITY COUNCILMEN

FROM: T. JENNENE NORMAN-VACHA, CITY MANAGER

SUBJECT: WORKSHOP – DISCUSSION ON PENSION & RETIREMENT PLANS

DATE: DECEMBER 6, 2012

On August 14, 2012 City Council met in a workshop setting to discuss City pension and retirement plans. Paul Shamoun, Account Executive, Department of Insurance & Financial Services, Florida League of Services provided general information about pension/retirement funds across the State and how other cities are responding to gain control of their funds for long-term sustainability.

Additionally, Patrick Donlon, Foster & Foster appeared before Council providing information specific to the City's 175 and 185 Chapter Retirement Plans.

Following presentations and discussion, City Council stated that they were interested in exploring benefit changes where there are concerns. Particular emphasis of discussion was the City's Chapter 175 and 185 plans. Council discussed looking at options, including possible changes to some of the current defined benefits, creating a "hybrid" plan for new hires/future, and/or other options. Council members indicated that they would like to work with the Police and Fire Pension Trust Boards. Council members stated that they wanted to continue discussions shortly after the new fiscal year.

We discussed that there are many things to consider from a short and long-term financial perspective, as well as legal and liability constraints. There is no "quick fix" and Council should develop a full understanding of any action that is brought forward for consideration.

Enclosed are materials to facilitate our discussions for the workshop. The materials center around four (4) areas:

1. General recent news on pension plans (FRS & Chapter Plans) across the State
   - A. Florida League of Cities "Pension Reform Now" Toolkit and associated position papers;
   - B. Florida League of Cities – Florida Pensions newletters, including April, August and October 2012;

C. "Tough Choices – Facing Florida's Governments, Years in the Making: Florida's Underfunded Municipal Pension Plans" from the Leroy Collins Institute and rebuttal memorandum issued by Klausner, Kaufman, Jensen and Levinson; and
D. Florida Retirement System (FRS) comparison of Actuarial Assets to Liabilities and Benefit Payments.

2. General recent news on pension plans across the Nation
   A. "The Great Recession: Pressures on Public Pensions, Reforms & Employment Relations" issued by the National Institute on Retirement Security;
   B. "State Retirement Plans for Public Safety Employees" issued by the National Conference of State Legislatures; and
   C. "Checklist of State Defined Benefit, Defined Contribution and Hybrid Plans for State Employees and Teachers" written by Ron Snell, National Conference of State Legislatures.

3. Brooksville's pension plans (some materials previously provided to City Council)
   A. City of Brooksville – Pension and Retirement Plans an overview provided for City Council workshop of August 14, 2012;
   B. Contributions for Brooksville's Pension and Retirement Plans for FY 2012-13 and rates if all employees were under FRS contribution rates;
   C. Historical Contributions for Brooksville's Pension and Retirement Plans; and
   D. Examples provided through the Leroy Collins Institute of governments with especially high pension costs.

4. Legal Constraints/Consideration
   A. City of Naples' Letter and the Florida Department of Management Services interpretation of the law on the use of insurance premium tax revenues; and
   B. "Issue Brief: Legal Constraints on Changes in State and Local Pensions" issued by the Center for State and Local Government Excellence.

5. Hybrid Plans
    A. "State Cash Balance, Defined Contribution and Hybrid Retirement Plans" issued by the National Conference of State Legislatures;
    B. "Hybrid Pension Plans Attracting More States, Cities" published in *Governing* magazine (and www.governing.com); and
    C. "Best Practice – Essential Design Elements of Hybrid Retirement Plans (2008) (COBRA)" issued by Governmental Finance Officers Association.

Staff will present and discuss information contained in the provided materials. Further we will seek specific direction on how City Council wants to proceed over the next several months leading into the budget process for fiscal year 2013-14.

Attachment 1-A

PENSION
REFORM
NOW!

Pension Reform Advocacy Kit

Florida League of Cities

Dear League Member,

State mandated pension benefits for local police and firefighters are hurting our ability to provide services to our local citizens. Tallahassee lawmakers insist on supporting union-driven initiatives that meddle in local pension and benefit negotiations.

We must stand together to bring sensible fiscal reforms to local city police and firefighter pensions...for the future of our communities and to secure our ability to provide fair compensation and benefits to future police and firefighters.

In the coming weeks, the Florida League of Cities will develop a comprehensive legislative strategy that seeks to return common sense and sustainability to local pensions, and it starts with YOU.

WE ARE ASKING YOU TO DO TWO THINGS:

1. *Please take the time – in the very near future – to meet with your state legislative delegation and explain why these reforms are necessary for Florida's future.*
2. *Encourage your city to pass a resolution in support of real pension reform. We have included the following sample resolutions for your convenience: a short and long version specifically relating to chapters 175 and 185 F.S. (for police and fire pension plans), and a resolution dealing with the general topic of unfunded mandates.*

If your city passes a resolution, please send a copy of it to your local legislative delegation and to Allison Payne at apayne@flcities.com.

Thank you.

KEY MESSAGES FOR LAWMAKERS

When meeting with Florida lawmakers please stress the following points:

- **We respect the work of our local police and firefighters.** First and foremost, we respect, admire and appreciate our local police and firefighters. We also want them to have good salaries and sensible benefit packages for a long time to come.
- **Union driven pension mandates are hurting our future.** We care about the future and we care about our police and firefighters. If we are to have a sustainable future, state lawmakers *must* roll-back union-driven initiatives that force taxpayers to pay far more than negotiated wage and benefit packages.
- **State required benefits help unions, hurt taxpayers.** Local unions already have collective bargaining rights – let's respect those rights. The pro-union initiatives supported by *state* lawmakers undermine local contract negotiations, drive up costs and put upward pressures on taxes.
- **Multiple Constitutional Amendments have hurt our ability to meet pension demands.** Beginning with Amendment 1 in 2008, lawmakers have put a series of Amendments in our State Constitution that severely restrict local governments' ability to meet the rising pension demands forced upon us by those same lawmakers. Enough is enough! We need to work together to lower taxes, roll back union-mandated pension benefits, and bring fiscal common sense to local pension systems.
- **We need to end state meddling in local decisions.** Local pension plans are negotiated locally and are paid by local taxpayers, using local tax dollars. State lawmakers and local officials need to work together to end the state's meddling in local affairs and find a way to bring sensible reform to union-driven pension demands that are unsustainable and unworkable.

KEY MESSAGES FOR THE PUBLIC

Safeguarding local police and firefighter pensions is a critical issue for Florida's 410 cities, towns and villages. Union driven police and firefighter pension mandates imposed on municipalities by past lawmakers in Tallahassee are driving costs up. Reversing state level police and fire union influence and past legislative meddling is required to safeguard local pensions, protect taxpayers and allow needed reforms.

The current taxpayer-funded pension system is unstable, unsustainable and unreliable for future police officers and firefighters. The time has come to fix the system by implementing responsible reform that protects pensions for the future.

The pension issue is incredibly complicated. It is important to communicate the concerns of Florida's municipalities in a way that is easy for people to understand and framed appropriately to win the public policy debate.

Under the umbrella "pension reform now" message, key supporting message elements include:

- **Respect the work of police officers and firefighters – and protect taxpayers.**
- **Identify how the current pension system is unsustainable, unsound and subject to potential abuse.**
- **Identify the current problems exacerbated by state level police and fire union activities and actions by past legislatures.**
- **Support responsible reforms that stop pension abuse, protect pensions so they will be there for future generations of police officers and firefighters and safeguard taxpayer dollars.**

This messaging approach is supported by scientific research that shows when it comes to police and firefighter pensions, Floridians are most concerned by issues related to safeguarding tax dollars, reducing state level police and fire union influence with the state legislature, and preventing specific pension abuses, like the disability determination and those who retire and make a large sum of money at an early age.

Research shows our most effective messages must communicate support for these key elements:

- Safeguarding tax dollars.
- Reducing state level police and fire union influence.
- Stopping specific abuses of the system.
- Enacting responsible reforms to protect pensions for future generations.

These are the strongest points to make to win the debate and bring people to our side of the issue.

In this messaging, we are positioned to be advocates for responsible pension reform that curbs abuse in the system and puts the system on a more stable footing for the future.

The bottom line is, **we support well-deserved pensions for police and firefighters that are sound, secure and sustainable – not only for current officers and firefighters, but for those who choose to protect and serve in the future.**

SHORT VERSION: DRAFT RESOLUTION ON POLICE AND FIREFIGHTER PENSION AND DISABILITY PRESUMPTION REFORMS

2012-______

A RESOLUTION OF THE [CITY/TOWN/VILLAGE OF_______] SUPPORTING POLICE OFFICER AND FIREFIGHTER PENSION PLAN AND DISABILITY PRESUMPTION REFORMS TO MAKE THE PLANS SUSTAINABLE, SOUND AND SECURE FOR CURRENT AND FUTURE POLICE OFFICERS AND FIREFIGHTERS.

(Please add any additional information specific to the City/Town/Village)

WHEREAS, to honor their service now and in years to come, current and future police officers and firefighters in the [City, Town, Village of _______] deserve pension plans that are sound, secure and sustainable; and

WHEREAS, [City, Town, Village of _______] opposes unfunded mandates from the Florida Legislature that have created a pension plan system for city police officers and firefighters that is unstable, unsustainable and unreliable for current and future police officers and firefighters; and

WHEREAS, state level police and fire unions have exercised undue influence on the Florida Legislature relating to the provision of city police officer and firefighter pensions and disability presumptions; and

WHEREAS, the Florida Legislature has imposed significant unfunded mandates onto the [City, Town, Village] relative to the operation of the [City's, Town's, Village's] police officer and firefighter defined benefit pension plans by mandating minimum pension benefit levels and mandating the use of revenues to fund pension plan costs; and

WHEREAS, unfunded city police officer and firefighter pension mandates from the Florida Legislature result in a direct expenditure of local taxpayer dollars without the benefit of local taxpayer input; and

WHEREAS, the Florida Legislature has provided that health conditions related to heart disease, hypertension or tuberculosis suffered by a police officer or firefighter are presumed to be job related, and these "disability presumptions" are applicable to both workers' compensation and disability pension claims; and

WHEREAS, the Florida Legislature has written and the courts have interpreted the disability presumption laws so favorably toward these employees that cities and other government employers basically cannot overcome the presumption and show the health condition was not work related; and

WHEREAS, the Florida Legislature transferred all operational and administrative control of police and firefighter pension plans from the [City/Town/Village] to a legislatively created board of trustees, a separate legal entity apart from the [City, Town, Village] that exercises broad powers outside the [City's/Town's/Village's] control, and is not required to provide fiscal transparency or accountability for substantial amounts of public funds; and

WHEREAS, the [City, Town, Village] is seeking immediate mandate relief from the Florida Legislature and requests the Legislature to untie its hands so that it can responsibly address its pension and other personnel issues locally and in a manner that best serves its taxpayers, stops potential pension abuse and protects pensions for current and future generations of police and firefighters.

NOW, THEREFORE, BE IT RESOLVED BY THE [COUNCIL/COMMISSION] OF THE [CITY/TOWN/VILLAGE OF ________], FLORIDA:

Section 1. That the [City/Town/Village] hereby supports responsible police and firefighter defined benefit pension and disability presumption reforms to ensure sound, secure and stable pensions will be there for current and future police and firefighters.

Section 2. That the [City/Town/Village] believes local issues should be addressed locally and hereby requests the Florida Legislature to remove itself from the local collective bargaining process between the [City/Town/Village] and its police and firefighters.

Section 3. That the [City/Town/Village] hereby requests the Florida Legislature to remove mandates establishing minimum pension benefit standards for police and firefighter pensions, remove the requirement to provide new, extra pension benefits to police and firefighters, and allow the [City/Town/Village] to use insurance premium tax revenues to pay for the level of pension benefits for police and firefighters that meets the needs and priorities of the [City/Town/Village].

Section 4. That the [City/Town/Village] hereby requests the Florida Legislature to enact responsible reforms to bring a fairer balance to the application of disability presumption laws relating to certain health conditions suffered by firefighters and police officers by allowing a disability presumption to be overcome by a preponderance of the evidence, and allowing certain individual risk factors to be considered when applying a disability presumption, such as tobacco or alcohol use, weight and diet, genetics and lifestyle choices.

Section 5. That the [City/Town/Village] hereby requests the Florida Legislature to impose reasonable fiscal transparency and accountability standards on legislatively created police and firefighter pension boards of trustees.

Section 6. That the [City/Town/Village] urges the Florida Legislature to pass and the Governor to approve the above responsible reform recommendations relating to police and firefighter pension plans and disability presumptions in the 2013 legislative session.

Section 7. That the [City/Town/Village] Clerk is directed to transmit a copy of this resolution to Governor Rick Scott, the Florida Legislature, and the Florida League of Cities, Inc.

Section 8. That this resolution shall be effective upon adoption.

PASSED IN OPEN AND REGULAR SESSION OF THE [CITY COUNCIL/ COMMISSION OF THE CITY/TOWN/ VILLAGE OF ________], FLORIDA, THIS __________ DAY OF _________, 2012

LONG VERSION: DRAFT RESOLUTION ON POLICE AND FIREFIGHTER PENSION AND DISABILITY PRESUMPTION REFORMS

2012-______

A RESOLUTION OF THE [CITY/TOWN/VILLAGE OF_______] SUPPORTING POLICE OFFICER AND FIREFIGHTER PENSION PLAN AND DISABILITY PRESUMPTION REFORMS TO MAKE THE PLANS SUSTAINABLE, SOUND AND SECURE FOR CURRENT AND FUTURE POLICE OFFICERS AND FIREFIGHTERS.

(Please add any additional information specific to the City/Town/Village)

WHEREAS, the [City/Town/Village] deeply honors and respects the services provided and sacrifices made by police officers and firefighters, and desires to provide current and future police officers and firefighters with a pension system that is sound, sustainable and reliable. The [City/Town/Village] also desires to protect local taxpayers from unsustainable and unsound pension levels, and remove undue state level police and fire union influence and past legislative meddling with local police and firefighter pensions. The [City/ Town/Village] supports responsible reforms that protect pensions so they will be there for future generations of police officers and firefighters and safeguard taxpayer dollars; and

WHEREAS, a priority of the [City/Town/Village] is for the Florida Legislature to address numerous legislative actions it has taken throughout the past 40 years relating to the [City's/Town's/Village's] police and firefighter defined benefit pension plans. These actions have had significant negative fiscal impacts on the [City/Town/Village] and its taxpayers. The legislative reforms the [City/Town/Village] is seeking do not provide cities with a "hand-out" from or a "bail-out" by the Legislature relative to police and firefighter pensions. Rather, the [City/Town/Village] seeks reasonable and responsible changes to state law to "level the playing field" and allow cities to determine and implement police and firefighter pension reform at the local level; and

WHEREAS, in 2011, the Florida Legislature passed SB 1128, which took important initial steps in reforming city police and firefighter defined benefit pension plans. The legislation addressed several issues, including prohibiting "spiking" of pension benefits by restricting the use of overtime and unused sick or annual leave payments for pension purposes; and creating a task force to study issues with various disability presumptions for firefighters and police and corrections officers. Importantly, the 2011 bill did not address the 1999 legislative mandate to perpetually provide "extra" pension benefits to police and firefighters with insurance premium tax revenues; and

WHEREAS, prior to 1999, cities were largely free to bargain with local police and firefighter unions, or provide for the non-unionized police and firefighters, the pension benefits that best fit the priorities and needs of the city and its police and firefighters. In 1999, the Florida Legislature amended Chapters 175 and 185, Florida Statutes, relating to city police and firefighter defined benefit pensions to require that additional city insurance premium tax revenues (taxes on property and casualty insurance premiums) over a base amount be used to provide only "extra" pension benefits to police officers and firefighters. An "extra" pension benefit is a pension benefit that must have been given to police and firefighters after 1999 and the benefit must be greater than a pension benefit provided to general city employees. In aggregate numbers, this mandate has required cities and city taxpayers to provide more than $520 million in new "extra" pension benefits to police officers and firefighters since 1999. This mandate to keep providing "extra" pension benefits is not sustainable, rather the [City/Town/Village] needs the flexibility to use insurance premium tax revenues for the current or a decreased level of police and firefighter pension benefits to meet the [City's/Town's/Village's] budget constraints. Only the Legislature can remove the state mandate for cities to perpetually provide new, "extra" pension benefits to police and firefighters; and

WHEREAS, due to severe budget constraints and rapidly increasing personnel costs, the [City/Town/Village] has attempted to reduce pension costs for general employees, police and firefighters. Numerous cities have successfully reduced pension benefit costs for general employees, but current state laws restrict the ability of cities to reduce pension benefit levels for police and firefighters. Until very recently, the state Department of Management Services ("DMS") required city police and fire pension benefit levels to remain at or above the pension benefit levels in place in 1999 (many cities provided a high level of police and fire pension benefits in 1999). Add to this requirement the requirement for cities to provide "extra" pension benefits to police and firefighters, and the unsustainability of this scheme becomes evident. If a city either reduced a police or firefighter pension benefit to a level below the 1999 level or failed to provide "extra" pension benefits, the pension plan would violate state law and the city would forfeit all insurance premium tax revenues. Thus, when cities have attempted to bring police and fire pension costs under control, their actions have been effectively blocked by the DMS; and

WHEREAS, the Florida Legislature has provided that health conditions relating to heart disease, hypertension or tuberculosis suffered by a firefighter, law enforcement officer or correctional officer are presumed to be job related. These "disability presumptions" are applicable to both workers' compensation and disability pension claims and have introduced significant opportunities for abuse in the police and firefighter pension system. Courts have interpreted the presumption laws so favorably toward these employees that cities and other government employers basically cannot overcome the presumption and show the health condition was not work related. This means the state, counties and cities may be inappropriately incurring workers' compensation and disability pension expenses. On January 1, 2012, a state Task Force on Public Employee Disability Presumptions issued findings and recommendations to the Legislature. Changes to presumption laws supported by a majority of Task Force members include: providing the presumption may be overcome by a preponderance of evidence; and allowing certain individual risk factors to be considered when applying the presumption, such as tobacco or alcohol use, weight/diet, genetics and lifestyle choices. These recommendations are designed to bring a fairer balance to the application of presumption laws. It is important to remember that just because an individual does not have a disability presumption does NOT mean he or she cannot make a workers' compensation or disability pension claim. Rather, it just means that the individual must show the health condition is work related, just like every other employee who makes a workers' compensation or pension claim; and

WHEREAS, beginning in 1986, the Florida Legislature transferred all operational and administrative control of city police and firefighter defined benefit pensions to legislatively created boards of trustees. These boards of trustees run afoul of local control and are separate legal entities apart from a city that exercise broad powers outside a city's control, such as directing all investments of the pension fund; hiring plan attorneys, actuaries and other professionals; and making regular and disability pension determinations. In spite of being legislatively created entities and not locally controlled, all costs and expenses, including investment losses, incurred by the boards of trustees of pension plans ultimately become a cost to the city because the city is responsible for paying for all pension benefits. Additionally, boards of trustees are not required to provide fiscal transparency or accountability for substantial amounts of public funds.

NOW, THEREFORE, BE IT RESOLVED BY THE [COUNCIL/COMMISSION] OF THE [CITY/TOWN/VILLAGE OF ________], FLORIDA:

Section 1. That the [City/Town/Village] hereby supports responsible police and firefighter pension and disability presumption reforms to ensure sound, secure and stable pensions will be there for current and future police and firefighters.

Section 2. That the [City/Town/Village] hereby requests the Florida Legislature to remove the state mandate for cities to perpetually provide new, "extra" pension benefits to police and firefighters with insurance premium tax revenues provided under Chapters 175 or 185, Florida Statutes.

Section 3. That the [City/Town/Village] hereby requests the Florida Legislature to allow cities to transition to other retirement or pension programs for police and firefighters and continue to receive insurance premium tax revenues to pay for the retirement expenses.

Section 4. That the [City/Town/Village] hereby requests the Florida Legislature to amend current statutory disability presumptions for firefighters, law enforcement officers and correctional officers relating to health conditions caused by tuberculosis, heart disease or hypertension to allow the presumption to be overcome by a preponderance of evidence, and allow certain individual risk factors to be considered when applying the presumption.

Section 5. That the [City/Town/Village] hereby requests the Florida Legislature to require statutorily created police and firefighter pension boards of trustees to adopt and operate under an administrative expense budget, and require a detailed accounting of pension boards of trustees' expenses.

Section 6. That the [City/Town/Village] hereby requests the Florida Legislature to require police and firefighter pension boards of trustees and cities to work together for a fiscally responsible distribution of plan assets if a city must terminate its police or firefighter retirement plan.

Section 7. That the [City/Town/Village] urges the Florida Legislature to pass and the Governor to approve the above responsible reform recommendations relating to police and firefighter pension plans and disability presumptions in the 2013 legislative session.

Section 8. That the [City/Town/Village] Clerk is directed to transmit a copy of this resolution to Governor Rick Scott, the Florida Legislature, and the Florida League of Cities, Inc.

Section 9. That this resolution shall be effective upon adoption.

PASSED IN OPEN AND REGULAR SESSION OF THE [CITY COUNCIL/ COMMISSION OF THE CITY/TOWN/ VILLAGE OF ________], FLORIDA, THIS __________ DAY OF _________, 2012.

DRAFT RESOLUTION
OPPOSING UNFUNDED STATE MANDATES ON CITIES

2012-_____

A RESOLUTION OF THE [CITY/TOWN/VILLAGE OF _______]
OPPOSING UNFUNDED STATE MANDATES ON CITIES.

WHEREAS, the [City/Town/Village of ________] is concerned with the negative impacts unfunded state mandates have on the services provided by cities and with the fiscal impacts they have on local taxpayers; and

WHEREAS, an unfunded state mandate is generally defined as a state law requiring a city to spend funds or to take an action requiring the expenditure of funds without the state providing an adequate funding source; and

WHEREAS, unfunded state mandates continuously force cities to adjust local service priorities and raise local taxes and fees to pay for such unfunded mandates; and

WHEREAS, cities are forced to pass the increased costs associated with unfunded state mandates to the citizens and taxpayers of the city; and

WHEREAS, the priorities and programs of local citizens of cities are often curtailed when limited local funds must be diverted to pay for unfunded state mandates; and

WHEREAS, unfunded state mandates are not fair to local property owners or elected city officials who are trying to address local priorities and problems with a limited amount of financial resources; and

WHEREAS, prior to 1990 the state legislature passed hundreds of unfunded state mandates on to cities; and

WHEREAS, the citizens of Florida passed a state constitutional amendment in 1990 to limit the ability of the state legislature to pass unfunded state mandates on to cities (Article VII, Section 18, Florida Constitution); and

WHEREAS, even with the 1990 state constitutional amendment to limit unfunded state mandates, the state legislature continues to pass unfunded mandates under various exceptions to the law; and

WHEREAS, the following unfunded state mandates serve as examples of mandates cities across the state are required to comply with or to fund:

- Police Officer and Firefighter Pensions, Chapters 175 and 185, F.S. In 1999, the state legislature mandated that cities use any increases in insurance premium tax revenues to provide additional, "extra pension benefits" in police officer and firefighter pension plans. These extra benefits are in addition to benefits already provided. In aggregate numbers, it is estimated that cities have had to provide over $500 million in "extra pension benefits" to firefighters and police officers since 1999.
- Workers' Compensation and Disability Pensions, Section 112.18, F.S. This mandate establishes a disability presumption for firefighters and police officers who suffer any health condition caused by hypertension or heart disease. The presumption is that the condition occurred because of the job and the legal presumption is nearly impossible to overcome. This mandate has dramatically increased city funding requirements relating to workers' compensation and disability pensions.
- Group Health Insurance – Section 112.0801, F.S., requires cities, and other governments, to offer subsidized health, hospitalization and other insurance coverage to city retirees. This is a significant mandate, as it requires governments to offer their retirees health and hospitalization insurance at artificially low rates to the retiree, thereby making the employer pay the difference.

- Environmental Regulation – Chapter 403 includes numerous state mandates to cities in the area of environmental regulation. Section 403.064, F.S., requires cities applying for a permit for a domestic wastewater treatment facility to prepare a water reuse feasibility study. Cities must implement water reuse, if feasible, and prepare an annual water reuse report to the Department of Environmental Protection. Section 403.067 is a joint state and federal mandate that requires cities to reduce nonpoint source pollution reductions from stormwater runoff and septic tanks. The cost of retrofits for stormwater alone is estimated in the hundreds of millions. Section 403.0891 requires cities to develop a stormwater water management program within their comprehensive plans. Section 403.702 requires cities to plan and provide solid waste management and requires them to determine the "full cost" for providing resource recovery, recycling and disposal. This section also requires cities to develop and implement recycling programs.
- State Building Code – Chapter 553, Part IV, F.S., requires each city to adopt and enforce the state building code. Cities must use employees "certified" by the state to enforce the code. Cities must also add a "surcharge" to every building permit, which is used by the state to oversee the enforcement of the codes.
- Effective Public Notice – various Florida statutes require cities to purchase ad space in newspapers as the only method of meeting public notice requirements, even when equally effective and lower cost alternatives are available.
- Agency Rules – State agencies often propose rules that have significant fiscal impacts on cities. Recent examples include irrigation rules proposed by various water management districts, energy efficient land use rules and "need" based population analysis rules. In many instances cities must file administrative challenges just to get the agency to reconsider or reduce the fiscal impact.
- Consultants Competitive Negotiations Act – Section 287.055, F.S., requires a city to proceed through an extensive selection and negotiation process when it retains architects, engineers, landscape architects, or surveyors and mappers. Bids are based on qualification with no consideration of cost.

WHEREAS, the [City/Town/Village of ________] requests the state legislature to make reasonable and responsible changes to current state laws to eliminate existing unfunded state mandates on cities, and further requests the state legislature to honor the intent of the 1990 state constitutional amendment restricting unfunded state mandates and not pass any unfunded state mandates in the future.

NOW, THEREFORE, BE IT RESOLVED BY THE [COUNCIL/COMMISSION] OF THE [CITY/TOWN/VILLAGE OF ________], FLORIDA:

Section 1. That the [City/Town/Village of ________] hereby requests the Florida Legislature to make reasonable and responsible changes to current laws to eliminate existing unfunded state mandates on cities.

Section 2. That the [City/Town/Village of ________] hereby requests the Florida Legislature to honor the intent of the 1990 state constitutional amendment restricting unfunded state mandates and not pass any unfunded state mandates on cities in the future.

Section 3. That the [City/Town/Village of ________] urges the Governor to approve any legislation making reasonable and responsible changes to current state laws to eliminate existing unfunded state mandates on cities.

Section 4. That the [City/Town/Village of ________] Clerk is directed to transmit a copy of this resolution to Governor Rick Scott, the Florida Legislature, and the Florida League of Cities, Inc.

Section 5. That this resolution shall be effective upon adoption.

PASSED IN OPEN AND REGULAR SESSION OF THE [COUNCIL/COMMISSION OF THE CITY/TOWN/VILLAGE OF __________] , FLORIDA, THIS __________ DAY OF ____________, 2012.

PLEASE PROVIDE A COPY OF YOUR CITY'S ADOPTED RESOLUTION TO:

Speaker of the House
The Honorable Will W. Weatherford
Florida House of Representatives
420 Capitol
402 S. Monroe Street
Tallahassee, FL 32399

Senate President
The Honorable Don Gaetz
Florida Senate
409 Capitol
404 S. Monroe Street
Tallahassee, FL 32399

Please also provide a copy of your city's adopted resolution to your House and Senate delegations. Follow the links below to find contact information for your House/Senate members.

House of Representatives
http://www.myfloridahouse.com/Sections/Representatives/representatives.aspx

Senate
http://www.flsenate.gov/Senators/

Please also provide a copy to:
Allison Payne
Florida League of Cities
Fax (850) 222-3806 or
E-mail: apayne@flcities.com

301 South Bronough Street • Suite 300 • P.O. Box 1757 • Tallahassee, FL 32302-1757 • (850) 222-9684 • Fax (850) 222-3806 • www.floridaleagueofcities.com

Use of Insurance Premium Tax Revenues for City Police and Firefighter Defined Benefit Pensions under Chapters 175 and 185, Florida Statutes

The state Legislature, beginning in the 1930s, encouraged cities to create and operate police and firefighter pensions pursuant to chapters 175 (fire) and 185 (police), Florida Statutes, by allowing cities to impose an insurance premium tax to pay for the pension benefits. The tax is applied to the premium for property and casualty insurance policies covering properties within a city, and currently over 200 cities impose the tax to help pay for their police and firefighter pensions. Chapters 175 and 185 require the provision of defined benefit pensions.

City police and firefighter pensions are funded from four primary sources: insurance premium tax revenues; employee contributions; earnings on pension fund investments; and employer contributions. By law, the city is ultimately responsible for all pension plan assets and liabilities (pensions to retirees), and is required to fund pension plans on a sound actuarial basis.

Prior to 1999

Prior to 1999, cities were largely free to bargain with local police and fire unions, or provide for the non-unionized police and firefighters, the pension benefits that best fit the priorities and needs of the city and its police and firefighters. Cities were required to use insurance premium tax revenues for "extra pension benefits" for police and firefighter defined benefit pension plans operating under chapters 175 and 185. "Extra pension benefit" was defined at that time to mean pension benefits for police/fire that were in addition to or greater than the pension benefits provided to general employees of the city. Therefore, prior to 1999, cities were restricted in using insurance premium tax revenues to pay for only the incremental cost of police and fire pension benefits that exceeded the pension benefit levels given to general employees of the city.

Also, prior to 1999, cities were not required to meet the minimum pension benefit levels established in chapters 175 and 185. A few cities operated what are known as "Chapter Plans," which provide pension benefits at the set minimum levels in chapters 175 and 185. However, the vast majority of cities participating in chapters 175 and 185 are known as "local law plans," and these plans provided various pension benefits with some benefits not meeting the minimum benefit levels and other benefits exceeding the minimum benefit levels. For example, prior to 1999, a city may have provided a 3% accrual rate rather than the chapter minimum accrual rate of 2%; however, the city may not have met another chapter minimum benefit such as a minimum retirement age of 52 with 25 years of service. Finally, prior to 1999, cities could use insurance premium tax revenues as a funding source for their police and firefighter pension plans even if those plans did not meet all of the minimum benefit levels in chapters 175 and 185.

1999 State Legislation

The state Legislature in 1999 fundamentally changed how cities provide and pay for police and fire pensions under chapters 175 and 185. The 1999 law requires all plans operating under chapters 175 and 185, including "local law plans," to meet all the minimum pension benefit levels in chapters 175 and 185, regardless of if some existing pension benefits exceeded various minimum benefit levels. Cities received no recognition, or set-off, under the 1999 law if some of their pension benefit levels exceeded the chapter minimum benefit levels; rather, cities, typically operating under three year collective bargaining agreements, had to maintain the existing excess benefit levels and also increase all other benefit levels to at least the chapter minimum levels.

The 1999 law also substantially revised how cities use insurance premium tax revenues in providing "extra pension benefits" to police and firefighters. While the legislation did not change the definition of "extra pension benefit" (pension benefits given to police/fire greater than pension benefits given to general employees), the state Department of Management Services ("DMS") immediately imposed an interpretation that to be an "extra pension benefit" the benefit not only had to exceed the pension benefit level given to general employees but it also had to have been provided to police/fire after March 12, 1999 (the effective date of the 1999 law).

The 1999 law made a distinction between the amount of insurance premium tax revenues generated prior to 1997 and the amount generated after 1997. The law defined a new term of "addition premium tax revenues" to mean insurance premium tax revenues received by a city that exceed the amount received for calendar year 1997. Until very recently, the DMS "inaccurately" interpreted the provisions of chapters 175 and 185 to require cities to use additional premium tax revenues to meet any minimum pension benefit levels that the plan did not already meet (in 1999 various city police and fire pension plans did not meet all of the minimum pension benefit levels of chapters 175 and 185). (The DMS's new interpretation is discussed below). Then, under the previous interpretation, once the minimum pension benefit levels were met, any subsequent additional insurance premium tax revenues were required to be used to provide "extra pension benefits." As noted above, an "extra pension benefit" must be a pension benefit in excess of a pension benefit level provided to general city employees, and the "extra pension benefit" must have been provided to police/fire after March 12, 1999. In 2004, the Legislature amended the definition of "extra benefit" to include the DMS's interpretation that to be an extra pension benefit the benefit has to have been provided to police/fire after March 12, 1999.

The distribution of city insurance premium tax revenues for the year 1997 amounted to approximately $70 million. This amount is typically referred to as the "base year" amount, and represents an amount of money that cities may use to pay for the level of police/fire pension benefits in existence prior to March 12, 1999. Under the DMS's previous interpretation, any amounts over the $70 million generated in future years had to have been used to meet any minimum pension benefit level that was not already met by the pension plan, and once all minimum pension benefit levels were met, any additional increases in insurance premium tax revenues had to have been used to provide new, "extra" pension benefits to police and firefighters. The 1999 law did not specify what "extra" pension benefits had to be provided to police/fire, rather this determination has been left to the local collective bargaining process. In aggregate numbers, this state law mandate has required cities and city taxpayers to provide more than $520 million in new, "extra" pension benefits to police and firefighters since 1999. (Please see the attached chart for the yearly amounts of insurance premium tax revenues mandated to be used for "extra pension benefits.")

Cities Attempting To Reduce Pension Benefit Costs

Because of ongoing severe budget constraints and rapidly increasing personnel costs, cities have attempted to reduce pension costs for general employees, police and firefighters. Numerous cities have successfully reduced pension benefit costs for general employees, but current state laws restrict the ability of cities to reduce pension benefit levels for police and firefighters.

Until recently, the DMS required city police and fire pension benefit levels to remain at or above the pension benefit levels in place in 1999. Add to this requirement the requirement over the past 12 years for cities to provide "extra" pension benefits to police and firefighters, and the unsustainability of this scheme becomes evident. If a city either reduced a police or firefighter pension benefit to a level below the 1999 level or failed to provide "extra" pension benefits, the pension plan would violate state law and the city would forfeit all insurance premium tax revenues. Thus, when cities attempted to bring police and fire pension costs under control, their actions were effectively blocked by the DMS.

Recent Department of Management Services Interpretation

Beginning with an August 14, 2012, letter to the City of Naples (with subsequent letters to other cities), the state Department of Management Services ("DMS") has acknowledged that its previous interpretation of the law on the use of insurance premium tax revenues "appears inaccurate." The letters provide a substantially different interpretation of the 1999 law, with the interpretation following the precise language in chapters 175 and 185.

The letters provide that the DMS previously interpreted the 1999 law to mean that in order for a city to receive any insurance premium tax revenues it had to provide the chapter minimum benefits to police/fire and it had to preserve benefit levels in place on March 12, 1999. However, in reviewing the law again, the DMS states "this interpretation appears inaccurate."

Quoting directly from chapters 175 and 185, the letters provide: "The law actually states that local law plans in effect on October 1, 1998, like the (city's), 'must comply with the minimum benefit provisions of this chapter only to the extent that additional premium tax revenues become available to incrementally fund the cost of such compliance' (emphasis in the letters)." The letters continue to provide that the phrase "only to the extent that" qualifies the law's requirement that local law plans "comply with the minimum benefit provisions" of either chapter 175 or 185. This qualification means that, for local law plans in effect on October 1, 1998, the law compels them to provide chapter minimum benefits only to the extent that such benefits can be funded with "additional premium tax revenues." Additional premium tax revenues are defined as revenues "which exceed the amount received for calendar year 1997."

Thus, for local law plans in effect on October 1, 1998, the law states that chapter minimum benefits must be provided only to the extent that they can be funded with insurance premium tax revenues received in excess of the amount received for calendar year 1997. Once there are sufficient "additional premium tax revenues" to fund the chapter minimum benefits, the law states that any "subsequent additional tax revenues" must be used to fund "extra benefits." This subsequent additional tax revenue is the only amount earmarked for "extra benefits" for local law plans in effect on October 1, 1998.

The letters then state that if a city local law police or fire pension plan was in effect on October 1, 1998, the law allows the city to provide benefits below the chapter minimums and below those in effect on March 12, 1999, if there is insufficient "additional premium tax revenues" to fund the chapter minimum benefits. Once the city has sufficient additional premium tax revenues to provide all chapter minimum benefits, any subsequent additional premium tax revenues must then be used for extra benefits.

While not stated directly in the letters, the DMS basically provides that the yearly insurance premium tax revenues received by cities are to be divided into three separate "pots" for use.

Pot 1: The amount of insurance premium tax revenues equal to the amount the city received for 1997 (referred to as the "base-year" amount), which is to be used to pay for any police or fire pension plan benefit or cost.

Pot 2: The amount of insurance premium tax revenues in excess of the "base-year" amount (referred to as "additional premium tax revenues"), which is to be used to pay for the chapter 175 or 185 minimum benefit levels. If there are insufficient additional premium tax revenues to pay for the chapter minimum benefit levels, the city may provide a benefit level that falls below the chapter minimum benefit levels and also falls below the benefit levels provided on March 12, 1999.

Pot 3: The amount of insurance premium tax revenues, if any, in excess of the additional premium tax revenues required to fund the chapter minimum benefit levels (referred to as "subsequent additional tax revenues"), which must be used to provide "extra benefits." Thus, cities are required to provide "extra" pension benefits to police and fire only if there is any insurance premium tax revenues remaining after Pots 1 and 2 are fully funded.

The letters will generate police and fire pension discussions throughout the state and will likely lead to further interpretation questions to DMS. While no action has been filed to date, the recent DMS interpretation may be challenged. Also, police and fire pension benefits are typically covered under collective bargaining agreements, which can be negotiated at various times as provided under collective bargaining laws.

The Recent Department of Management Services Interpretation Does <u>Not</u> Negate the State Mandate to Provide "Extra" Pension Benefits

While the recent DMS interpretation significantly reduces the state mandate to provide police and firefighters with "extra" pension benefits with specified insurance premium tax revenues, the interpretation does not negate or remove the mandate from state law. The recent DMS letters to cities do rectify the 12 year old "inaccurate" interpretation of state law by following the precise language in the city police and fire pension statutes regarding the use of insurance premium tax revenues. However, even with this accurate or correct interpretation, the current statutes continue to mandate the provision of "extra" pension benefits with a portion of city insurance premium tax revenues. The Legislature must affirmatively act to remove the "extra" pension benefits mandate from state law.

For more information contact: Kraig Conn, Legislative Counsel for the Florida League of Cities at (850) 222-9684.

Historical Insurance Premium Tax Distributions
1983 – 2011
Police and Fire – Combined

		Premium Tax Distribution	Estimated Amount Required for "Extra Benefits"	Annual Increase/(Decrease)	Percentage Increase/(Decrease)
	1983	$25,453,000		$2,581,000	11.28%
	1984	$31,463,000		$6,010,000	23.61%
	1985	$36,713,000		$5,250,000	16.69%
	1986	$39,550,000		$2,837,000	7.73%
	1987	$41,066,000		$1,516,000	3.83%
	1988	$42,923,000		$1,857,000	4.52%
	1989	$43,689,000		$766,000	1.78%
	1990	$44,017,000		$328,000	0.75%
	1991	$44,309,000		$292,000	0.66%
	1992	$46,149,000		$1,840,000	4.15%
	1993	$47,229,000		$1,080,000	2.34%
	1994	$52,036,000		$4,807,000	10.18%
	1995	$58,349,000		$6,313,000	12.13%
	1996	$64,485,000		$6,136,000	10.52%
	1997	$67,871,000		$3,386,000	5.25%
Base Year	1998	$70,687,000		$2,816,000	4.15%
	1999	$72,220,000	$1,533,000	$1,533,000	2.17%
	2000	$74,502,000	$3,815,000	$2,282,000	3.16%
	2001	$83,417,000	$12,730,000	$8,915,000	11.97%
	2002	$94,600,000	$23,913,000	$11,183,000	13.41%
	2003	$106,276,000	$35,589,000	$11,676,000	12.34%
	2004	$110,739,000	$40,052,000	$4,463,000	4.20%
	2005	$117,786,000	$47,099,000	$7,047,000	6.36%
	2006	$126,119,000	$55,432,000	$8,333,000	7.07%
	2007	$135,290,000	$64,603,000	$9,171,000	7.27%
	2008	$131,111,000	$60,424,000		
	2009	$129,956,000	$59,269,000		
	2010	$127,591,000	$56,904,000		
	2011	$131,359,000	$60,672,000		

TOTAL ESTIMATED AMOUNT OF $522,035,000 REQUIRED FOR "EXTRA BENEFITS"

Source: Department of Management Services, Division of Retirement, Municipal Police Officers and Firefighters' Retirement Trust Funds Office

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City Police and Firefighter Pensions and Disability Presumptions: The Need to Reform State Legislative Actions

A priority of the Florida League of Cities for the 2013 legislative session is to address numerous actions taken by the Florida Legislature over the past 40 years relating to city police and fire defined benefit pensions. These actions have had significant fiscal impacts on cities and city taxpayers. Chapters 175 and 185, Florida Statutes, relating to city police and fire pensions require the provision of defined benefit pensions.

The reforms sought don't provide cities with a "handout" from, or a "bailout" by, the Florida Legislature relative to city police and fire pensions. Rather, the League seeks reasonable changes to a few state laws to level the playing field and allow cities to determine and implement city police and fire pension reform at the local level. The goal is to keep police and fire pensions sustainable, sound and secure for current and future generations of police officers and firefighters, and safeguard taxpayer dollars.

A series of questions and answers is provided below to help better understand the history of city police and fire pensions and disability presumptions in Florida.

Didn't the Legislature pass city police and fire pension reforms in 2011?

In 2011, the Legislature passed SB 1128, which took the first steps in reforming city police and fire defined benefit pension plans. The legislation addressed several issues, including:

- prohibiting "spiking" of pension benefits by restricting the use of overtime and unused sick or annual leave payments for pension determination purposes; and
- creating a task force to study issues with various state law disability presumptions for firefighters, law enforcement officers and corrections officers.

It is important to note that the 2011 bill did not address the 1999 legislative mandate for cities to perpetually provide "extra" pension benefits to police and firefighters with city insurance premium tax revenues.

What did the Legislature do with regard to city police and fire pensions and insurance premium tax revenues in 1999?

Prior to 1999, cities were largely free to bargain with local police and firefighter unions, or to provide for non-unionized police and firefighters, the pension benefits that best fit the priorities and needs of the city, its police and its firefighters. In 1999, the Legislature amended Chapters 175 and 185, Florida Statutes, relating to city police and fire defined benefit pensions to require that specified city insurance premium tax revenues (taxes on property and casualty insurance premiums) be used to provide only "extra" pension benefits to police officers and firefighters.

The criteria for defining an "extra" pension benefit are that the benefit must have been given to police and fire after 1999, and the benefit must be greater than a pension benefit provided to general city employees. In aggregate numbers, this mandate has required cities and city taxpayers to provide more than $520 million in new extra pension benefits to police officers and firefighters since 1999.

This state mandate for cities to keep providing extra pension benefits is not sustainable; rather, cities need the flexibility to use insurance premium tax revenues for either the current level or a decreased level of police and fire pension benefits to meet city budget constraints. Only the Florida Legislature can remove the state mandate for cities to perpetually provide new, "extra" pension benefits to police and fire. (A more detailed paper on the use of Insurance Premium Tax Revenues is available).

Why can't cities just pass police and fire pension reforms at the local level without action by the Legislature?

Because of severe budget constraints and rapidly increasing personnel costs, cities have attempted to reduce pension costs for general employees, police and firefighters. Numerous cities have successfully reduced pension benefit costs for general employees, but current state laws restrict the ability of cities to reduce pension benefit levels for police and firefighters.

Until very recently, the state Department of Management Services ("DMS") required city police and fire pension benefit levels to remain at or above the pension benefit levels in place in 1999 (many cities provided a high level of police and fire pension benefits in 1999). Add to this requirement the requirement for cities to provide "extra" pension benefits to police and firefighters, and the unsustainability of this scheme becomes evident. If a city either reduced a police or firefighter pension benefit to a level below the 1999 level or failed to provide "extra" pension benefits, the pension plan would violate state law and the city would forfeit all insurance premium tax revenues. Thus, when cities have attempted to bring police and fire pension costs under control, their actions have been effectively blocked by the DMS.

Does the 2012 Department of Management Services interpretation of state laws on city police and fire pensions negate the state law mandate to provide "extra" pension benefits?

No, the 2012 DMS interpretation does not negate the state mandate to provide "extra" pension benefits to police and firefighters. In 2012, the DMS, through a series of letters to cities, has rectified a 12 year old "inaccurate" interpretation of state law. The 2012 interpretation follows the precise language in the city police and fire pension statutes regarding the use of insurance premium tax revenues. However, even with this accurate or correct interpretation, the current statutes continue to mandate the provision of "extra" pension benefits to police and firefighters with a portion of city insurance premium tax revenues. The Legislature must affirmatively act to remove the "extra" pension benefits mandate from state law. (A more detailed discussion of the 2012 DMS interpretation is available).

What are disability presumptions for firefighters, law enforcement officers and corrections officers?

The Legislature has provided that health conditions relating to heart disease, hypertension or tuberculosis suffered by a firefighter, law enforcement officer or correctional officer are presumed to be job-related. These "disability presumptions" cover state, county and city employees and are applicable to both workers' compensation and disability pension claims.

Courts have interpreted the presumption laws so favorably toward these employees that cities and other government employers basically cannot overcome the presumption and show the health condition was not work-related. This means the state, counties and cities may be inappropriately incurring workers' compensation and disability pension expenses.

On January 1, 2012, a state Task Force on Public Employee Disability Presumptions issued findings and recommendations to the Legislature. Changes to presumption laws supported by a majority of Task Force members include: providing the presumption may be overcome by a preponderance of evidence; and allowing certain individual risk factors to be considered when applying the presumption, such as tobacco or alcohol use, weight/diet, genetics and lifestyle choices.

These recommendations are designed to bring a fairer balance to the application of presumption laws. It is important to remember that just because an individual does not have a disability presumption does *not* mean he or she cannot make a workers' compensation or disability pension claim. Rather, it just means that the individual must show that the health condition is work-related, just as every other employee who makes a workers' compensation or pension claim must do. (A more detailed paper on Disability Presumptions is available).

Who controls the operation and administration of a city police and fire pension, the city or legislatively created pension boards of trustees?

Beginning in 1986, the Legislature transferred all operational and administrative control of city police and fire defined benefit pensions to legislatively created boards of trustees. These boards are separate legal entities apart from the city and exercise broad powers outside the city's control, such as directing all investments of pension assets; hiring plan attorneys, actuaries and other professionals; and making regular and disability pension determinations.

All costs and expenses, including investment losses, incurred by the boards of trustees of pension plans ultimately become a cost to the city because the city is responsible for paying for all pension benefits. In addition, boards of trustees are not required to provide fiscal transparency or accountability for substantial amounts of public funds.

In 2011, the Legislature took a good first step toward reforming city police and fire pensions and disability presumptions. However, much more work is needed to accomplish significant reform.

For more information contact: Kraig Conn, Legislative Counsel for the Florida League of Cities at (850) 222-9684.

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"Heart/Hypertension" Disability Presumptions for Firefighters / Law Enforcement Officers / Correctional Officers

Various state laws provide that health conditions relating to heart disease, hypertension or tuberculosis suffered by a firefighter, law enforcement officer or correctional officer are presumed to be work-related. These "disability presumptions" cover state, county and city employees and are applicable to both workers' compensation and disability pension claims.

For instance, under the disability presumption, if a police officer suffers a heart attack it is presumed to be work-related. The police officer receives the disability presumption regardless of when the heart attack occurred – it could have occurred immediately after responding to a crime or during a skiing vacation in Colorado. Also, the police officer receives the disability presumption regardless of engaging in lifestyle activities that could increase the risk of heart attack – such as smoking cigarettes or being overweight – or having a genetic/hereditary predisposition to heart disease.

Disability presumption laws have been drafted by the Legislature and interpreted by the courts so favorably toward employees that cities and other government employers basically cannot overcome the presumption and show the health condition was not work-related. This means that the state, counties and cities may be inappropriately incurring workers' compensation and disability pension expenses.

On January 1, 2012, a state Task Force on Public Employee Disability Presumptions issued findings and recommendations to the Legislature. The Task Force Report provides that for State of Florida Data: "Over a 12 year period from FY 1999-2000 to FY 2010-2011, the actual paid cost of presumption claims has increased by approximately 330 times from $24,493 to $8.1 million. This increase in large part was due to 2003 changes in the law that added correctional officers to eligible employees." The Report also includes County/Sheriff Department Data and Municipal Government Data, which generally shows the increased frequency and cost associated with disability presumption claims for law enforcement officers and firefighters.

Changes to disability presumption laws supported by a majority of Task Force members include: excluding an employee from the presumption if the employee has been or is a user of tobacco products; requiring an employee to meet age standards; allowing the presumption to be overcome by a preponderance of the evidence; and allowing certain individual risk factors to be considered when applying the presumption, such as alcohol use, weight/diet, genetics and lifestyle choices. These proposals are designed to bring a fairer balance to the application of disability presumption laws.

It is important to note that just because an individual does not have a disability presumption does not mean he or she cannot make a workers' compensation or disability pension claim. Rather, it means the individual must show the health condition is work-related, just like every other employee who makes a workers' compensation or a disability pension claim.

An example of the problems faced by cities and other governmental employers relating to application of the "heart/hypertension" disability presumption laws is shown by recent activities involving a former City of Tampa firefighter. The firefighter made both a workers' compensation claim and a disability pension claim under the disability presumption for a heart attack he suffered. While noting that the claimant smoked, the pension board of trustees voted 6-1 to grant the disability pension based on the disability presumption. However, a judge denied the workers' compensation claim after determining the claimant's heart disease and resulting heart attack was primarily caused by his smoking and untreated high cholesterol.

Another example involves a former City of Orlando police officer seeking a disability pension. On two separate occasions the pension board of trustees denied the disability pension application, finding the officer's health condition to be a congenital heart condition that was pre-existing at the time of employment. The board's conclusions were rejected by the courts based on the heart disability presumptions. At the third hearing, the board granted the disability pension based on the disability presumption and court decisions.

For more information contact: Kraig Conn, Legislative Counsel for the Florida League of Cities at (850) 222-9684.

Attachment 1-B

Florida Pensions

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Welcome to the third issue of the Florida League of Cities' newsletter, *Florida Pensions*. This publication will provide your city with municipal pension stories from around the state and country. The goal is to share ideas and examples among members of the Florida League of Cities.

Over the past five years, the ever-increasing cost of providing pension plans for municipal employees has become a huge concern for many municipalities. The economic downturn of 2007 significantly affected the financial state of cities across the nation. Furloughs, layoffs, reduction in services and other cost-saving measures, such as pension reform, have become necessary for many municipalities.

While there are a variety of pension programs and retirement plans available for municipalities to use, the common goal is to provide this employee benefit with a well-funded and sustainable program. Each town, village and city in Florida is unique. Through its home rule powers, each municipality is given the ability to determine the best solution for its employees and its community. However, the tried-and-true lessons learned from other cities can be a useful tool as you assess your programs.

This issue of *Florida Pensions* includes an article from the Government Finance Officers Association on Designing and Implementing Sustainable Pension Benefit Tiers. It also highlights the pension histories and recent changes of three Florida municipalities: the City of Naples, the City of New Smyrna Beach, and the City of South Miami. Their stories offer a wide spectrum of potential ideas to address current pension liabilities and shortfalls.

Changes – big and small – can affect the success of a pension plan. We hope you will use these real-life examples as your city plans the future of its retirement program.

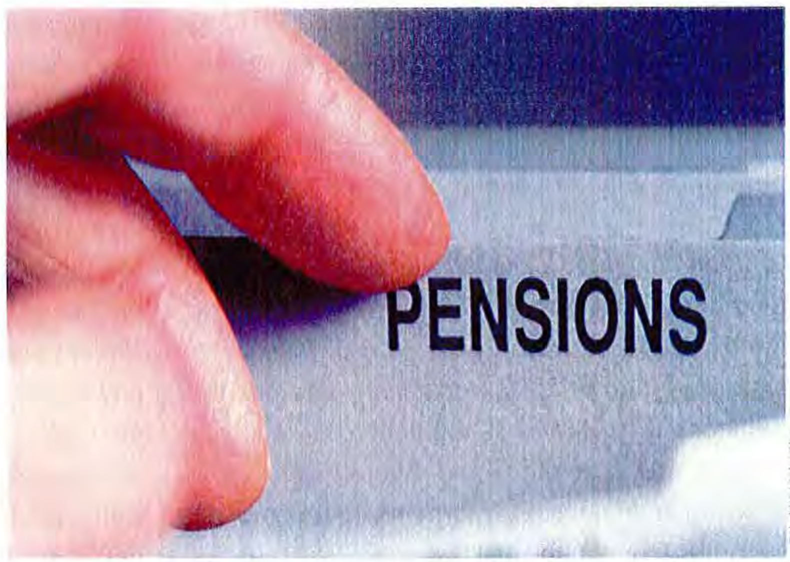
Want your city to be featured?

Has your municipality recently made changes to its retirement program? If you would like your city to be featured in the next issue of *Florida Pensions*, please contact us. Something can be learned from every experience, and sharing yours can help others plan for the future. Our goal is to collect stories from across the state. Let's work together to generate and discuss effective pension ideas and help our cities succeed!

To set up an interview, please contact Monica Beyrouti at (850) 701-3618 or *mbeyrouti@flcities.com*. For more pension resources, visit the "Research and Resources" library at *www.floridaleagueofcities.com*.

GOVERNMENT FINANCE OFFICERS ASSOCIATION BEST PRACTICE

Designing and Implementing Sustainable Pension Benefit Tiers (2011)



Background. In times of fiscal stress, many state and local governments face formidable financial challenges that will require difficult decisions to ensure the continued sustainability of their pension plans. Economic cycles, combined with funding deficiencies and enhanced benefits, can create unfunded liabilities for these plans. As state and local governments review total compensation packages in an effort to manage future costs and ensure sustainability, many are changing the structure of their employee pension benefits. One of the changes some governments have made is to limit existing pension benefits to current employees and create lower-cost pension benefit tiers for new employees.[1] Such tiers may combine defined benefit and defined contribution plan designs.[2] In some cases, these changes can also be applied to existing employees.

Recommendation. The Government Finance Officers Association (GFOA) recommends that jurisdictions considering new benefit tiers examine the following issues: A government's authority to revise its pension benefits, the overall goals it wants to accomplish by doing so, and the effect of such changes on the workforce; and the financial impacts resulting from changes to pension plan design, as well as the effects on employees. The GFOA further recommends that as governments consider new benefit tiers, they solicit input from actuaries during the analysis, design and implementation related to forecasting benefit costs, determining funding adequacy, and making decisions regarding employer and employee contribution rates.

In examining the first set of issues, GFOA recommends the following review process:

1) **Identify and address legal constraints.** Consult with legal counsel to identify any federal and state legal impediments. In some states, there may be a legal foundation for changing current employees' pension benefits prospectively. However, many states have constitutional restrictions, statutory provisions, or case law limiting or proscribing such changes.[3] Governments should also review collective bargaining laws, labor contracts, and other potential restrictions such as local ordinances and plan documents before embarking on plan design changes.[4]

2) **Identify financial sustainability goals.** Identify key factors that are likely to affect the financial sustainability of current benefit levels. Based on this information, establish a pension benefit cost goal for the overall plan, for particular employee groups, and/or for each benefit tier. This target gives employers a fact-based context for evaluating alternative benefit tier designs.

3) **Review total compensation and the impact of pension benefit tiers.** Consider how the government's total compensation package compares to those of other employers in the labor market in which it competes and how current benefits support workforce management objectives.[5] Total compensation that exceeds market rates creates unnecessary costs for taxpayers; compensation that falls below market rates may eventually impair the quality of services the government delivers.

   Employers also need to keep in mind the effect of pension benefit tiers on the equitable treatment of employees, employee morale and the jurisdiction's ability to recruit, motivate and retain employees.

4) **Investigate alternative plan design options.** Conduct a broad review of options. Some public employers offer new employees a hybrid plan that includes a mix of defined benefit and defined contribution features. Hybrid structures take many forms that can be customized for an employer's workforce. (Click here to see the GFOA's best practice on *Essential Design Elements of Hybrid Retirement Plans.*)

5) **Reconsider Other Postemployment Benefits (OPEB).** Along with pension benefits, retiree medical benefits should be sustainable and competitive. Developing a new tier for pension benefits offers an opportunity to evaluate the design of OPEB benefits, identifying alternative benefits or plan designs that have the potential to control costs and increase long-term sustainability.[6] (Click here to see the GFOA's best practice on *Ensuring the Sustainability of Other Postemployment Benefits.*)

The second set of issues relates to understanding how changes in key plan design elements will affect the government's financial goals and its employees. (Click here to see the GFOA's best practices on *Essential Design Elements of Defined Benefit Plans, Defined Contribution Plans, and Hybrid Retirement Plans.*) These elements include:

1) **Retirement ages.** Normal Social Security retirement age is now 67 for Americans who were born after 1960. In light of this, employers should consider recalibrating normal retirement ages for new hires. Where legally permissible and appropriate, governments might choose to incrementally increase the retirement age for current employees, provided the change does not affect protected accrued benefits. Governments that provide early retirement should recognize the actuarial cost of this

practice, and they should consider funding the early retirement benefit through both employer and employee contributions. (Click here to see the GFOA Advisory on *Evaluating the Use of Early Retirement Incentives*, which recommends extreme caution if considering early retirement incentives.)

2) **Pension formula multipliers.** When establishing multipliers for pension benefits, consider the amount of income the pension is designed to replace in retirement, taking into account the availability of Social Security, Medicare, employer-provided retiree medical benefits,[7] and the amount of personal savings employees can reasonably be expected to have at retirement. Employers might also consider whether it is appropriate to limit the maximum benefit to a specified percentage of final average earnings.

3) **Cost of living allowances (COLAs).** If a system provides a COLA, it must be actuarially funded for the system to remain financially sound. If new benefit tiers are established, they should have affordable COLA limits while also providing sufficient inflation protection for retirees. (Click here to see the GFOA's advisory on *Responsible Management and Design Practices for Defined Benefit Pension Plans*.)

4) **Employee contribution requirements.** Governments that do not already require employee contributions may need to consider establishing them. Governments that create new, lower-benefit tiers for new employees may also wish to consider different contribution rates for existing and new employees to provide some level of equity between the groups.

5) **Benefit enhancements.** Governments that establish new benefit tiers should express their intent to make future changes only on a prospective basis, in order to avoid increasing pension liabilities through retroactive modifications, and should include this intent in all policy statements and plan documents that explain new benefit tiers. (Click here to see the GFOA's advisory on *Responsible Management and Design Practices for Defined Benefit Pension Plans*.)

6) **Purchase of service credit.** Governments should consider whether they will permit employees to purchase service credit within or among the jurisdiction's benefit plans. Governments that allow employees to purchase service credits in new benefit tiers should ensure that the cost of such credits is based on an actuarial valuation.

7) **Anti-spiking provisions.** Governments should consider including provisions that exclude extraordinary income from final average compensation calculations in their new benefit tiers. Extraordinary income includes lump sum payouts of vacation, sick and compensatory time as well as extraordinary overtime pay. Allowing these payments to be included in final average compensation increases retirement system liabilities, often without prefunding and often amortized over an extended period of time, long after the employee's period of active service.

8) **Vesting periods.** Governments should evaluate potential impacts on employee recruitment and retention before implementing longer vesting periods for new hires, which might decrease plan liabilities.

9) **Notice to employees and transition issues.** In making changes to current employees' pension benefits, governments need to provide ample time and sufficient notice so participants can adapt to such changes. A multi-year implementation may help employees adjust. New employees should receive specific information on the particular benefit tier that applies to them. (Click here to see the GFOA's best practice on *Preparing an Effective Summary Plan Description for Retirement Systems.*) In addition, governments should clearly indicate how benefit tiers will apply when employees are rehired or are transferred within the organization.

Notes

[1]A tier refers to a group whose benefit formulas are different from those of other pension plan members, usually predecessor employees. For example, a new benefit tier might apply to employees hired after a specific date, while those hired previously receive different benefits. In states where laws allow, a new tier can also be established for current employees hired after a certain date.

[2]The National Conference of State Legislatures maintains an ongoing tally of recent developments in state pension laws, which might be useful to employers considering new benefits tiers (available by clicking here).

[3]If state law allows public employers to change plan benefits prospectively for current employees, this right should be clearly stated in the plan documents that are distributed to employees. If there is no explicit or implied contract that entitles an employee to accrual of benefits indefinitely under the current benefit structure for future service, this should be clearly stated in the plan documents as well. Consult with legal counsel to ensure that such descriptions do not violate the requirement that benefits be "definitely determinable" under Internal Revenue Code 401(a). Generally, a plan does not provide definitely determinable benefits if a member's ability to receive the benefit is conditioned on the employer's discretion, absent plan changes.

[4]See "Public Pension Plan Reform: The Legal Framework" by Amy B. Monahan, *Education and Finance Policy*, Fall 2010.

[5]Employers should consider whether state and local government employees' total compensation, which includes both salary and all benefits, may be less than their private sector counterparts with comparable education and experience. (See "Out of Balance? Comparing Public and Private Sector Private Compensation Over 20 Years," Center for State and Local Government Excellence, 2011.) Jurisdictions should also take into account the total compensation available to current and future employees, including any Social Security coverage.

[6]See "Strategies to Consider as OPEB Costs Escalate" by Girard Miller, *Government Finance Review*, February 2011.

[7]For example, a lower multiplier may be sufficient for general employees who have Social Security and a Medicare benefits supplement, but a higher multiplier might be more appropriate for employees who are outside of Social Security. Moreover, multipliers are generally lower for hybrid plans that combine a defined benefit plan with a defined contribution plan.

Approved by the GFOA Executive Board, May 22, 2011.

City of Naples

County: Collier
Population: 19,451

During the past few years, the City of Naples has worked hard to reduce the cost of its general, police and fire pension plans. Concerns about the sustainability of the pension plans were first raised by the City Council in 2008. The council appointed a blue ribbon committee to address the economy, city expenses and revenues, and areas of opportunity to improve the city's finances. The committee issued a report in 2009 concluding that the current and future burden of pensions should be evaluated immediately. The first step was a negotiated agreement with fire employees for a stop-and-restart through the Chapter 175 money. This saved the city $600,000 in 2009.

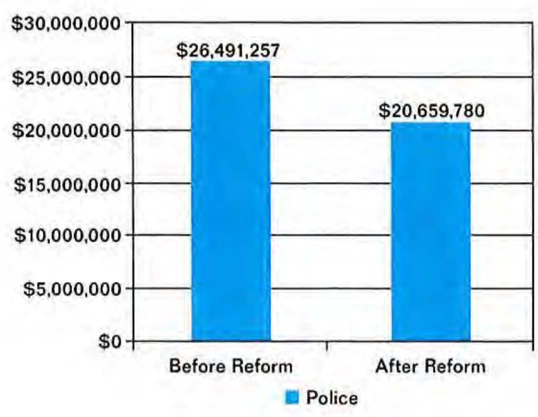
> **It is important to have alternatives because how you make your assumptions has a big influence. Come to the table with a lot of different reform options.**
> *~ Bill Moss, City Manager*

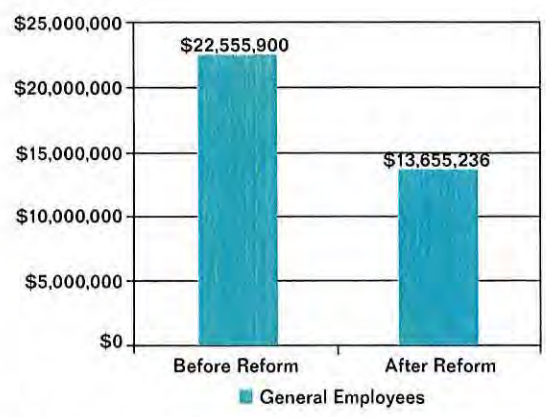
Next, the city contracted with an independent actuary and attorney knowledgeable in Florida pension law to provide an overview of the current plans and expected costs over the next 30 years. The study looked at reform options being implemented by other municipalities and by the state. They looked at every possible option because even the smallest changes can make a big difference.

In 2011, the actuary and attorney presented the City Council with three options: a low-benefit plan, a medium-benefit plan, and a Florida Retirement System (FRS) equivalent plan. The city was looking for a plan that would reduce costs, remain competitive in the employment market, and maintain equality between the general, police and fire plans. The state reduced FRS benefits effective July 1, 2011. In August 2011, the council decided an FRS-equivalent plan was the best fit and began negotiations with representatives of the general, police and fire unions.

In September 2011, an agreement was reached with two labor unions representing a majority of general employee. The agreement provided for previously earned benefits to be frozen and future benefits for current and future employees to be reduced starting October 1, 2011. This reform produced an immediate reduction of $9 million in unfunded liability and an estimated savings of $78 million over the next 30 years.

REDUCED UNFUNDED LIABILITY





Source: Actuarial Impact Statement – Police Pension – March 6, 2012
Source: Actuarial Impact Statement – General Employee Pension – September 15, 2011

It's important to work with an attorney and actuary that are independent from the pension boards and knowledgeable on Florida pensions.

~ *Roger Reinke, Assistant City Manager*

Negotiations with the Fraternal Order of Police union began in September 2011 and took effect on March 31, 2012. Similar to the general employee pension reform, the current police plan was frozen. Benefit accrual after March 31, 2012, would be subject to the new reduced benefits, including an elimination of a cost of living adjustment (COLA). Reforming the police pension plan created an immediate reduction of $5.8 million in unfunded liability and an estimated savings of $34 million over the next 30 years.

The City of Naples and the Professional Firefighters of Naples union were unable to come to an agreement during their pension reform negotiations. An impasse was declared in January 2012, and a special magistrate hearing was held in August 2012. The city is currently waiting for a recommendation before taking further action. Naples believes the current fire pension plan is unsustainable and that reform is essential to control taxpayer costs.

The decision to reduce benefits in the police pension plan resulted in a loss of state premium tax funding through Chapter 185, Florida Statutes. On March 16, 2012, Naples Mayor John Sorey wrote a letter to Gov. Rick Scott appealing the decision. On August 14, 2012, the mayor received a response from the state Division of Retirement. The letter replied that the state changed its interpretation of the law pertaining to premium tax revenues and re-awarded the premium tax dollars to Naples. This decision, known as the "Naples Letter," has statewide implications that will change all municipalities' use of Chapters 175 and 185 premium tax dollars in the future. For Naples, this new interpretation will save the city approximately $500,000 a year.

Currently, 88 percent of Naples employees have agreed to pension reform. The agreements reached on the general and police pensions have a projected savings of $112 million over 30 years. In addition, the results of the "Naples Letter" will also yield large savings for the city. As Naples moves forward, the administration is confident the reforms will provide a sustainable pension benefit to its employees.

CITY OF NAPLES

PRE-OCTOBER 2011
DEFINED BENEFIT

GENERAL

Multiplier: 2.5 percent
Eligibility: Age 60 with five years of service; or Rule of 85
Employee Contribution: 5 percent
Post Retirement: No COLA

POST-OCTOBER 2011
DEFINED BENEFIT

GENERAL

Multiplier: 1.6 percent
Eligibility: Age 65 with eight years of service; or 33 years of service
Employee Contribution: 3 percent
Post Retirement: No COLA

PRE-MARCH 2012
DEFINED BENEFIT

POLICE

Multiplier: 3.63 percent
Eligibility: Age 50; or 25 years of service
Employee Contribution: 5 percent
Post Retirement: 3 percent COLA between age 55 and 62.

POST-MARCH 2012
DEFINED BENEFIT

POLICE

Multiplier: 3 percent
Eligibility: Age of 60 with eight years of service; or 30 years of service
Employee Contribution: 3 percent
Post Retirement: No COLA

City of New Smyrna Beach

County: Volusia
Population: 22,668

In October 2012, the City of New Smyrna Beach will be implementing recently approved pension changes to its fire pension plan. Increasing pension costs urged the city to explore ways to reform the plan. After pension reform discussions and negotiations, the city and its employees agreed upon pension reform for both current and new employees.

> **We offered a lot of education to our employees on exactly what was going on financially with their pension program and emphasized the importance of working together with the goal to make the system sustainable.**
> *~ Carol Hargy, SPHR, Director of Human Resources*

New Smyrna Beach is thankful to have a healthy working relationship with the fire union. The pension changes were negotiated and agreed upon without going to impasse. The new changes to the plan will reduce pension costs and improve the future stability of the plan for both the city and the firefighters.

The pension changes for current employees take effect in October 2012. The pension reform includes two elements for current fire employees: employee contributions and the deferred retirement option plan (DROP) interest rates.

Previously, employees were required to make a 1 percent contribution to the pension program. With the new plan, employee contributions will increase from the original 1 percent to 10 percent over a three-year period. Starting in October 2012, the employee contribution will increase to 4 percent, followed by 7 percent in 2013 and 10 percent in 2014.

With a large number of New Smyrna Beach employees using the DROP program, changes to this aspect of the plan were necessary. Previously, employees going into DROP were guaranteed a 6.5 percent interest rate. The new DROP provisions provide an interest rate of up to 6.5 percent, depending on plan net earnings.

New hire pension changes took effect in July 2012. New employees receive a 2 percent multiplier, as opposed to the previously offered 3 percent. Also, only an employee's base compensation will be considered pensionable earnings. They will be required to make a 10 percent employee contribution to the plan and will not have the option of utilizing DROP. New Smyrna Beach expects one-third of its fire employees to be new hires within the next three to four years. This 30 percent turnover of staff who will be entering the new hire pension plan will significantly help control pension costs.

In addition to the changes to the current and new hire plan provisions, the city also reduced pension costs by revising its amortization schedule of unfunded liabilities. By switching from a 15-year amortization period to a 20-year period, the city will save $116,000.

During the reform process, New Smyrna Beach and the fire union organized numerous meetings to have educational discussions on the financial stability of the current plan. The city took time to explain the sustainability and details of the current plan to employees in an effort to communicate the need for reform. These discussions and meetings helped employees understand the need to increase their contributions and ultimately created a strong working relationship.

CITY OF NEW SMYRNA BEACH

PRE-OCTOBER 2012 FOR CURRENT EMPLOYEES

DEFINED BENEFIT

FIRE

Multiplier: 3 percent

Eligibility: Age 55 and 10 years of service; 25 years of service

Employee Contribution: 1 percent

DROP: Guaranteed 6.5 percent earnings

POST-OCTOBER 2012 FOR CURRENT EMPLOYEES

DEFINED BENEFIT

FIRE

Multiplier: 3 percent

Eligibility: Age 55 and 10 years of service; 25 years of service

Employee Contribution: Increase from 1 percent to 10 percent by 2014

DROP: Interest will be plan earnings net expenses up to a max of 6.5 percent

NEW HIRES POST-JULY 2012

DEFINED BENEFIT

FIRE

Multiplier: 2 percent of base compensation

Eligibility: Age 55 and 10 years of service; 25 years of service

Employee Contribution: 10 percent

DROP: Not offered

City of South Miami

County: Miami-Dade
Population: 12,363

Just over a year ago, the City of South Miami adopted changes to reform its general and police pension plans. When reviewing the financial future of the city, the administration looked for options to save tax dollars without eliminating city services used by residents.

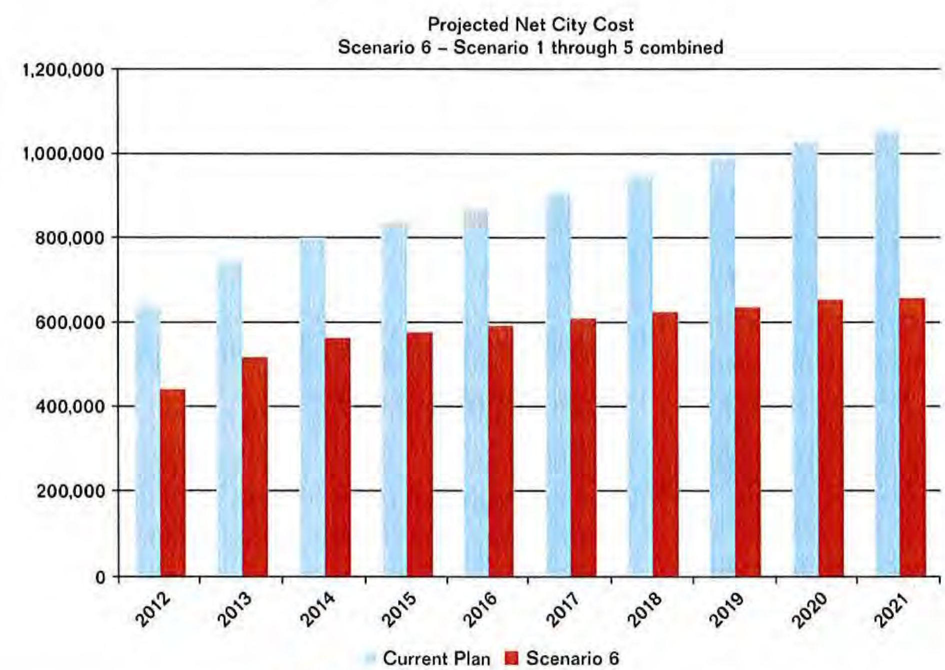
With retirement costs being the largest expenditure, the city decided to look into reform options. The current pension system was unsustainable and extremely costly to both the city and its employees. Separate negotiations with the American Federation of State County and Municipal Employees and the Police Benevolent Association took place over the summer of 2011. The city believes both sides worked together during negotiations to produce a productive reform that will benefit both the city and employees.

Two changes were negotiated for the police pension plan, in addition to incorporating state-mandated changes. The reform includes changing the final average compensation from the employee's best three years to the average of the employee's best five years. Second, a decision was made to change the composition of the police pension board. State-required changes included limiting overtime hours for pension calculations to 300 hours per year, and eliminating hazard and vacation pay from pension calculations. South Miami police employees like that their extra-duty hours are not pensionable because they get more money directly in their paychecks.

While the police plan only adopted a few changes, the general employee pension plan underwent large reform. During negotiations, both the administration and the general employee unions agreed to close the current defined benefit plan to new employees.

All new employees hired after October 1, 2011, will join the IMCA-RC defined contribution (DC) 401a plan. With this DC plan, employees have the option of contributing any percent of their earnings to their 401a.

SOUTH MIAMI PENSION PLAN ACTUARIAL STUDY AS OF OCTOBER 1, 2010



"City management must work closely and openly with the unions during the collective bargaining agreement negotiations to ensure proper communication is provided with reference to the true and accurate costs associated with pension benefits."
~ Alfredo Riverol, Chief Financial Officer

Employees are not required to make a contribution; however, the city will make a matching contribution up to 7 percent. Employees hired before October 1, 2011, had a one-time option to opt out of their defined benefit plan and join the new DC 401a plan. At that time, 29 percent of the general employees chose to opt out and join the DC plan. The previously accrued benefits of general employees are frozen and payable under the current terms of the pre-2011 plan at the defined normal retirement date – the later of attainment of age 55 and completion of 10 years of credited service.

Employees who already worked for the city and choose to continue in the general employees defined benefit pension plan will be receiving reformed benefits on their earnings after September 31, 2011. The benefits accrued with the reformed plan will be payable at the proposed new normal retirement date – the later of attainment of age 60 and completion of 10 years of credited service. The benefit accrual rate was reduced from 2.75 percent to 2.25 percent per year for future credited service. The definition of final monthly compensation (FMC) is revised for future benefit accruals to the average of the final 60 months of basic compensation but not less than the current FMC as of October 1, 2010. Basic compensation excludes commissions, overtime pay, bonuses and any other forms of additional compensation outside of base wages. Lastly, general employees will no longer receive a cost of living adjustment (COLA) on future benefit accruals.

For some general employees, the reform provided relief. By having the opportunity to opt out of the defined benefit plan, they gained the ability to decide how much they want to invest in their DC 401a plan. These changes will reduce the burden on taxpayers and provide a more sustainable and flexible pension benefit for the employees of South Miami.

CITY OF SOUTH MIAMI

PRE-OCTOBER 2011 FOR CURRENT EMPLOYEES

DEFINED BENEFIT

GENERAL

Multiplier: 2.75 percent
Eligibility: Age of 55 with 10 years of service
Employee Contribution: 7 percent*
Post Retirement: COLA up to 3 percent annually

POST-OCTOBER 2011 FOR CURRENT EMPLOYEES

Option to remain in reformed DB plan or opt out to new ICMA-RC defined contribution (DC) 401a plan

GENERAL

Multiplier: 2.25 percent
Eligibility: Age of 60 with 10 years of service
Employee Contribution: 7 percent*
Post Retirement: No COLA on earnings after October 2011

*Should the city contribution for general employees be actuarially determined to exceed 7.0 percent, not including expenses, both the city and the general employees will share equally in the amount in excess of 7.0 percent.

NEW HIRES POST-OCTOBER 2011 DEFINED CONTRIBUTION

GENERAL

ICMA-RC defined contribution (DC) 401a plan

Employee Contribution: No minimum contribution required
Employer Contribution: Match employee contribution up to 7 percent

VOLUME 1 | ISSUE 2 | AUGUST 2012

Florida Pensions

301 South Bronough Street • Suite 300 • P.O. Box 1757 • Tallahassee, FL 32302-1757 • (850) 222-9684 • Fax (850) 222-3806 • www.floridaleagueofcities.com

Welcome to the second issue of the Florida League of Cities' newsletter, *Florida Pensions*. This publication will provide your city with municipal pension stories from around the state and country. The goal is to share ideas and examples among Florida League of Cities members.

Over the past five years, the ever-increasing cost of providing pension plans for municipal employees has become a huge concern for many municipalities. The economic downturn of 2007 significantly affected the financial state of cities across the nation. Furloughs, layoffs, reduction in services and other cost-saving measures, such as pension reform, have become necessary for many municipalities.

While there are a variety of pension programs and retirement plans available for municipalities to use, the common goal is to provide this employee benefit with a well-funded and sustainable program. Each town, village and city in Florida is unique. Through its home rule powers, each municipality is given the ability to determine the best solution for its employees and its community. However, the tried-and-true lessons learned from other cities can be a useful tool as you assess your programs.

This issue of *Florida Pensions* highlights the pension histories and recent changes of three Florida municipalities: the City of Oakland Park, the City of Tallahassee, and the City of West Palm Beach. Their stories offer a wide spectrum of potential ideas to address current pension liabilities and shortfalls. They include cities with defined benefit plans, defined contribution plans and original "hybrid" plans.

Changes – big and small – can affect the success of a pension plan. We hope you will use these real-life examples as your city plans the future of its retirement program.

Want your city to be featured?

Has your municipality recently made changes to its retirement program? If you would like your city to be featured in the next issue of *Florida Pensions*, please contact us. Something can be learned from every experience, and sharing yours can help others plan for the future. Our goal is to collect stories from across the state. Let's work together to generate and discuss effective pension ideas and help our cities succeed!

To set up an interview, please contact Monica Beyrouti at (850) 701-3618 or *mbeyrouti@flcities.com*. For more pension resources, visit the "Research and Resources" library at *www.floridaleagueofcities.com*.

City of Oakland Park

County: Broward
Population: 41,549

Over the last five years, the City of Oakland Park has made many changes to help improve the financial sustainability of its General Employee Pension Plan. The decline in the economy and financial climate in Florida caused Oakland Park's pension contributions to drastically increase.

In 2000, the General Employee Pension Plan was more than 100 percent funded with a ratio of 109.7 percent. In 2010, that funding ratio decreased to only 45.7 percent funded. In turn, the city's required contribution continued to increase to more than $2.5 million in 2010 and more than $3 million in 2011.

The first change to the plan, made in 2007, closed the then-current defined benefit plan to all new hires. Current employees had the option of remaining in the defined benefit plan or switching to a Florida Retirement System (FRS) plan. Most of those employees chose to remain in the defined benefit plan. Another modification was made to the General Employee Pension Plan in 2009 when employees agreed to contribute 4 percent of their pay to continue accruing the same benefits. The FRS plan became the new pension benefit for all employees hired after 2007.

However, the city determined that the continued increasing costs and lower funded ratio needed to be re-addressed. The City Commission and staff decided that, in the best interest of all stakeholders, the accrual of benefits in the general employee defined benefit pension plan had to be terminated. All employee bargaining units and the City Commission agreed to move those employees to a 401(a) defined contribution plan. When they retire, employees in the city's defined benefit plan will still receive their benefits accrued until 2011; however, they will no longer accrue any additional benefits in the closed plan. The new 401(a) plan will initially include a 6 percent city contribution and a 3 percent employee contribution.

Oakland Park

		UAAL Amortization	Admin. Expense	Normal Cost	Defined Contribution @ 6%	Employee Contribution to GEPP
Current GEPP FY 12 Estimated Cost	$3,153,582	$2,191,312	$78,515	$1,099,143	$0.00	($215,388)
Proposed City Contribution (DC 6.0%) effective 10/1/2011; Employee contribution 3%	$2,246,422	$1,831,276	$78,515	$1,099,143	$336,631	($0)

FY 12 Financial Impact $907,160

Source: Estimate provided by The Segal Company based on FY 2011 Actuarial Valuation prepared by Southern Actuarial Services

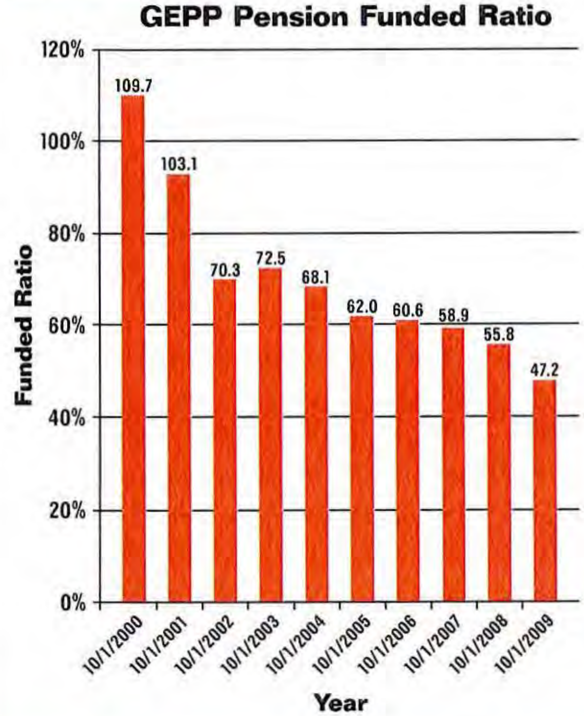
These pension changes will save Oakland Park almost $1.3 million in fiscal year 2013. The pension reform and new plans will help improve the city's funding ratio and continue to provide sustainable pension benefits for its employees.

Other pension reforms included adjusting the membership of the General Employee Pension Plan's Board of Trustees. The board was changed from the original composition of two citizens, two employees and the finance director to a ministerial composed of the city manager, finance director and human resources director.

Along with implementing its new decisions on pension reform, Oakland Park is currently facing issues with the state actuary. The General Employees Pension Plan 2010 Actuarial Report states that the assumed rate of return on its asset allocation is 7.75 percent. The former Board of Trustees changed the rate of return from 8.0 percent to 7.75 percent in 2009. While the current asset allocation of the plan indicates the assumed rate of return of 7.75 percent was well within the target, the state has still not accepted the city's plan. Subsequently, the new Board of Trustees lowered the assumed rate of return to 7.50 percent for the 2012 Actuarial Valuation in response to a request from the state actuary, which increased the cost to the city.

The decision by the City of Oakland Park City Commission and the employees to halt the further decline of the plan by stopping the continued benefit increase with its corresponding cost has proved to be an excellent decision. Had the decision to completely freeze the benefits of the plan not occurred, the city could have been faced with increasing budgetary contributions due to the increasing benefit cost. The city is still waiting for a final response from the state actuary regarding the acceptance of the 2010 Actuarial Valuation and the city's plan to fund the defined benefit plan over the next 15 years. While Oakland Park's pension changes are improving its financial situation, the process has not been easy.

Oakland Park



PRE 2007

DEFINED BENEFIT

GENERAL EMPLOYEES

Multiplier: 3.5%
Eligibility: 62
Employee Contribution: 0.0%
Post Retirement: No COLA

POST 2007

2007-2011 DEFINED BENEFIT

GENERAL EMPLOYEES

Multiplier: 3.5%
Eligibility: 62
Employee Contribution: 4% (starting in 2009)
Post Retirement: No COLA

2011 DEFINED CONTRIBUTION 401(A)

GENERAL EMPLOYEES

City Contribution: 6%
Employee Contribution: 3%
All new hire employees after 2007 receive pension benefits through the FRS.

City of Tallahassee

County: Leon
Population: 180,954

By following a few key principals, the City of Tallahassee has continued to maintain a sustainable and successful pension plan. Tallahassee has three separate funds: general, fire, and police that they invest together. They offer all of their employees a hybrid plan that has contributed to keeping their costs down. The city believes that the combination of defined benefit and defined contribution plans provides employees with a reliable financial benefit upon retirement.

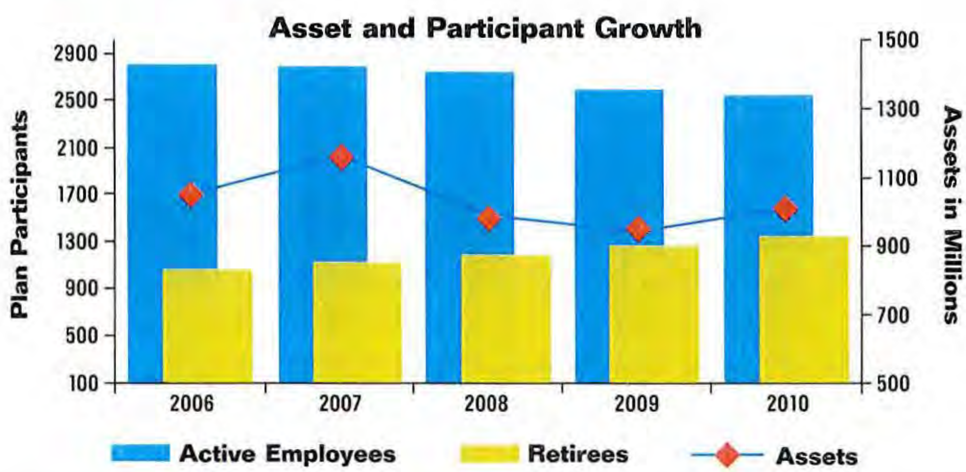
Tallahassee is continuously evaluating their current plan and considering ways to change it. One key principal they follow is to never add new benefits without a way to pay for them. The city is open to adopting new benefits into their plans, as long as employees are willing to pay for them. Past negotiations have resulted in increased cost-of-living adjustments (COLAs) and, in return, higher employee contributions.

Tallahassee has found it beneficial to treat each employee plan separately and negotiate different benefits for each sector. The city is required by ordinance to make annual contributions to their plan to maintain actuarial adequacy. The ordinance also requires the necessary funds to be included in the annual budget. Past contributions in over-funded years have helped them survive the recent economic downturn and decrease in investment returns.

Through the defined benefit plan, employees have the ability to utilize a Deferred Retirement Option Plan (DROP). If an employee is eligible to retire and continues to work, that employee has the option to enter the DROP program for up to three years. When entering DROP, the employee stops accumulating DB benefits and begins receiving a monthly pension check into a 401K account. The employee then receives full access to the money accumulated in the 401K. This helps provide an additional benefit to those who continue to work after meeting the retirement eligibility.

For the defined contribution plan, the city makes contributions for the general employees, and uses Chapters 175 and 185, Florida Statutes, funds for fire and police. No employee contributions are required for the defined contribution plans; however, the city offers a matching program that is available upon retirement. With this program, the city will match an

Tallahassee



employee's money in his or her defined contribution account, if that employee commits to taking monthly payments instead of the lump sum. This encourages employees to budget their money after retirement.

Through the plan, employees do not pay into or receive Social Security benefits. Tallahassee strives to continue to keep costs low while providing sufficient retirement benefits to every employee.

Tallahassee

CURRENT PLAN

POLICE

DEFINED BENEFIT

Multiplier: 3% first 20 years of service; 4% after; 81% cap
Eligibility: Age 55 and 5 years of service; 25 years at any age
Employee Contribution: 8.55%
Post Retirement: 3% COLA upon retirement at age 55 or after; other conditions apply depending on entry date

DEFINED CONTRIBUTION

Funds contributed from Chapter 185 money annually; divided between police officers each year

FIRE

DEFINED BENEFIT

Multiplier: 3% first 20 years of service; 4% after; 81% cap
Eligibility: Age 55 and 5 years of service; 25 years at any age
Employee Contribution: 12.99%
Post Retirement: 3% COLA starting at age 52

DEFINED CONTRIBUTION

Funds contributed from Chapter 175 money annually; divided between fire fighters each year

GENERAL

DEFINED BENEFIT

Multiplier: 2.25%; 81% cap
Eligibility: Age 62 and 5 years of service; 30 years at any age
Employee Contribution: 3.75%
Post Retirement: 3% COLA

DEFINED CONTRIBUTION

Employer Contribution: 5% of salary

City of West Palm Beach

County: Palm Beach
Population: 100,482

The City of West Palm Beach is one of the few cities in Florida that has pension plans created by the State of Florida through a special act of the Legislature. Therefore, any changes to the fire pension plan or police pension plan must be approved by the Florida Legislature. Both the Police Pension Fund and the Fire Pension Fund were created in 1947. Unlike the police and fire plans, West Palm Beach general employees receive a defined contribution pension plan. During the 2012 legislative session, the City of West Palm Beach proposed pension changes that will reduce costs over the next two years. Economic impact statements estimate a total savings of $3,452,789 for the Fire Pension Fund through 2013.

The changes to the special acts include a unique reform on employee contributions. Both the fire and police plans have the employee contribution rate increasing for approximately one year, followed by a decreased employee contribution afterward. For example, the fire employee contribution will increase from 19.2 percent to 25 percent from May 2012 to October 2013, and then decrease to 13.1 percent. Both plans are also reducing their multipliers in an effort to reduce costs. West Palm Beach offers both a Deferred Retirement Option Program (DROP) and a BackDROP, which provide more flexibility to employees reaching retirement age. Proposed changes for the Fire Pension Program eliminate the requirement for members to elect participation in DROP within a specific period of time. It requires future retirees to roll their DROP account balances out of the plan within six months of termination of employment. West Palm Beach hopes these changes will bring the plan to a point of sustainability and provide a valuable retirement to their police and fire employees.

West Palm Beach

CURRENT PLAN
DEFINED BENEFIT

FIRE

Multiplier: 4%

Eligibility: Age 50 with 15 years of service; Age 55 with 10 years of service; 26 years of service

Employee Contribution: 19.2%

Post Retirement: No COLA

POLICE

Multiplier: 3%

Eligibility: Age 50 with 20 years of service; Age 55 with 10 years of service; 25 years of service

Employee Contribution: 11%

Post Retirement: CPI increase beginning at age 65 with 3% cap for any one year

NEW PLAN
DEFINED BENEFIT

FIRE

Multiplier: 3%

Eligibility: Age 50 with 15 years of service; Age 55 with 10 years of service; 26 years of service

Employee Contribution: 25% from May 2012-October 2013; 13.1% after October 2013

Post Retirement: No COLA

POLICE

Multiplier: 2.68%

Eligibility: Age 50 with 20 years of service; Age 55 with 10 years of service; 25 years of service

Employee Contribution: 18% from October 2011-October 2013; 11% after October 2013

Post Retirement: CPI increase beginning at age 65 with 3% cap for any one year

Florida Pensions

VOLUME 1 | ISSUE 1 | APRIL 2012

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This issue of *Florida Pensions* provides retirement plan design options from the Government Finance Officers Association (GFOA) and highlights the pension histories and recent changes of three Florida municipalities. Their stories offer a wide spectrum of potential ideas to address current pension liabilities and shortfalls. They include cities with defined benefit plans, defined contribution plans and original "hybrid" plans.

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Government Finance Officers Association
Developing a Policy for Retirement Plan Design Options (1999, 2007) (CORBA)

Background. The retirement benefit is a form of compensation designed to assist the employer in the recruitment and retention of public employees and other workforce management goals. It is also provided to assist employees in preparing for retirement and compensate individuals for their years in public service. Broadly speaking, there are two types of retirement plans, defined benefit and defined contribution.

Defined benefit plans, with very few exceptions, provide a retirement benefit calculated using a formula based upon a plan participant's years of service and compensation. Generally, both employers and participants contribute to these public sector defined benefit plans. All assets accumulated to fund the retirement benefits are invested by the retirement board or a central agency responsible for investing government funds. All investment-related risk is generally borne by the employer. These plans are predominant in the public sector, covering over 90 percent of full-time public sector employees.[1]

Principal features of defined benefit plans generally include:

1. Investment risk born by the plan sponsor;
2. Life expectancy risk born by the plan sponsor;
3. Survivor and disability coverage generally provided;
4. Guaranteed lifetime annuity to members at retirement unless they choose an alternate payment method;
5. Investments directed by the plan;
6. Generally lower investment costs associated with a defined benefit plan as compared to other plan designs;
7. More useful tool for employers to attract and retain employees for full careers and to manage workforce levels; and
8. Guaranteed or ad-hoc cost-of-living adjustments provided to annuitants.

A **defined contribution** plan provides for benefits based solely on the assets available in an employee's individual account, to which both employees and employers may contribute. All employees have their own accounts set up within the plan to which contributions and investment gains and losses are recorded. Typically, under a defined contribution plan, employees direct the investment of their contributions among investment options selected by plan trustees, the employer or the employer's designated agent and therefore fully bear the investment risk. The dollar amount accumulated in a defined contribution plan will vary depending upon the amount contributed to the plan, the investment performance, the level of risk taken, and the fees paid.

Principal features of defined contribution plans generally include:

1. Portable vested benefits;
2. Employer obligations fulfilled annually as contributions are made, so there is no unfunded liability;
3. Investments directed by participants;
4. Account balances at retirement dependant upon a combination of investment rate of return, contribution levels and the period of investment;
5. Easier to understand account values as participants can see their balance on a regular basis;
6. Investment risk and fees born by participant;
7. Life expectancy risk born by the participant;

[1] U.S. Department of Labor. Bureau of Labor Statistics. Employee Benefits in State and Local Governments, 1998.

8. No cost of living allowances after retirement; however, participants continue to earn investment income on their remaining assets; and
9. Neither disability nor survivor coverage generally provided.

In addition to defined benefit and defined contribution plans, some entities provide retirement benefits through **"hybrid plans"** that incorporate features of both defined benefit and defined contribution plans.

For any of these plans, the actual costs to plan sponsors and participants are determined by the number and amount of benefits actually paid to recipients, and the source and amount of plan contributions and investment returns.

Recommendation. The Government Finance Officers Association (GFOA) recommends that state and local governments have a policy statement that will guide their on-going plan design decisions. This policy should encourage governments to provide sustainable and properly funded retirement plans, which will attract employees in a competitive labor market, facilitate effective management of the workforce, and fulfill retirement needs.

In developing a policy for retirement plan design, a state or local government should consider the following:

- Purpose of the retirement plan (e.g., level of replacement income and purchasing power retention);
- Ability of public retirees to contribute to the economic viability of their community and not become a financial liability to the community in which they live due to inadequate retirement income;
- Organization's philosophy regarding employer and employee responsibilities in preparing for retirement;
- Availability of Social Security, retiree medical benefits, disability and survivor benefits, and supplemental (e.g. 457) savings plans;
- Costs, including the employer's ability to sustain payments and perhaps increase benefits over time and cost predictability;
- Labor market considerations such as competitive environment, workforce mobility, length of employee service, and recruitment and retention of employees;
- Investment risk and control, including how investment risk is allocated between employer and employee;
- Portability of benefits;
- A plan design that can be communicated to and understood by plan participants;
- Employee educational efforts; and
- Advantages of the different types of plans (e.g., defined benefit, defined contribution and hybrid.)

References

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- *An Elected Official's Guide to Defined Benefit and Defined Contribution Plans*, Nicholas Greifer, GFOA, 1999.
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Approved by the GFOA's Executive Board on March 2, 2007.

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Town of Palm Beach

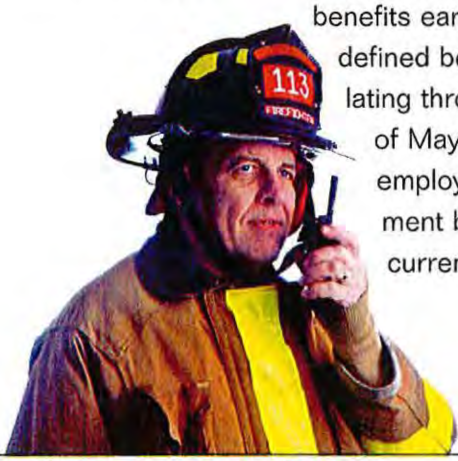
County: Palm Beach
Population: 8,350

"Change is hard, but this change is essential. It will restore the affordability of this benefit for the taxpayers while ensuring the sustainability of this benefit for the employees and our families."
~ Peter Elwell, Town Manager

Effective May 1, 2012, the Town of Palm Beach will change retirement benefits for both current and new-hire employees. While Palm Beach is one of the first municipalities in Florida to completely reform its pension system, the town's new hybrid system has some unique characteristics that will hopefully ensure it a sustainable future.

After increasing employee salaries and benefits from 2001 to 2006, the unexpected economic downturn in 2007 left their pension funds in an unhealthy state. If reform was not made, professional forecasts predicted municipal pension costs of $20 million in 2020. Liabilities of this proportion made pension reform necessary for current employees in addition to new-hires.

Over the past two years, the Town Council, administration and bargaining units have been reviewing options for pension reform. Negotiations reached an impasse and the Town Council is imposing its final decision. The reform includes moving from a defined benefit plan to a hybrid combination of a defined benefit and defined contribution plan, as well as consolidating the three general, fire and police boards into one. The town is also withdrawing from Chapters 175 and 185, Florida Statutes. Current employees will receive any benefits earned previously through the old defined benefit plan, but will start accumulating through the new hybrid system as of May 1. The hybrid system will provide employees with two sources of retirement benefits without increasing their current contributions.



"The hybrid plan adds needed flexibility to the town's retirement programs. It will allow the town to adjust the match up or down as economic cycles come and go, and it will allow employees to take their DC account with them upon leaving town employment."
~ Peter Elwell, Town Manager

Town of Palm Beach

BUDGETED TOWN COSTS FOR THE PENSION PLAN PER EMPLOYEE

	FY2008	FY2009	FY2010	FY2011	FY2012
General	11,229	10,464	11,882	14,803	3,060
Lifeguards	13,991	11,195	13,664	16,485	1,733
Police	30,732	27,145	30,562	39,842	17,338
Fire-Rescue	33,227	31,044	36,263	44,303	23,031

CURRENT PLAN

DEFINED BENEFIT PLAN

GENERAL

Multiplier: 2.75 percent

Eligibility: Age 55 and 10 years of service; 30 years at any age

Employee Contribution: 6.47 percent

Post Retirement: 2 percent COLA after two years of retirement; surviving spouse program

FIRE

Multiplier: 3.5 percent

Eligibility: Age 50 and 10 years of service; 20 years at any age; "Rule of 65"

Employee Contribution: 6.82 percent

Post Retirement: 2 percent COLA after two years of retirement; surviving spouse program

POLICE

Multiplier: 3.5 percent

Eligibility: Age 50 and 10 years of service; 20 years at any age; "Rule of 65"

Employee Contribution: 6.98 percent

Post Retirement: 2 percent COLA after two years of retirement; surviving spouse benefit included

NEW PLAN

DEFINED BENEFIT PLAN

GENERAL, FIRE AND POLICE

Multiplier: 1.25 percent

Eligibility: Age 65

Employee Contribution: 2.47 percent or 4.47 percent General (depending on years of service and hire date); 4.82 percent Fire; 4.98 percent Police

Post Retirement: No COLA; surviving spouse benefit optional ("buy down")

DEFINED CONTRIBUTION PLAN

GENERAL

Town Contribution: Match up to 4 percent

Employee Contribution: Mandatory 2 percent or 4 percent depending on years of service and hire date

Withdrawal Eligibility: Age 55

FIRE

Town Contribution: Match up to 4 percent

Employee Contribution: Mandatory 2 percent

Withdrawal Eligibility: Age 50

POLICE

Town Contribution: Match up to 4 percent

Employee Contribution: Mandatory 2 percent

Withdrawal Eligibility: Age 50

City of Clearwater

County: Pinellas
Population: 107,805

The City of Clearwater recently reached agreements with its collective bargaining units to implement changes to the defined benefit pension plan for current employees, and to create a second tier of benefits for new-hire general employees. A city ordinance requires a voter referendum to adopt any changes to the current pension plans.

From 2000 to 2011, the city's pension fund contributions increased from 7 percent of covered payroll to about 25 percent of payroll. This significant increase, partnered with projections of continued contribution-level increases, prompted the city to seek potential pension reform options. By proactively making pension changes now, the city hopes to improve the pension funds and prevent the city and residents from unmanageable financial liabilities. The city is required by ordinance to contribute at least 7 percent of its overall payroll to the plan, despite investment returns each year. This helped the city build up a surplus of funds in the past and assisted in weathering poor returns over the past 10 years.

In addition to adding a second tier of benefits for new-hire general employees, changes to current employees' plans are also up for referendum. One change is delaying the 1.5 percent cost-of-living adjustment (COLA) for five years for general employees, and eliminating COLAs completely from the fire and police plans. Current general employees will no longer accrue pensionable earnings on overtime or bonuses, and public safety employee contributions will increase to 10 percent of salary.

The city will also be offering a new "Partial Lump Sum Option" that will allow any interested employees to receive 10 percent, 20 percent or 30 percent of their total pension benefit in a one-time lump sum payment directly upon retirement. The Fire and Police SHARE plans of Chapters 175 and 185, Florida Statutes, funds will not be altered. Clearwater employees do not pay into or receive social security and, therefore, are extremely dependent on the security of their retirement benefits.

The city hopes that these changes will help create a secure and sustainable program. The city anticipates the reform saving approximately $400 million over the next 30 years. If approved by voter referendum, all changes will become effective in January 2013.

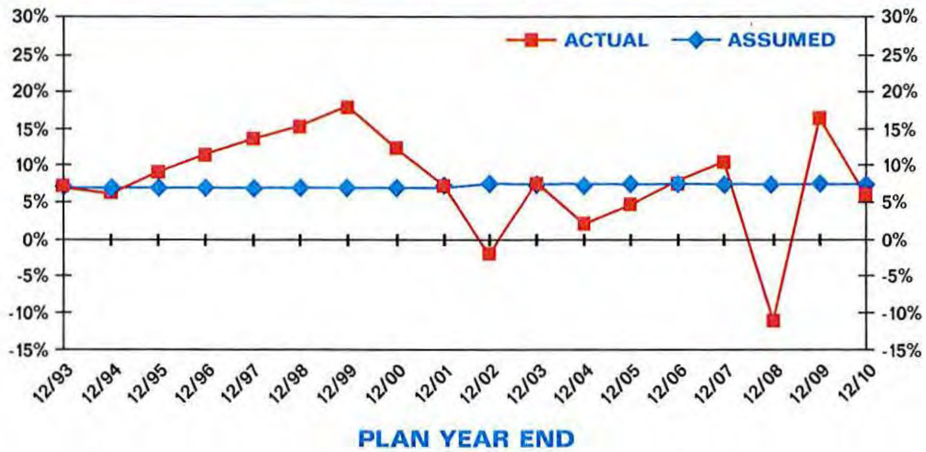
"These changes will reduce the city's long-term pension costs to a point where the city feels they can be sustained. However, even though our plan is very well funded (over 97 percent), we still had to find ways to reduce benefit levels for current and future employees. It illustrates that the challenge of providing public employees a retirement benefit must be balanced by the ability to pay."

~ Joe Roseto, Human Resources Director, City of Clearwater

City of Clearwater

> **"We were able to work together with our unions to reach a compromise that addressed our concerns about costs and still maintained a fair retirement benefit."**
>
> ~ *Joe Roseto, Human Resources Director, City of Clearwater*

INVESTMENT RETURN BASED ON ACTUARIAL VALUE OF ASSETS



Graph Source: City of Clearwater Employee's Pension Plan Actuarial Valuation Report as of January 1, 2011.

CURRENT PLAN

DEFINED BENEFIT PLAN

GENERAL

Multiplier: 2.75 percent
Eligibility: Age 65 and 10 years of service; Age 55 and 20 years of service; 30 years of service
Employee Contribution: 8 percent
Post Retirement: 1.5 percent COLA after six months of retirement

FIRE AND POLICE

Multiplier: 2.75 percent
Eligibility: Age 55 and 10 years of service; 20 years of service at any age
Employee Contribution: 8 percent
Post Retirement: 1.5 percent COLA after six months of retirement

NEW PLAN

DEFINED BENEFIT PLAN ADJUSTMENTS FOR CURRENT EMPLOYEES

GENERAL

Current employees will continue with old plan benefits other than below.
No overtime or additional pays accrued with the new plan will be included in pensionable earnings
1.5 percent COLA after five years of retirement
Minimum disability pension amount reduced from 66.66 percent to 42 percent
Adjusted Survivor Benefit Plan

FIRE AND POLICE

Employee contribution increased to 10 percent
No COLA for pensionable earnings accrued after new plan

DEFINED BENEFIT PLAN FOR NEW HIRES (SECOND TIER)

GENERAL ONLY

Multiplier: 2 percent
Eligibility: Age 60 and 25 years of service
Employee Contribution: 8 percent
Post Retirement: 1.5 percent COLA after five years of retirement; Minimum disability pension amount reduced from 66.66 percent to 42 percent; Adjusted Survivor Benefit Plan

City of Miramar

County: Broward
Population: 122,982

"We are always discussing options of pension reform, and considering different ways to reduce costs."
~ Natasha Hampton, Human Resources Director, City of Miramar

The City of Miramar offers four separate defined benefit plans for general, police, fire and management employees. In 2008, Miramar was one of the first municipalities in Florida to adopt a second tier of benefits into its police pension plan. The second police tier decreased the multiplier for new hires from 3.25 percent to 3.0 percent, and created an overall benefit cap at 80 percent of salary. The years of service required for retirement at any age increased from 20 years to 25 years for second-tier employees only. Miramar receives state funding from Chapters 175 and 185, Florida Statutes, which goes into separate SHARE funds for fire and police.

Besides the addition of the second tier to the police plan in 2008, the city has not made any changes to the first-tier police plan, or to the fire, general or management plans. However, the City of Miramar is always open to pension discussion and options of reform. Two of the city's contracts are up for renewal in October 2012. The long-term goal is to assess all city pension plans for possible reform without comprising the integrity of sound recruitment and fiscal due diligence.

GENERAL DEFINED BENEFIT

Multiplier: 2.75 percent - 3.0 percent depending on years of service
Eligibility: Age 65 with seven years of service; 20 years at any age
Employee Contribution: 7.36 percent
Post Retirement: No COLA

POLICE FIRST TIER DEFINED BENEFIT

Multiplier: 3.25 percent (80 percent cap)
Eligibility: Age 55 and 10 years of service; 20 years at any age
Employee Contribution: 13.4 percent
Post Retirement: 2 percent COLA after five years of retirement

POLICE SECOND TIER DEFINED BENEFIT

Multiplier: 3 percent
Eligibility: Age 55 and 10 years of service; 25 years at any age
Employee Contribution: 13.4 percent
Post Retirement: Ad Hoc variable benefit to be funded by Chapter 185, Florida Statutes, revenues

FIRE DEFINED BENEFIT

Multiplier: 3 percent (80 percent cap)
Eligibility: Age 55 and 10 years of service; 25 years at any age
Employee Contribution: 8.47 percent
Post Retirement: 3 percent COLA

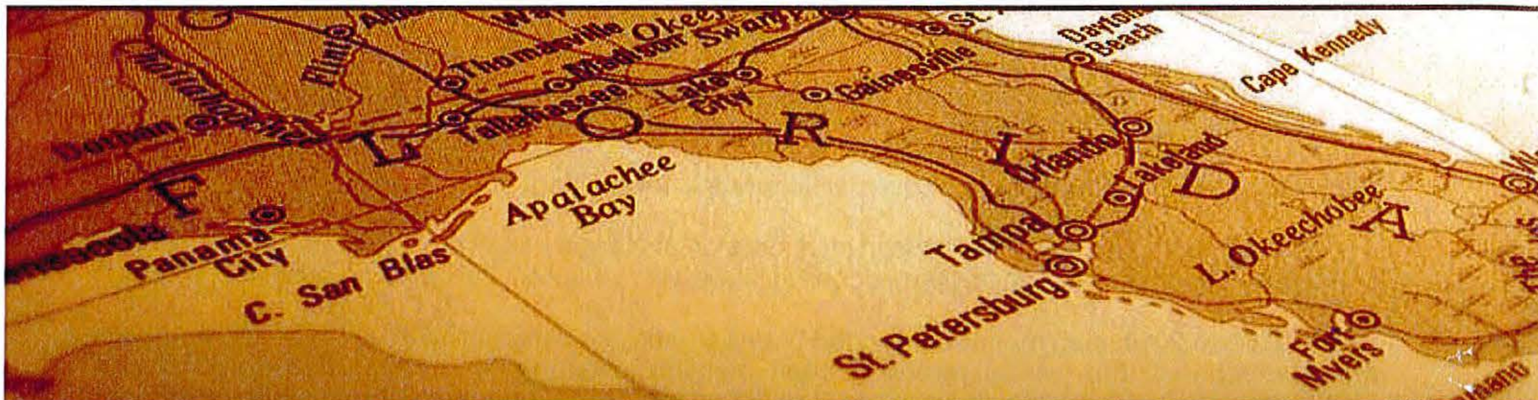
MANAGEMENT DEFINED BENEFIT

Multiplier: 3 percent - 4 percent depending on years of service; additional service beyond 10 years is multiplied by an additional 2.75 percent (80 percent cap)
Eligibility: Age 62 and five years of service; age 55 and 10 years; 20 years at any age
Employee Contribution: 13.5 percent
Post Retirement: No COLA

Attachment 1-C

TOUGH CHOICES

FACING FLORIDA'S GOVERNMENTS



YEARS IN THE MAKING: FLORIDA'S UNDERFUNDED MUNICIPAL PENSION PLANS

In recent months, municipal pensions in Florida have been under increased scrutiny. Cities as varied as Jacksonville and Temple Terrace have sought to deal with poorly funded pension plans. In November 2011, *Report Card: Florida Municipal Pension Plans*, authored by the LeRoy Collins Institute (LCI), highlighted the problem giving "D" or "F" grades to nearly one-third of the pension plans in Florida's 100 largest municipalities.[1] The report used recent financial statements to grade municipal plans and did not include plans in municipalities with populations less than 20,000. In doing so, LCI could not address whether the problems were short-term—the result of temporarily depressed market conditions—or whether similar problems exist in smaller cities and towns.

Years in the Making: Florida's Underfunded Municipal Pension Plans addresses both issues. The report uses data from the 2005 to 2011 Annual Reports of Florida Local Government Retirement Systems, published by the Florida Department of Management Services (DMS), to analyze several important trends in all 492 local government pensions.[2] This approach gauges whether Florida's municipal pension plans are fundamentally healthy and just need time to weather the current financial storm, or have structural problems that require significant repair.

LEROY COLLINS INSTITUTE

September 2012

LCI's trend analysis indicates that the problems facing many municipal pension plans are long-standing and not likely to be quickly resolved. Specifically, spanning the past few years, LCI finds:

› **The underfunding of Florida municipal pensions is not new, nor was it caused by the recent drop in the stock market – though market conditions have certainly made the problem worse.**

- The typical municipal pension plan's funding levels have been below 80 percent since 2004 and those levels have continued to decline nearly every year since 2001.

- Asset values fell sharply in 2008, and while they have mostly returned to their pre-2007 values, asset values are growing slowly.

› **The ratio of retirees relative to active participants is increasing.**

- The number of active participants in local pension plans has been fairly constant, but the number of retired participants is on the rise - doubling in the typical public safety plan over the last five years.

› **From 2004 to 2010, plan managers tended to underestimate salary growth of covered employees and overestimate the rate of return on their pension investments—actions that contribute to optimistic pension liabilities and can result in failing to contribute sufficient funds into retirement plans.**

- During most of this time, the typical pension plan's actual salary growth exceeded the assumed rate of growth used to forecast its liability.

- Additionally, the typical pension plan's actual rate of return on its investments was less than the assumed rate used to forecast its liability.

› **Annual pension contributions and the portion of those contributions that are used to pay down the unfunded liability have risen.**

- Annual pension contributions have significantly increased as a share of payroll.

- The portion of the annual contribution that goes toward paying down the unfunded liability in the typical plan has risen significantly.

- The employees' and state's portion of the annual contribution has not changed, but the portion paid by local governments has significantly increased, especially for public safety plans.

› **A new troubling trend may be emerging where annual payouts exceed contributions.**

- The year 2010 was the first year in recent history when the amount of money paid to retirees in the typical plan was more than the contribution for benefits that were earned in that year.

■ A Note on Reading the Figures in this Report

The Figures in this report provide information on "typical" pension plans. LCI uses "median" values to identify "typical" observations.

The median is the middle observation—half of the values are larger than the median and half of the values are smaller. The median differs from the average because it is not disproportionately affected by extremely high or extremely low values (so-called outliers).

In the bar chart Figures (such as Figures 2 and 3), each bar rises up to the median value in each year.

In the box plot Figures (such as Figure 1), the line in the center of the box is the median value. The top of the box identifies the value that is greater than 75 percent of the observed values. The bottom of the box identifies the value that is greater than 25 percent of the observed values. Each box, therefore, identifies the middle 50 percent of observations. The length of the lines coming out of the top and bottom of the boxes are equal to 1.5 times the height of their boxes and indicate the expected variation of most of the bottom and top 25 percent of the observations. "Any observed values that fall outside of the box and its lines are considered outliers, are relatively rare, and are not presented in the graphs (as noted by phrase "excludes outside values" on each of the figures)."

Also, a brief note on the years of data in this report. All of the Figures in this report provide data over multiple years. The years in Figures 4 and 5 (participant information) are the years of the annual reports (2005 to 2011). The rest of the report uses the year of the actuarial valuation date.

■ Underfunding is Not a New Problem

Much of the recent discussion on pension plans has focused on their funding levels (plan assets/plan liabilities). While any level below 100 percent is technically underfunded, it is widely, though not universally, held that the 80 percent funding level is a useful benchmark for identifying public sector plans that are in trouble (i.e., those falling below the benchmark).

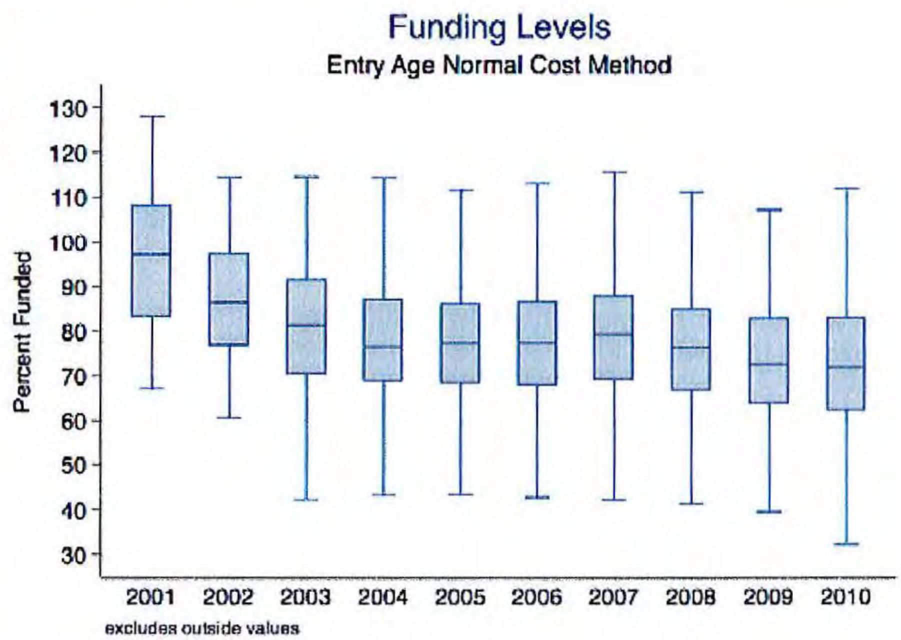


Figure 1

Figure 1 illustrates the change in funding levels from 2001 to 2010 for governments using the entry age normal cost method.[3] It combines police, firefighter, and general employee plans because their trends are very similar (in terms of direction and funding levels).

LCI's data source (DMS's Annual Reports of Florida Local Government Retirement Systems) provides information on funding ratios in previous years, which allows us to use the 2005 annual report to look at funding ratios as far back as 2001. Figure 1 clearly shows that the typical funding levels of Florida municipal pensions started falling well before 2008.

In 2001, the typical municipal pension was nearly 100 percent funded.[4] In 2002, funding levels fell to just below 90 percent and then to approximately 80 percent in the following year. Funding levels remained relatively stable from 2004 to 2007, with more than half of the pension plans under 80 percent funded during that period of relatively strong market returns.

The financial crisis is certainly associated with a drop in funding levels after 2007. However, it is important to note that funding levels dropped in every year (except 2007) over the past decade. Besides the drops in 2002 and 2003, annual declines have been relatively small, but they have steadily fallen to the point where the typical pension plan is approaching the 70 percent funding level in 2010 (meaning that nearly half of the municipal pension plans in the state were less than 70 percent funded). In 2009 and 2010, nearly three quarters of all pension plans were fewer than 80 percent funded and, conversely, a little more than one quarter of the municipal pension plans were more than 80 percent funded.

These results indicate that the current pension funding issues are not the direct result of the recent drop in the stock market and suggest that discussions about structural repairs to municipal pension plans are prudent responses to a decade-long trend.

One complication in judging the effect of the market decline, however, is that the actuarial valuation of pension assets that is used to calculate the funding ratio is not the market value of those assets, but is usually a smoothed average of recent market values. This means that dramatic changes in market values from one year to another will not be fully represented in the funding ratio for several years. As such, market values of pension assets must be evaluated.

■ Although Asset Growth has Slowed, Values Have Recovered from their 2007 Decline

A key issue in assessing the funding levels of municipal pensions is whether the current underfunding concerns are associated with "paper" losses in the values of pension assets and if better market conditions will correct much or all of the underfunding issue.

In a very optimistic sense, the paper-loss hypothesis is always true, since especially large increases in asset values could certainly cover the liabilities; however, it is difficult to find credible market observers who are willing to predict such large returns in the foreseeable future.

Figure 2 illustrates the loss of market value of assets for the typical municipality's **general employee plan** in 2008. But, it also shows that those values rebounded in 2009 and 2010. The 2009 and 2010 levels are below the high point of 2007, but are above the pre-2007 values.

Even though the asset values have returned, the growth rate over this period has been slowed by the financial crisis. The growth in the median total asset values between 2004 and 2010 represents an annual growth rate of approximately 4.6 percent, far below the plans' assumed growth rates of 8 percent (this assumption is discussed later in this report).

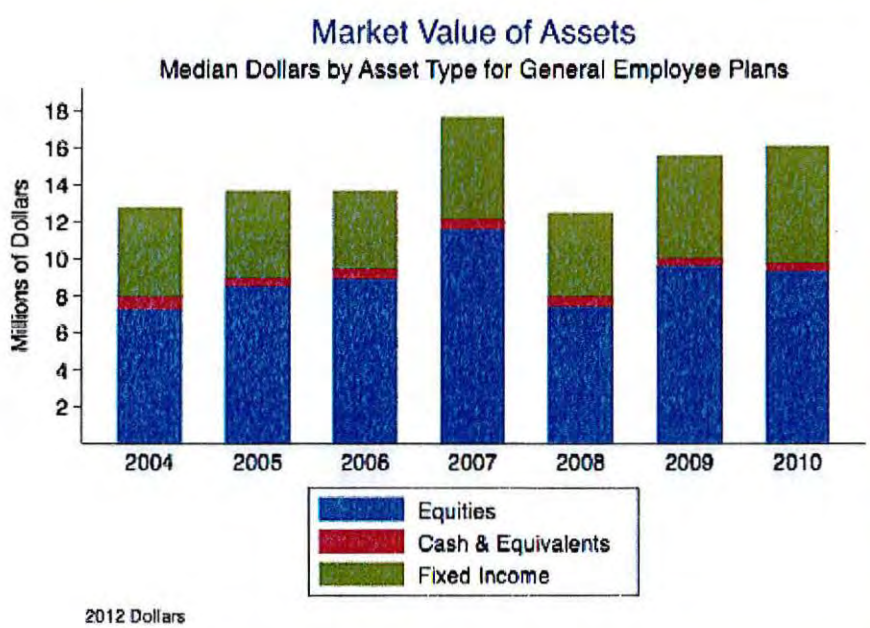


Figure 2

The bars in Figure 2 (and Figure 3) are divided into the typical plan's allocation across three broad asset classes: equities (e.g., stocks, real estate & mutual funds), cash & cash equivalents (e.g., cash on hand, certificates of deposit, money market accounts), and fixed income (e.g., bonds, mortgages, corporate debt, treasury notes, bond funds).

Figure 2 shows that pension funds are usually about 60 percent invested in stocks and about 35 percent in bonds. This allocation has remained fairly constant from 2004 to 2010 (plus or minus about 4 percentage points from year-to-year). This allocation is roughly equivalent to the allocation of mutual funds that are targeted toward retirement in about 25 to 30 years. This suggests that most pension plan administrators maintain a consistent asset allocation strategy through changing market conditions and are not chasing yields through stocks during bull markets and running to safety (in bonds or cash) during bear markets.

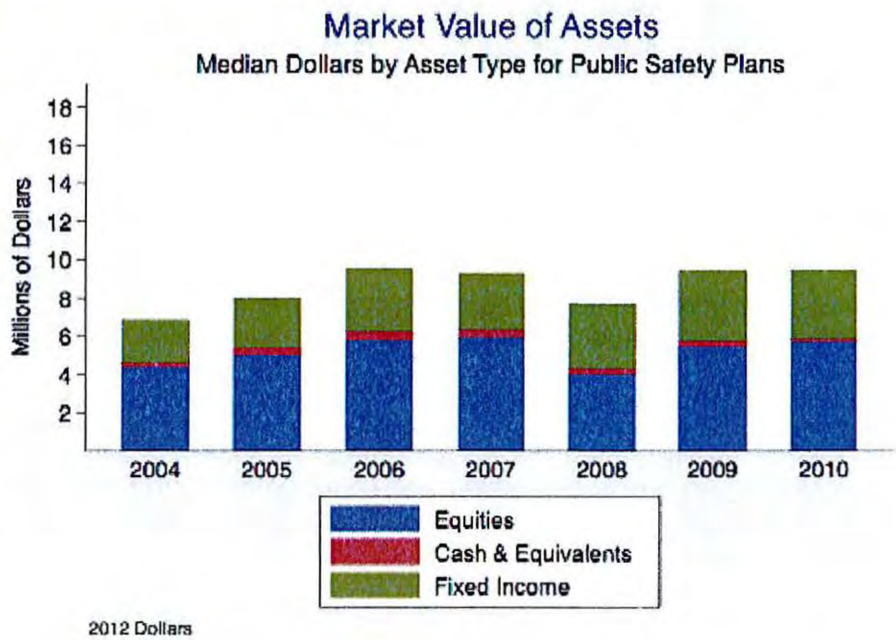


Figure 3

Figure 3 presents the market value of assets in **public safety pension plans** (those covering firefighters and police officers) and their allocation levels from 2004 to 2010. The dollar-value scales in Figures 2 and 3 are held the same to help demonstrate the relative difference in the asset values of general employee and public safety employee pension funds - though readers should be aware that most general employee plans cover more than three times the number of plan participants.

Like the general employee plans, public safety funds are also approximately 60 percent invested in equities and about 35 percent invested in bonds.

It is to be noted again that the market value of equity funds dropped significantly in 2008 and that the value returned to near 2007 levels by 2009, but the values have not grown and have actually declined slightly from 2006 to 2010.

Next, the demands on these plans must be considered.

■ Growth in Retirees Outstripping Growth in Employees

There are three different kinds of participants in pension plans. ***Active participants*** are individuals who are currently working and earning future pension benefits. ***Retired participants*** are individuals who are retired and are collecting their pension benefits. ***Terminated participants*** are individuals who are no longer earning additional pension benefits, but have not retired.

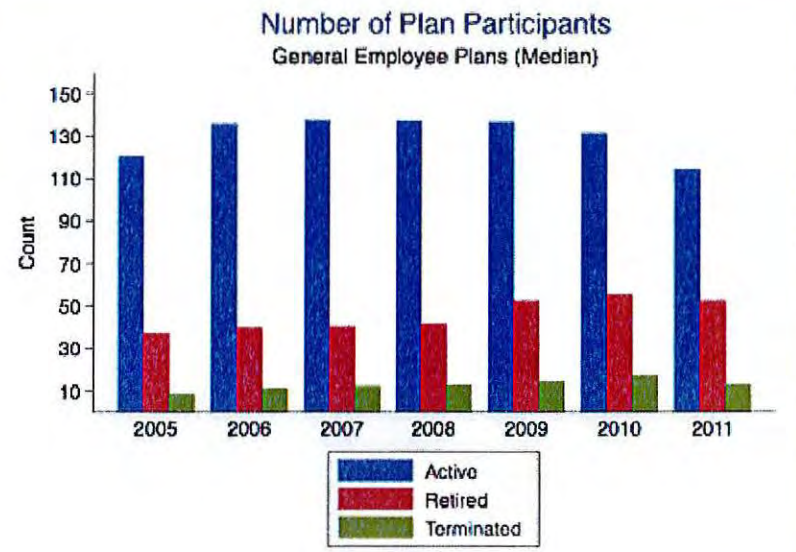


Figure 4

Figure 4 tracks the number of plan recipients by participant in **general employee** plans from 2005 to 2011. This Figure shows a general increase in the number of retired participants for the typical municipal plan.

In 2005, the typical plan had 120 active participants and 37 retirees; in 2011, it had 114 active and 52 retirees. Thus the number of employees stayed relatively stable over most of this time period, and has even declined in the past two years, but the number of retirees has increased—especially in 2009. The increase in the number of retirees is likely attributable to several factors, including demographic shifts and concerns that retirement incentives were going to become less generous (most notably by reducing the payouts or eliminating deferred retirement option programs—so-called DROP plans).

The number of terminated participants has increased slightly over the past seven years, but the number of terminated participants is much smaller than the number of active or retired participants.

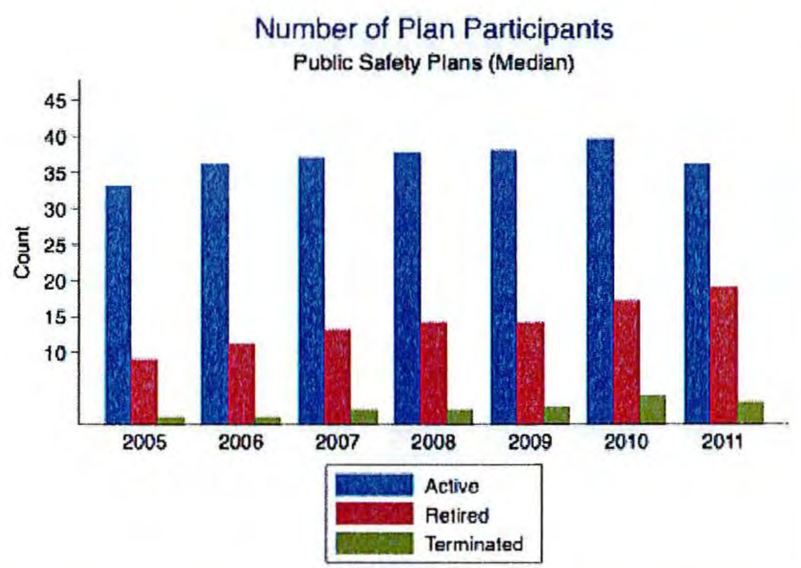


Figure 5

Figure 5 illustrates the distribution of participants in the typical public safety pension plans over the past seven years. Like the general employee plans, the number of active participants has remained fairly stable over the seven year period, with a slight drop in 2011, but the number of retired participants has doubled.

In 2005, the typical public safety plan had 33 active participants and 9 retirees; in 2011, there were 36 active participants and 19 retirees. As of 2011, there were more than half as many retired participants as active participants in the typical public safety plan.

This increase in the number of retirees is important because as the number of retired participants rises, so does the the size of the payouts from pension plans. That is not a problem for well-funded pension plans that are prepared for these pension outlays; but, it is a problem for governments with underfunded pension plans and those that did not anticipate the increase in retirement (such as those that provided retirement incentives in order to reduce payroll costs).

■ Accuracy of Pension Assumptions

In order to calculate pension liabilities, the trustees of pension plans, in consultation with their professional actuaries and advisors, make several important assumptions that are necessary to forecast their future pension benefits and then calculate the amount of money they need to have set aside to cover the benefits that have already been earned. That calculation results in the actuarially accrued liability, otherwise known as the pension liability.

If pension trustees make optimistic assumptions, they can lower the calculated liability. That may seem advantageous, but it only reduces the assumed size of the liability and does not affect the actual pension benefits. Over the long term, such overestimations will overstate the financial condition of the plan.

Important assumptions include the anticipated:

- Growth in employee salaries
- Long-term rate of return on the investment of pension assets
- Growth in the size of the payroll that is covered by the plan
- Inflationary rate
- Survival rate of pension beneficiaries

The DMS data provide information on the assumed and actual values of two of those key assumptions: salary growth and rates of return. In the next two Figures, focus is placed on the difference between actual and assumed values in recent years.

It is important to note, however, that these assumptions are not intended to be accurate every year; rather, they are intended to be accurate on average over many years (as much as 30 years). The actual growth in salaries and actual returns on investments will almost never be exactly the same as their assumed values. Sometimes actual values will be much higher than assumed levels and other times significantly lower. This is not problematic, so long as the average difference between actual and assumed values is small and does not bias pension plans toward underfunding their actual obligations.

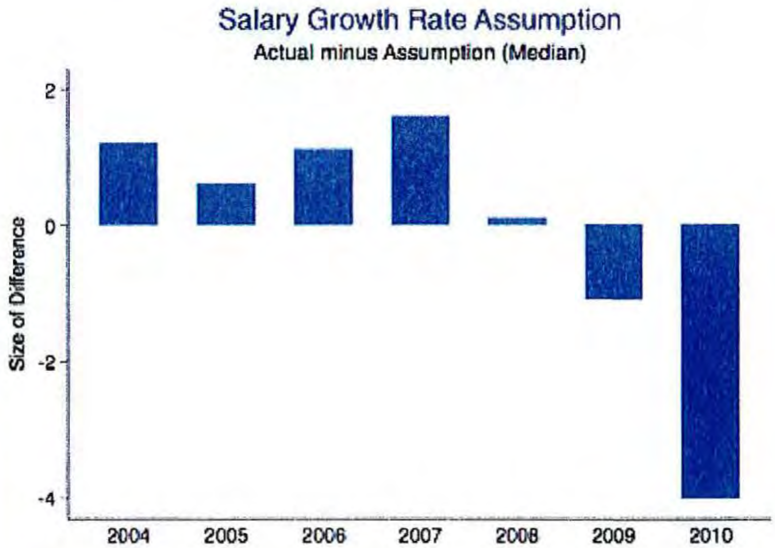


Figure 6

Figure 6 illustrates the accuracy of **salary growth** assumptions from 2004 to 2010 for general and public safety employees. Positive values mean that actual salary increases were greater than the assumptions. Because larger salaries lead to larger pension benefits for retirees, positive values mean that the actual growth in future pension benefits was greater than anticipated.

As Figure 6 shows, for the earliest years salary growth exceeded assumptions, but in the last two years, salary growth has fallen below assumptions. If the pre-2008 results are the norm, the consistent underestimation of salary growth is a likely contributor to the underfunding conditions prior to 2009. The shift from underestimating to overestimating in 2009 likely reflects the tight economic conditions facing many municipalities that have, in turn, significantly reduced salary growth. These last two years of overestimating salary growth will help correct the previous years' underestimations. This general trend is consistent across police, firefighter, and general employee plans.

The median assumed salary growth is 6.3 percent for police plans (from year-to-year the median assumption has been as low as 6 percent and as high as 6.5 percent), 5.9 percent for general employee plans (no lower than 5.7 percent in any single year during the time period analyzed), and 6 percent for firefighter plans (consistent in each of the years analyzed).

Another important assumption is the anticipated **long-term rate of return** on the investment of pension assets. This is similar to the rate of return that individuals may expect to earn on their own retirement investments. However, because pension plans have many participants entering and exiting the plan at different times, pension plans maintain a long-term investment strategy, whereas individuals are generally advised to change their investment strategies as they approach retirement to reduce their exposure to market risk and thereby accept lower rates of return.

The median assumed rate of return for all types of municipal plans was 8 percent in every year from 2004 to 2010. This is consistent with most public pension plans across the country.

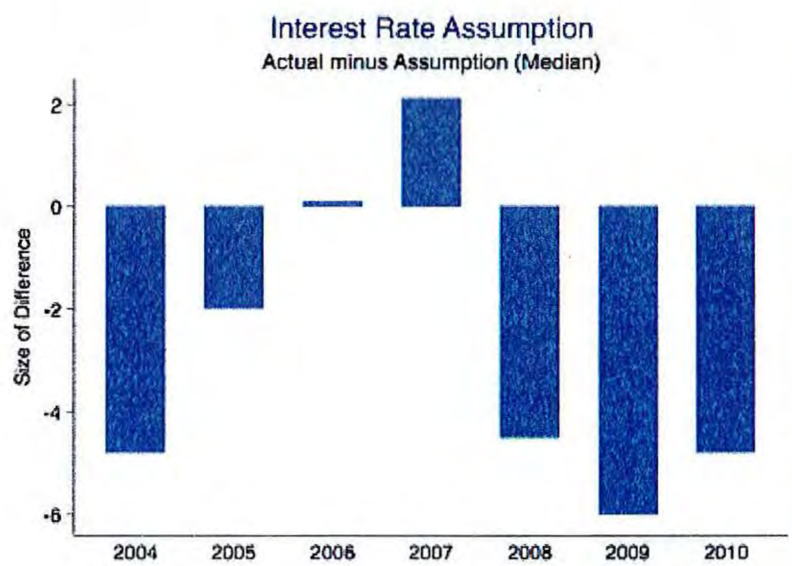


Figure 7

Figure 7 illustrates the accuracy of return on investment assumptions from 2004 to 2010. Positive values mean that typical investment returns were greater than assumed and negative values mean that actual returns fell short of the assumptions. When actual values are less than the assumed levels, plans will need to make up the difference by either achieving returns in future years that exceed their assumptions or by contributing more money into their pension plans out of budgetary resources.

It should not be a surprise that plans did not reach their investment return assumptions from 2008 to 2010. However, it is more unexpected that plans did not meet their assumptions in 2004 or 2005 and barely made their assumptions in 2006. In fact, 2007 was the only year that actual returns were greater than the assumption. Unfortunately, the data do not provide a longer-term analysis. There is a widely held concern that pension investors will seek to recover these "losses" by shifting assets into riskier stocks that pose the possibility of greater returns as well as risks of further losses. Trends are similar among police, fire, and general plans.

■ Trends in Annual Pension Contributions

Some in the pension community are critical of analyzing the health of pension plans based on their funding levels. They argue that the annual cost of pensions and a government's ability to meet those costs are key to the sustainability of pension funds. This position has merit. The rest of this report, therefore, looks at trends in annual pension contributions (i.e., the budgetary cost of pension plans born by taxpayers and pension participants).

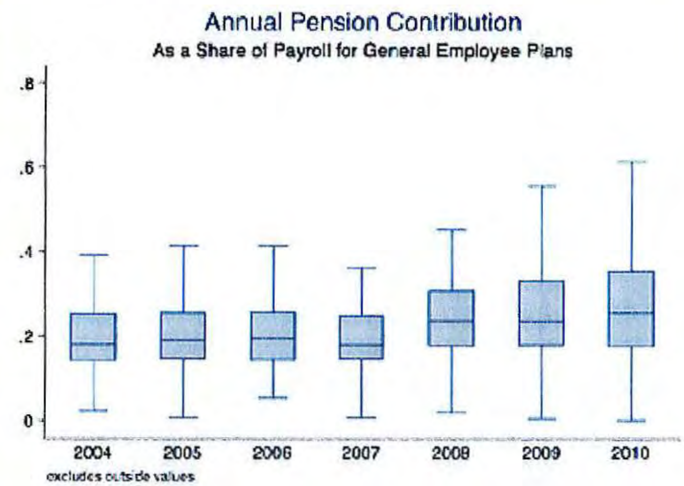


Figure 8

Figure 8 illustrates the growth in annual pension contributions as a share of the total covered payroll for **general employees** from 2004 to 2010. Annual contributions rose from 18 percent of covered payroll in 2004 to 25 percent of covered payroll in 2010. That is a 7-percentage point increase and means that over a fairly short period of time, pension contributions are growing steadily. Put another way, in 2004, pension contributions were less than 20 percent of a typical general employee's pay; in 2010 they were about a quarter of pay.

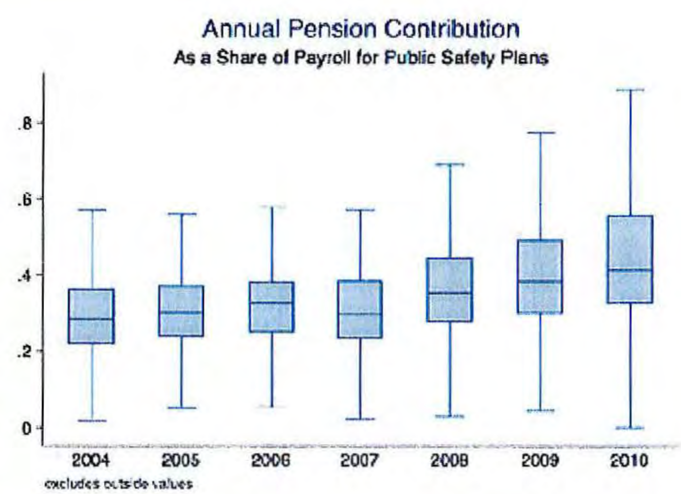


Figure 9

Figure 9 illustrates the growth in the total contributions for **public safety pension plans** from 2004 to 2010. Total contributions rose from 28 percent of covered payroll in 2004 to 41 percent of covered payroll in 2010. That is a 13-percentage point increase. That is, in 2004, pension contributions were a quarter of a typical public safety worker's pay and they are approaching half of their pay in just seven years.

Note that the rate of growth in annual contributions in public safety plans is significantly higher than in general employee plans, and the 2004 value for public safety workers is more than the 2010 value for general workers.

■ City Governments Paying More

One of the more concerning trends deals with the allocation of payment responsibility for municipal pensions. LCI's analysis over the past seven years shows that local governments are picking up the increase in annual pension costs—especially for public safety plans.

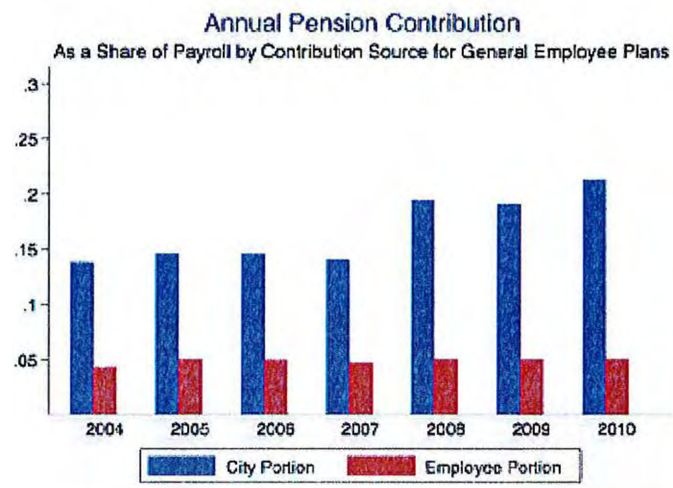


Figure 10

Figure 10 breaks out the total contribution of **general employee** plans into the portion that is paid by the municipality and the portion that the employee contributes out of his or her own pay. The growth in employee contributions is flat from 2004 to 2010. The city's portions, however, have risen significantly—from 13.8 percent in 2004 to 21.3 percent in 2010.

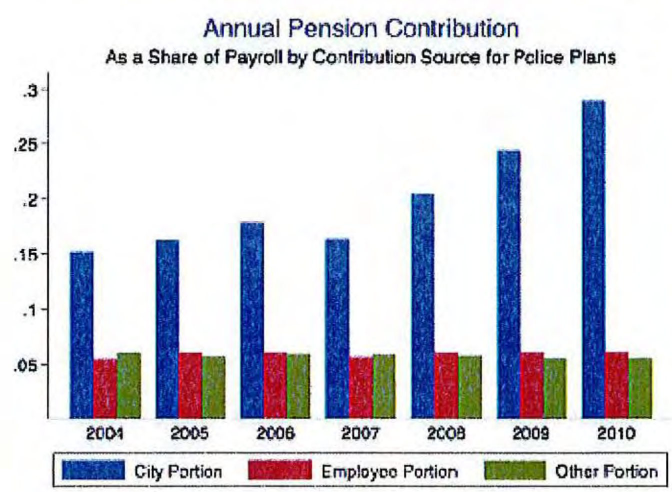


Figure 11

Figure 11 shows the contributions of employees and the city as a proportion of payroll for the typical **police pension** plan. It differs from Figure 10 because most police plans are also funded by the state through the return of insurance premium tax dollars collected within each city's jurisdiction. This Figure shows all three sources of funding.[5] Again, the growth in employee contributions is flat from 2004 to 2010. The growth in state contributions from premium tax dollars is also mostly flat. The municipalities' portions, however, have nearly doubled—from 15.1 percent to 28.9 percent.

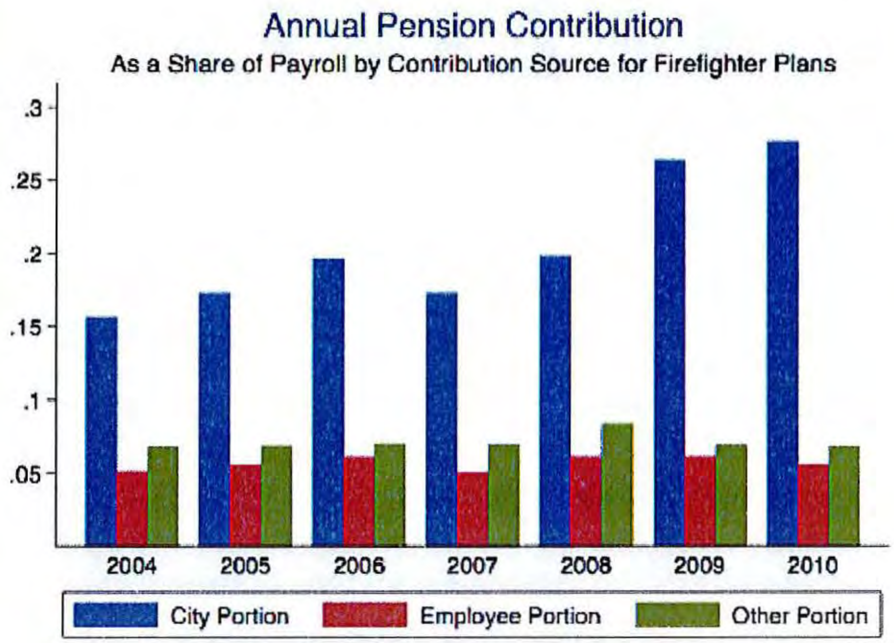


Figure 12

Figure 12 shows the portion of contributions in **firefighter** plans that is paid by the municipality, the portion that employees contribute out of their own pay, and the portion paid by the state through the return of insurance premium tax dollars that were collected within each municipality's jurisdiction. Again, the growth in employee contributions is flat from 2004 to 2010. The growth in state contributions is also mostly flat and is actually more than that of employees. The municipality's portion has risen significantly.

This growing contribution from municipalities comes at a time when many municipalities are fiscally stressed with revenues curtailed and demand for services intensified as a result of tough economic times.

■ Understanding the Increase in Contributions

Another way to look at the annual contributions is to consider how much of the total annual contribution can be attributed to benefits that are earned during the year by active participants (the normal cost) and how much can be attributed to paying down benefits that were earned in previous years, but are not covered by current assets (the unfunded portion of the liability).

The unfunded portion of the liability (referred to as the unfunded actuarial accrued liability or UAAL) does not need to be paid back in a single year (for most governments, this would be financially implausible). Rather, pension plans with unfunded liabilities are allowed to amortize that liability over many years (most amortize over about 30 years). Therefore, each year's pension contribution includes a portion to cover the benefits that were earned that year and a portion to pay off some of the unfunded liability (this is the UAAL contribution). When unfunded liabilities increase or if plans use shorter amortization periods, the UAAL contribution increases.

Figure 13 illustrates the increase in the normal cost of pensions and the increase in the cost of pensions associated with paying the UAAL contribution. The Figure shows that the rise in the pension contribution costs is partially associated with recognizing larger costs for current workers (the rise in normal contribution) but is especially influenced by lower funding ratios and the increase in payments toward paying for previously earned benefits (the rise in the UAAL contribution). In 2004, the UAAL was a small portion of the total contribution, but in 2010 it is more than a third of the cost.

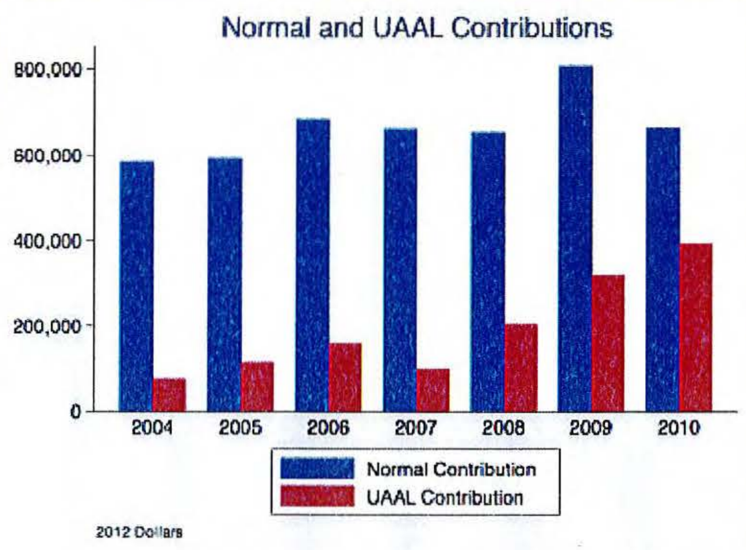


Figure 13

How does the size of annual contributions match up against the amount that is paid out each year in pension benefits?

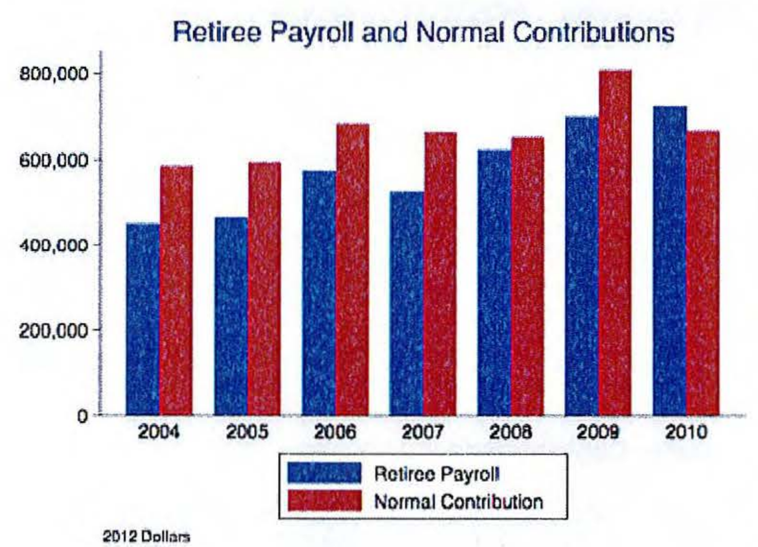


Figure 14

Figure 14 illustrates the payments to retirees (the so-called "retiree payroll") and compares that information to the normal contribution for pension plans each year. Recall that the normal contribution is the cost of benefits that are earned in a given year.

Figure 14 shows that normal costs were greater than the retiree payroll until 2010, which is the first year that the typical government paid out more money in retirement benefits than it contributed for benefits that were earned that year. This is significant because it indicates that Florida's municipalities are entering a period where earned benefits need to be paid and there is less time to improve underfunded plans.

This trend is similar for all classifications of employees.

■ Conclusion

This report analyzes recent trends in Florida municipal pensions using both funding levels and annual pension contributions. In doing so, it shows that current concerns about underfunded municipal pension plans were not caused by the downturn in the stock market. Rather, the underfunding began before the stock market fell—even when economic times in the state and nation were relatively strong. In short, it is a problem that has been years in the making.

Other findings include:

1. Pension contributions have increased substantially over the past seven years.
2. Local governments are picking up more of the pension costs, especially for public safety plans.
3. The number of retirees is on the rise and is outstripping the growth of active participants in municipal pension plans.
4. Plans tend to overestimate the growth in employee salaries and long-term rate of return on investment of pension assets.
5. Payments for unfunded liabilities are making up an increasing proportion of annual pension contributions.

This report shows that while employee and state pension contributions are fairly stable, those costs for municipalities (i.e., taxpayers) are growing—adding insult to injury for many cities struggling to make ends meet.

■ Endnotes

[1] A "D" plan was funded at 60-70 percent; an "F" plan was below 60 percent funded. Funding levels are measured as the percent of the plans' liabilities covered by its assets. A "D" means that assets covered only 60-70 percent of the plan's liabilities. LCI's research covered 87 of the largest 100 cities' plans offering defined benefits and not included in the Florida Retirement System (FRS). The remaining cities provided defined benefits to their employees or were part of the FRS. LeRoy Collins Institute. 2011. Report Card: Florida Municipal Pension Plans. November. http://bit.ly/rzxHyq

[2] LCI covers only those municipalities that offer defined benefit pension plans and plans that are outside of the FRS.

[3] The Entry Age Normal Cost Method is the most common actuarial cost method in Florida. Entry Age Actuarial Cost Method allocates the present value of the projected benefits of each individual in the actuarial valuation of the pension plan on a level basis over the service of the individual between the age that they enter the plan and the assumed age that they will exit the plan. New accounting standards require this cost method for all state and local government pension plans in fiscal years beginning after June 15, 2014. The general trend is the same across other funding methods, though the funding ratios for the other methods are higher.

[4] Other studies have shown that the funding levels of public pension plans were at their peak around 2000, but that those levels are not typical over the past 20 years. See J. Fred Giertz and Leslie E. Papke's (2007) "Public Pension Plans: Myths and Realities for State Budgets", National Tax Journal, LX (2), 305-323

[5] The state's portion is labeled "other portion" in this report to match the labeling in the original DMS reports.
A "D" plan was funded at 60-70 percent; an "F" plan was below 60 percent funded. Funding levels are measured as the percent of the plan's liabilities covered by its assets. A "D" means that assets covered only 60-70 percent of the plans' liabilities.

TOUGH CHOICES

Tough Choices: A research series focused on state and local government relationships from the LeRoy Collins Institute.

Established in 1988, the LeRoy Collins Institute is an independent, nonpartisan, non-profit organization which studies and promotes creative solutions to key private and public issues facing the people of Florida and the nation. The Institute, located in Tallahassee at Florida State University, is affiliated and works in collaboration with the State University System of Florida.

Named in honor of former Florida Governor LeRoy Collins, the Institute is governed by a distinguished board of directors, chaired by Allison DeFoor, D.Min. Other board members include executives, local elected officials, and senior professionals from throughout the state.

Beginning in 2005, the Institute published several reports in a series called, *Tough Choices: Shaping Florida's Future*. These publications provided an in-depth analysis of Florida tax and spending policy including Medicaid, PreK-12 education, higher education, and children's health and welfare. The research concluded Florida's pattern of low spending and low taxes conflicted with the growing demands of the state's residents, predicting trouble may be ahead.

In the newest research series, *Tough Choices: Facing Florida's Governments*, the Institute takes an objective look at the often tumultuous relationship between state and local governments in Florida. This report *Years in the Making: Florida's Underfunded Municipal Pension Plans* is the fourth release in this research series. This report was written by Dr. David Matkin, assistant professor at the Reubin O'D. Askew School of Public Administration and Public Policy. Godwin "Tommy" Thiruchelvam, a master of public administration student in the Askew School, also assisted with the analysis and interpretation of the data.

The *Tough Choices* research series is funded by the Jessie Ball duPont Fund. The Florida League of Cities generously provided support for this report. Future reports in the *Tough Choices* research series will examine trends in city and county spending and revenue, state proposals to limit local revenues, and differential effects of the economy and state mandates on fiscally distressed communities.

All publications from the Institute can be found at the Institute's website: http://CollinsInstitute.fsu.edu.

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KLAUSNER KAUFMAN JENSEN & LEVINSON

To: All Florida Pension Plans

From: Klausner Kaufman Jensen & Levinson

Re: LeRoy Collins Institute September 2012 Report

Date: October 5, 2012

On September 25, the LeRoy Collins Institute released a new white paper entitled *Years in the Making: Florida's Municipal Pension Plans* (hereinafter the 2012 "Study"), a continuation of their earlier 2011 report regarding municipal pension plans in Florida. The purpose of this memo is to share our thoughts with clients about the important role of defined benefit ("DB") plans in the public sector. We will use the 2012 Study as a foil to discuss retirement security and the advantages provided by DB plans. We also encourage clients to discuss the "trends" described by the 2012 Study with their actuary, so as to compare whether and how the new Study's conclusions have any bearing on their plan.

This memo begins with an overview of the 2012 Study. The second half of the memo addresses the underappreciated lifetime security and retirement income provided by DB plans and what some have described as the failure of the 401(k) experiment. In summary, the underlying purpose of this memo is to provide a broader and longer term perspective than the Collins Study, that is less hostile to public employee benefits.

2012 Collins Study

By way of background, the 2012 Study uses Annual Reports from the Department of Management Services ("DMS") from 2005 to 2011 to answer the following question posed by the Study's authors:

> whether Florida's municipal pension plans are fundamentally healthy and just need time to weather the current financial storm or have structural problems that require significant repair.

The Study doesn't justify, explain or define what would constitute a structural problem. Nor does the Study hint at any constructive "structural repairs" to the self identified problematic trends. With that said, as set forth below, the Study's findings are generally unremarkable for trustees who are

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familiar with DB plan funding and the undeniable poor investment experience over the past decade. More remarkable, however, and potentially suggestive of the Study's agenda, is the concluding sentence that plan costs are "adding insult to injury for many cities struggling to make ends meet." Yet, no mention is made of the hundreds of thousands of Floridians who earned their DB pensions during a lifetime of public service, or the advantages of DB plans compared to their inferior alternatives.[1]

According to the Study's introductory notes, the LeRoy Collins Institute attempts to report on the "typical" pension plan. It uses median values to do so, excluding variations which are deemed to be outliers. The number of outliers excluded from the universe of 492 plans is not identified.

Interestingly, in comparing plan data from 2001 to 2010, the 2012 Study fails to mention that a not insignificant number of plans were closed during this time period. We understand from the Division of Retirement that at least 67 of the municipal plans in Florida are currently closed to new participants. This fact may skew the Study's results, particularly with regard to the ratio of retirees to active participants. A closed plan, by definition, does not add any new members. Similarly, future payroll growth assumptions are irrelevant for a closed plan with no remaining active members. The distinction between open and closed plans is not addressed in the 2012 study. Moreover, the growth of pension contributions, as a percentage of covered payroll, becomes increasingly meaningless in the context of a closed plan.

The Study concludes with the following summary of its findings: (i) concerns about underfunded municipal pension plans were not caused by the downturn in the stock market, but rather under funding that began before the market fell; (ii) pension contributions have substantially increased from 2005 - 2011; (iii) local governments are picking up more of the pension cost; (iv) the number of retirees is growing and is "outstripping" the growth of active participants; (v) plans tend to overestimate assumed salary growth and investment earnings; (vi) payments for unfunded liabilities represent a growing proportion of annual pension contributions.

The Study's first finding announces that funding levels have declined nearly every year since 2001. According to the Study, "the problems facing many municipal pension plans are long-standing", yet the Study acknowledges that in 2001 the typical municipal plan was nearly 100% funded. In other words, the Study effectively minimizes the downturn in the stock market over the past decade, when the past ten years were book-marked by some of the most severe market dislocations in modern history. It is therefore puzzling why the Study concludes on page 12 by stating that the "underfunding began before the stock market fell." Moreover, the underlying resiliency of the plans' investment portfolios is too easily dismissed by the Study. Favorable market returns for the fiscal year that just ended on September 30 are of course omitted.

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[1] Readers are referred to the NCPERS website, www.ncpers.org for materials and fact sheets regarding defined benefit pensions and the retirement security they provide.

Figure 1 on page 2 of the Study compares funding ratios from 2001 to 2010. We remind readers of two bear markets in equities, the bursting of the tech and dot.com bubble, Enron, WorldCom, the 9/11 tragedy, two wars, the housing bubble, the subprime mess, the Lehman bankruptcy, the government takeover of Fannie Mae and Freddie Mac, AIG, and the new vocabulary of the Great Recession, the worst recession in seven decades. Indeed, as measured by the S&P 500, the calendar decade studied by the Collins Institute ended with a negative total return. Had an unlucky individual investor bought the S&P 500 on the last day of 1999 @ 1469, on a pure price basis they would have lost 24% as the index closed 2009 at 1115. Including dividends, the S&P lost 10% from January 1, 2000 to December 31, 2009. As a consequence, even well diversified portfolios were not immune from losses.

During this period, many individual investors in defined contribution ("DC") plans have had to postpone retirement as their DC and 401(k) balances were decimated. By not acting in accordance with a long-term investment policy, too many individual investors reacted emotionally and sold equities during market lows, prior to the current rebound.

By contrast, investment decisions in DB plans are made by professional money managers overseen by fiduciaries. As a result, DB plans were regularly investing and rebalancing their portfolios during market downturns. This is one of the reasons why over the long term DB plans consistently outperform their assumed investment rate of return.[2] This also illustrates the wisdom of Florida statutory requirements which mandate payment of actuarially determined contributions on an annual basis. By preventing plan sponsors from taking "funding holidays", DB plans are empowered to stick with their long term investment strategies.[3]

As for its second and third findings, the Study observes that over the past seven years "local governments are picking up more of the pension costs, especially for public safety plans." "While employee and state contributions are fairly stable," the Study expresses concern that the costs for municipalities are growing. This should not be a surprise, however, in light of the underlying investment and actuarial experience. Trustees understand that increasing employer funding obligations, by design, is what happens in a DB plan when investment risk rests with the plan sponsor.[4] This fact illustrates why the 401(k) experiment is considered by many to be a failure, as investment risk lies entirely with the individual investor. Increasing employer contributions

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[2] www.nasra.org/resources/issuebrief120626.pdf

[3] It is unfortunate that for the past several years, the Florida Legislature has only contributed the normal cost into the Florida Retirement System ("FRS"). By not making contributions to fund the growing FRS unfunded actuarial liability, the FRS funded ratio is projected to continually decline over the next two decades. Municipal plans in Florida annually fund both their normal cost and UAL, and accordingly are improving their funded ratios.

[4] At the same time, however, anecdotal evidence already suggests a meaningful trend of increased employee contributions and lower benefit packages for newly hired workers.

following adverse experience is the appropriate and necessary result to gradually restore DB plan funding, about which the Study otherwise seemingly complains.

No surprise for trustees, the Study illustrates the consistency by which Florida municipal DB plans have invested by employing long-term investment strategies. Unlike individual investors, the 2012 Study necessarily concedes that Florida municipal DB plans maintained "a consistent asset allocation strategy" during this challenging market environment and were not "chasing" returns or market timing. The Study describes an unattributed but "widely held concern that pension investors will seek to recover 'losses' by shifting to riskier stocks," but the Study's analysis actually provides proof to the contrary for Florida municipal DB plans.

Unlike DB plans, DC plan participants are generally required to reduce their exposure to market risk and thereby lower their expected returns as they age. By contrast, DB plans, through pooling market and longevity risk, are able to invest more cost effectively and obtain better long term investment returns. For any given level of retirement benefits, DB plans are less expensive than DC plans.[5]

The Study's fourth finding discovers that the number of retirees is growing and is "outstripping" the growth of active participants. In dramatic fashion, the Study is troubled by the fact that payouts may have exceeded contributions in 2010. Yet, actuaries and trustees are generally not concerned, as this merely reflects the maturation of the average DB plan. After all, the purpose for accumulating pension assets is not to store them up for perpetuity, but to pay them out. One should not be surprised or necessarily concerned when a pension plan distributes pension benefits.

Additionally, the Study's analysis is potentially flawed as it does not adjust for the fact that approximately 13% of the plans in the Study are closed and have no new active members. On page 5, the Study attributes the increase in the number of retirees to "several factors, including demographic shifts and concerns that retirement incentives were going to become less generous". Left entirely unmentioned is the downsizing, hiring freezes, and layoffs that have been implemented in recent years. Again, thankfully, many of these retirees have secure income from their DB pensions.

Ironically, to the extent that the Collins Institute or some of its supporters may be seeking to replace DB plans with DC plans, the net result would be to accelerate the replacement of participants with retirees. Actuarial studies have shown that closing a plan is likely to cost *more* over the short term. Any long-term cost savings of switching to a DC plan are uncertain.[6] We would argue that closing

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[5] Beth Almeida and William B. Fornia, "*A Better Bang for the Buck*" (Washington, National Institute on Retirement Security, 2008). www.nirsonline.org/index.php?option=com_content&task=view&id=121&Itemid=48

[6] *The Top 10 Advantages of Maintaining Defined Benefit Pension Plans* (NCPERS, January 2011) at page 6. www.ncpers.org/Files/2011_ncpers_research_series_top_ten.pdf

or terminating a DB plan after adverse actuarial experience is analogous to selling out of the market after a major correction. In hindsight, this often turns out to be a regrettable decision.

The Study's final findings express concern about plans overestimating assumed salary growth and investment earnings. Here too, one might question the Study's analysis. On page 7 the Study stresses the "consistent underestimation" of salary growth during 2004-2007. Less attention is paid to the more pronounced reverse trend in salary data starting in 2008. We understand that the deceleration of wage growth has generally continued into 2012, which will contribute to future actuarial gains.[7] In fact, some actuaries are recommending reductions in the salary assumption as an offset to the impact of lowering the investment assumption. Accordingly, the setting of assumptions is a dynamic process which should self correct over time with actuarial experience.

As described by the Study, it was "unexpected" that plans did not meet their investment assumptions in 2004 or 2005. We invite the Study's authors to revisit the data. The Study fails to explicitly recognize that plan data is generally reported on a fiscal year basis. Notwithstanding the introductory notes, to a casual reader figure 7 appears to treat the investment assumptions and investment returns on a calendar year basis. Moreover, not all plans submit annual actuarial valuations.

Accordingly, greater transparency would result if the Study disclosed how many plans are measured by each statistic. For example, the Study, which relies on the Division of Retirement's Annual Reports, does not disclose that valuations for the plan year ending 2010 were only available for *at most* 344 plans, not the full universe of 492 plans. Therefore, if the Study exclusively relies on the Division of Retirement's annual reports, *at best* 70% of the universe was analyzed in 2010 (before removing outliers, which are also not quantified). Making a larger point, we invite the Collins Institute to objectively examine longer term data and trends, without seizing on market turmoil to undermine a fundamentally sound and resilient retirement structure.

In Defense of DB Plans:

Disclaimer: In the opinion of Klausner, Kaufman, Jensen and Levinson, there is no better tool to attract, retain, and provide employees with a secure retirement than a DB plan. Since the severe market dislocation of 2008, it has become increasingly clear to many that relying solely on a DC plan will result in inadequate retirement benefits for the vast majority of participants. This is our perspective, which we openly admit.

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[7] Recent national data indicates that public sector wages have been below 1.5% for more than two years, and below two percent since the middle of 2009. http://wikipension.com/index.php?title=Compenation

As counsel for the National Conference on Public Employee Retirement Systems ("NCPERS"), we share NCPERS' philosophy that in a perfect world retirement income should be based on a three legged stool of Social Security, an employer sponsored DB plan, and personal savings (including supplemental DC accounts). The following discussion will summarize the critical role of DB plans for public employees.

In a political environment when Washington can agree on very little, it is noteworthy that this summer, Congress adopted and President Obama signed into law H.R. 4348. The Moving Ahead for Progress in the 21st Century Act ("MAP-21") was included in a two-year omnibus highway transportation bill. We mention the legislation, which provides funding relief for private sector DB plans, not because it has any direct application for public plans. Rather, MAP-21 illustrates that Congress understands the importance of defined benefit pension plans.
As critics of DB plans cannot deny, one of the major differences between a DB and DC plan is investment risk. When a DB plan is closed, investment risk is off-loaded to future hires. Increasingly, retirement professionals and academics are acknowledging that 401(k) plans were never intended or designed to replace DB plans. They cannot. DC plans at best provide a complement to DB benefits, particularly for public sector employees.

Serious observers are increasingly recognizing that all too often, employees who are permitted access to their DC or 457 balances withdraw from their plans to pay for college education, medical expenses, home improvement, home ownership, and other non-retirement related expenses. When "leakage" of DC assets is coupled with the fact that DC plans place all of the investment risk on employees, it is not hard to understand how DB plans are far superior options, especially for long-term employees. We leave for the investment professionals to explain the common mistakes that are made by individual investors, who are asked by DC plans to shoulder the responsibility for their own retirement. Another disadvantage of DC plans is that they force participants to serve in the role of professional money manager.

The story continues after a retiree separates from service. A DC plan retiree must budget their withdrawals over time and gradually reduce their exposure to riskier asset classes. DB retirees, by contrast, know in advance of the decision to retire that they will enjoy monthly retirement income, invested and overseen by fiduciaries. Thus, a DB plans allows retirees to maintain a stable portion of their pre-retirement standard of living.

In summary, the benefits of DB plans include:
• predictable, secure retirement income that retirees cannot outlive;
• pooling of longevity and investment risk;
• superior investment returns compared to DC plans;
• balanced and professional portfolio diversification by professional money managers and consultants to maximize returns over a long time horizon;
• more efficient with lower investment management fees and administrative costs than DC plans;
• reduced employee turnover, employee training and recruitment costs;
• disability and survivor benefits, which are critical for public safety employees;
• flexibility and the ability to facilitate orderly retirement succession by providing employees with the ability to retire even in difficult market environments;
• higher standard of living with less likelihood of retirees living in poverty;
• economic benefits for local economies if retirees remain in their local communities[8].

Klausner Kaufman Jensen and Levinson welcomes questions and invites you to visit our website, along with the following resources: www.robertdklausner.com; ncpers.org; nasra.org; nirsonline.org.

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[8] According to the *Pensionomics 2012* study by the National Institute on Retirement Security, 360,065 residents of Florida received a total of $7.2 billion in pension benefits from state and local pension plans in 2009. http://www.nirsonline.org/index.php?option=com_content&task=view&id=684&Itemid=48

Attachment 1-D

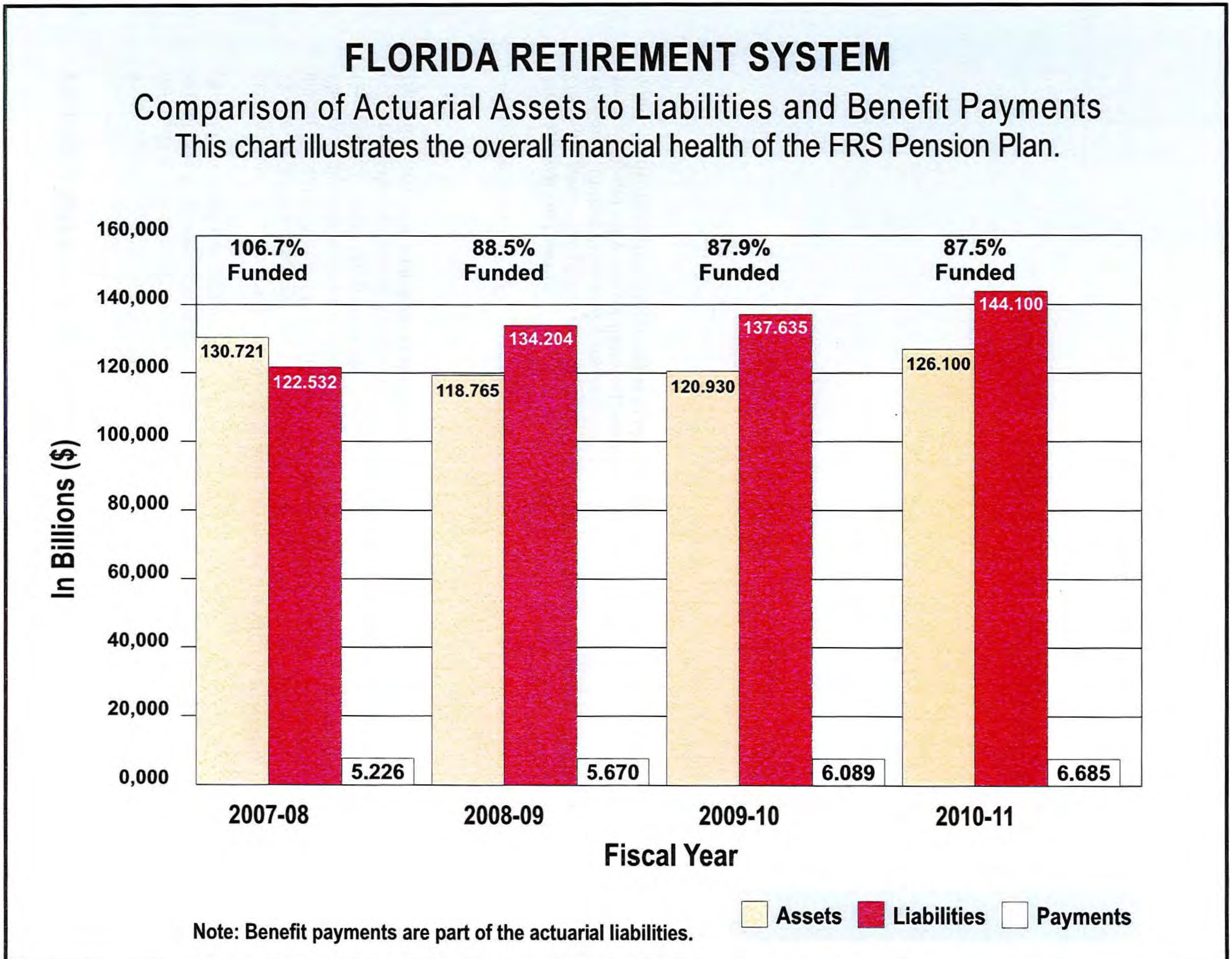
Funding of the FRS Pension Plan

The FRS Pension Plan funding valuation takes place annually, available December 1st and was 87.5 percent funded, as of July 1, 2011. You can view a chart (follows this page) that compares the plan's actuarial liabilities to the plan's actuarial assets for the past four fiscal years. The annual benefit payments to FRS retirees and beneficiaries (shown in white on the chart) are a part of the overall plan liabilities.

During years when the Pension Plan is determined to be less than 100% actuarially funded, the Florida Legislature may take steps to improve the funding level by increasing employee or employer contributions or lower plan costs by reducing future Pension Plan benefits. Pension Plan underfunding or future cost increases to fund the FRS may make it necessary for the Florida Legislature to lower the amount that employers contribute to Investment Plan members' accounts or increase the amount that employees contribute to their Investment Plan accounts. The legislature may make **changes to the FRS at any time**.

Pension Reform Lawsuit

On September 7, 2012, the Florida Supreme Court heard oral arguments regarding the requirement that FRS employees contribute 3% of their pay towards their retirement and the reduction in the cost-of-living adjustment. A final decision will be made by the Court at some future date. Once the ruling is made we will let you know the outcome.


FLORIDA RETIREMENT SYSTEM
Comparison of Actuarial Assets to Liabilities and Benefit Payments
This chart illustrates the overall financial health of the FRS Pension Plan.
160,000
140,000
120,000
100,000
80,000
60,000
40,000
20,000
0,000
In Billions ($)
106.7% Funded
88.5% Funded
87.9% Funded
87.5% Funded
130.721
122.532
5.226
118.765
134.204
5.670
120.930
137.635
6.089
126.100
144.100
6.685
2007-08
2008-09
2009-10
2010-11
Fiscal Year
Assets
Liabilities
Payments
Note: Benefit payments are part of the actuarial liabilities.

Attachment 2-A

The Great Recession

Pressures on Public Pensions, Reforms & Employment Relations

Issue Brief
November 13, 2012


Issue Brief

The Great Recession: Public Pension, Employment Relations & Reforms

By Ilana Boivie and Christian E. Weller

November 2012

NATIONAL INSTITUTE ON
Retirement Security

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Why This Study

- Increased attention to public pensions since 2008. In the wake of the financial crisis:
  - Pensions, like most investors, saw a substantial decline in funded levels.
  - State budgets experienced fiscal challenges due to declining revenues.
- Some have argued to replace public DB plans with cash balance or DC plans.
- Review evidence of DB effect on labor relations, and likely effects of switch.

Key Findings

- Public employers would attract a different labor force if they switched retirement benefits away from DB plans.
- Employee turnover would increase under DC and cash balance designs.
- When given a choice, public employers and employees choose to stay with DB plans.
- In the event of a switch, employers and employees would face higher costs.

DB Plans are Powerful Labor Management Tool

- DB plans prevalent in the public sector, make up 6.5% of total compensation.
- Roughly 30% of public employees not covered by Social Security, making the DB benefit all the more important.
- DB plans make up a smaller share of total compensation earlier in employees' careers than later.

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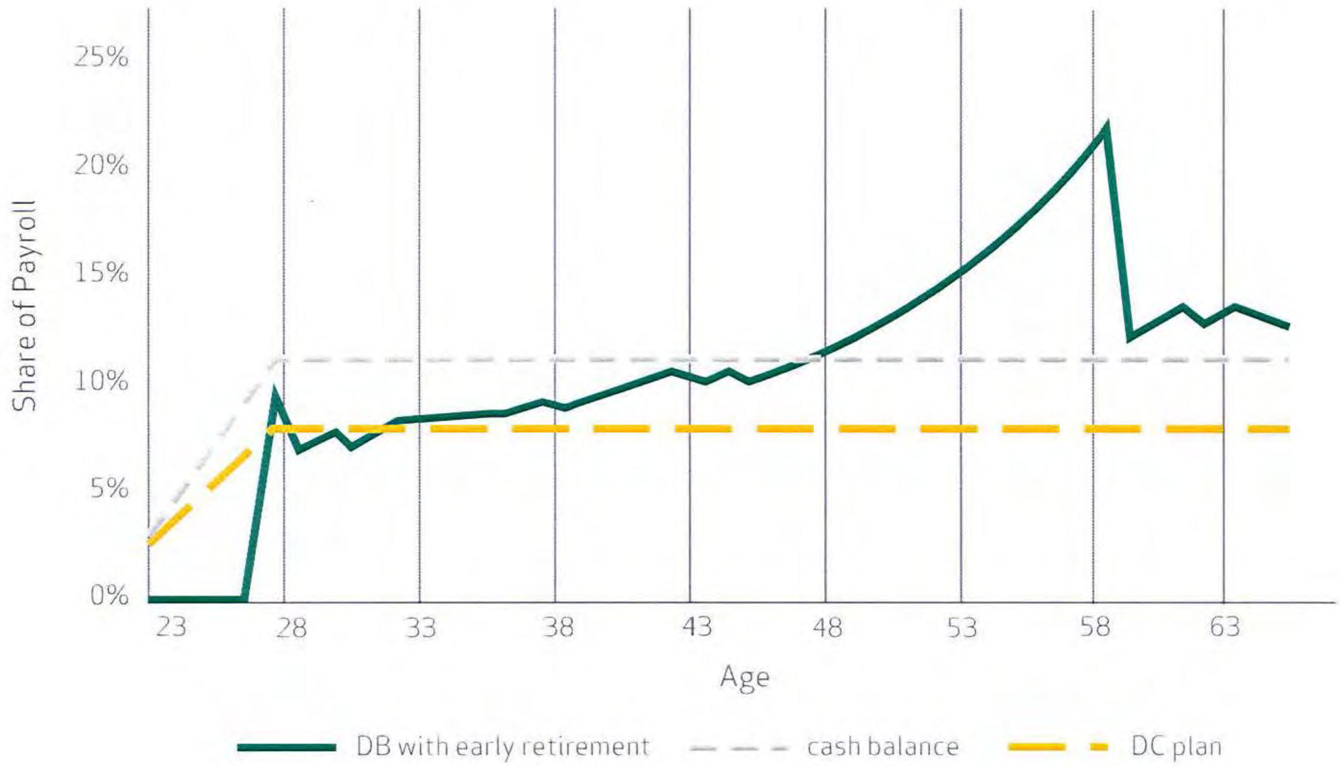
Annual Wealth Changes for New Teacher, Relative to Earnings

Figure 1:
Annual Wealth Changes of Teacher Entering in 2011 Relative to Earnings, Under DB Plan, Cash Balance Plan, and DC Plan, Constant Normal Cost



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Alternative Plan Designs

Table 1: Characteristics of Typical Pension Plans, by Plan Type

Characteristics	Defined Benefit Plan		Defined Contribution Plan
	Traditional	Cash Balance	401(k)/403(b) plans
Participation	Automatic	Automatic	Voluntary
Contribution	Employer and employee	Employer and employee	Employee with occasional employer matches
Investments	Determined by employer	Determined by employer	Typically determined by employee
Withdrawals	Annuity	Annuity or lump sum	Lump sum
Rollovers Before Age 65	Not permitted	Permitted if lump sum option exists	Permitted
Benefit Guarantee	Often Constitutionally guaranteed	Often Constitutionally guaranteed	None
Early Retirement Benefits	Common	Uncommon	Unavailable
Vesting	Up to a decade Or more	Typically shorter than in traditional pension plans	Typically immediate for employee contributions and often immediate for employer Contributions

Note: Cash balance plans typically do not exist in the public sector. The description thus relies on typical characteristics of private sector cash balance plans. Also, defined contribution plans are generally supplemental retirement savings plans in the public sector and thus tend to be voluntary.

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Alternative Plan Designs

- Employees face more risk under DC plans
  - Longevity risk
  - Investment risk
  - Inflation risk

- Cash balance plans are a "hybrid" of sorts
  - Technically DB plans
  - Pooled and professionally invested assets, like DB
  - Notional (hypothetical) account, like DC

- Both accrue benefits as a fixed earnings share, higher in earlier years than later, unlike traditional DB plans.

DB Plans Increase Recruitment and Retention

- Strong recruitment and retention effects mean that DBs serve as an effective HR tool:
  - Employees with DBs twice the probability of citing retirement as important factor in taking the job.
  - 69% of employees with DBs say retirement plan is an important reason to stay, versus 37% with DCs.
- This results in lower employee turnover:
  - DB firms have lower turnover rates than non-DB firms, ranging from 20 – 200%.
  - DB coverage increases tenure by 4 years compared to no plan, by 1.3 years compared to a DC plan.

DB Plans Increase Productivity

- Recruitment and retention effects translate into productivity gains due to DB plans:
  - Research finds productivity gains linked to DBs.
  - Firms moving from DB to DC experienced productivity losses relative to firms that kept DBs.
- DB plans encourage "efficient retirement":
  - Employees withdraw from the labor force as their productivity declines.
  - DBs can—and are—designed to facilitate appropriate and optimal retirement decisions.
  - Efficient retirement is crucial during economic downturns; no "job lock" with DBs.

DB Role in the Public Sector

- Public workers prefer DBs when given a choice:
  - 4% of Ohio employees opt for DC plan.
  - 68% of Washington employees choose the DB plan over the default combined DB-DC plan.
  - 75% of young teachers in West Virginia opted out of their DC plan and back into the DB plan.
- DBs may improve public sector productivity:
  - More likely to value their work than private workers.
  - Tend to invest more in their skills.
- Moving to a DC design could affect recruitment, retention, productivity among this workforce.

States Fiscal Challenges

- State revenues have declined:
  - 2012 Q1, revenues 5.5% below pre-recession levels.
  - $425 billion cut from budgets 2007-2011.
  - 2013 budget gap of $55 billion, closed.
- Pension funding levels have declined:
  - Wall Street losses affected all investors.
  - Funding levels fell from 85% in 2008 to 77% in 2010.
  - Estimated that additional contributions of 2.2% of payroll over 30 years can close funding gaps.

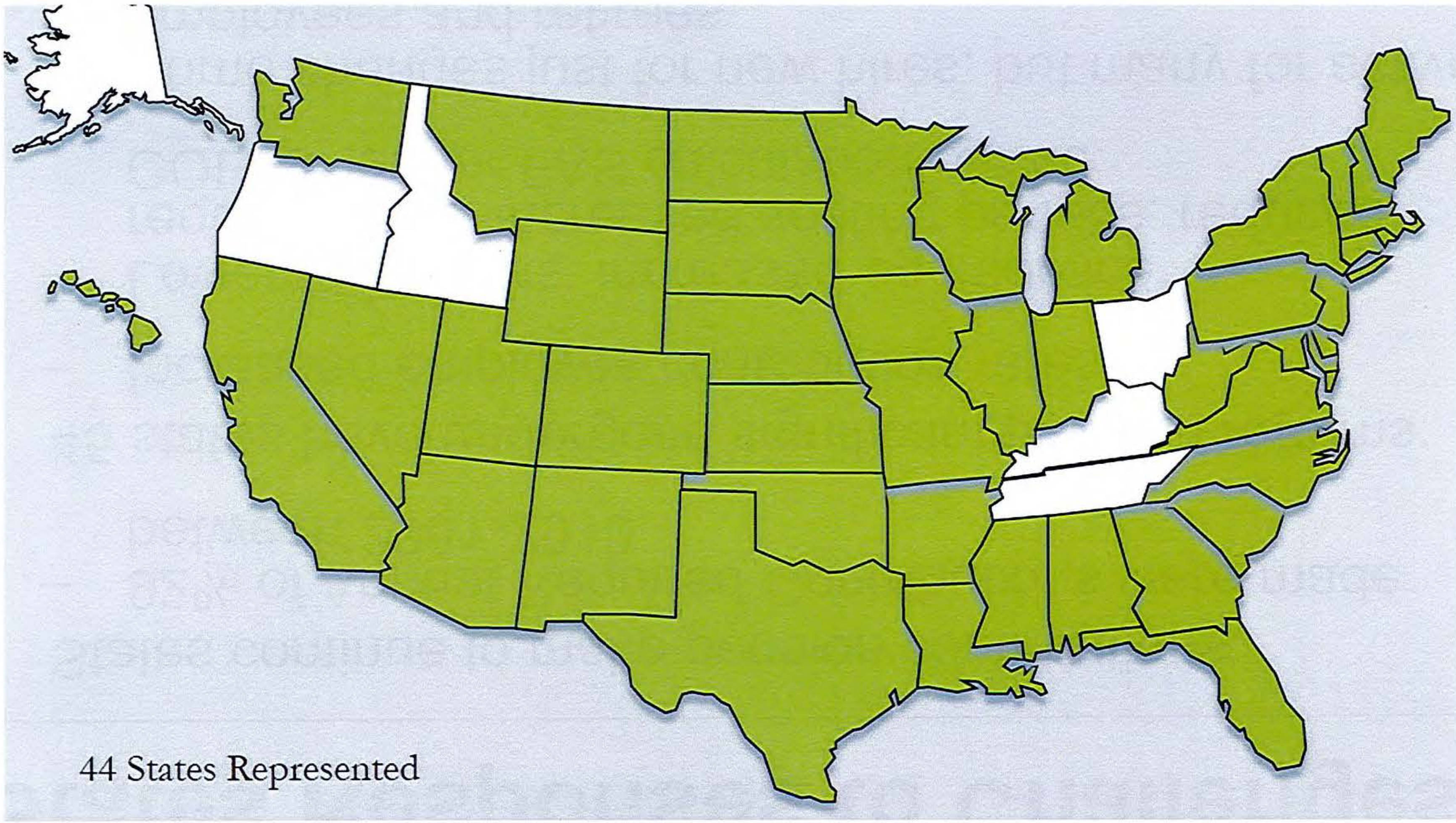
The Political Environment

- Political challenges to DBs often based in ideology:
  - Research finds that ideological orientation plays larger role that than pension/state finances.
  - States with Republican governments more likely to introduce DC bills.
- Recent political challenges include:
  - Tea Party, ATR, and other anti-tax groups.
  - 6 Republicans elected in 2010 introduced DC bills.
  - Federal interest includes the Public Employee Pension Transparency Act and the "No Pension Bailout" campaign.

States Responses to Challenges

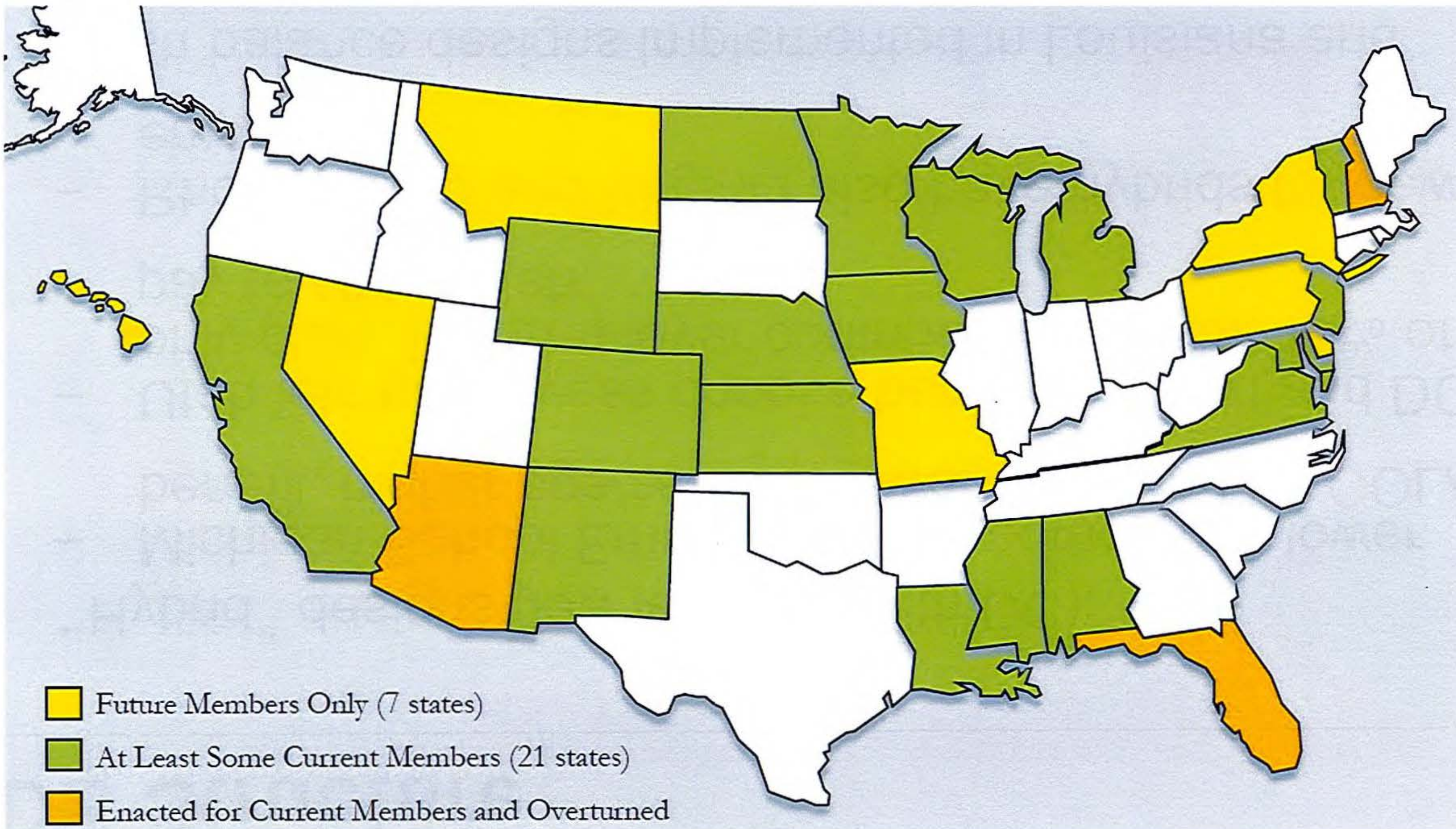
1. States continue to make pension contributions:
   - 92% of Annual Required Contributions were made between 2001-2010.
2. 45 states have undergone significant pension reforms:
   - Increased employee contribution rates.
   - Lowered benefits: increased age/service requirements, increased vesting periods, reduced COLAs, longer FAS calculation period.
   - Some changes just for new hires, but many for active employees and retirees.

Major Pension Legislation: 2009 - 2012



Source: The National Conference of State Legislatures

Employee Contribution Increases, 2009-2011



Source: The National Conference of State Legislatures

Few States Have Moved from DB Structure

- "Hybrid" designs (low level DB with DC):
  - Michigan School Employees: DB portion has lower benefit, higher age/service, lower FAS, and no COLA.
  - Utah lets employees choose between hybrid and DC-only plan. The employer contribution is a flat 10% of pay to either plan.
  - Rhode Island and Virginia also have hybrids for new employees.
- Cash balance designs implemented in Louisiana and Kansas.

Conclusions

1. Public employers would attract a different labor force if they switched retirement benefits away from DB plans.

   Employees would be less committed, and invest less in skills crucial to effective government.

2. Employee turnover would increase under alternative designs.

   With compensation no longer deferred into the future, employees have fewer economic incentives to stay.

Conclusions

3. In the event of a switch, employers and employees would face higher costs.

   Due to both ending the existing DB plan and because of higher investment and administrative costs in the new plan.

4. When given a choice, public employers and employees choose to stay with DB plans.

The Bottom Line

- The vast majority of states have stayed with DB pensions, even as they have undergone major pension reforms.
- DB pensions meet the dual goals of recruitment and retention for employers and economic security for employees.
- The Great Recession presented challenges, but governments have shown willingness to address these so that they can effectively compete for skilled employees in the future.

Issue Brief

The Great Recession: Public Pension, Employment Relations & Reforms

By Ilana Boivie and Christian E. Weller

November 2012

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Attachment 2-B

NATIONAL CONFERENCE *of* STATE LEGISLATURES

The Forum for America's Ideas

STATE RETIREMENT PLANS FOR PUBLIC SAFETY EMPLOYEES

Ronald Snell

August 2012

INTRODUCTION

This report describes the retirement plans that state governments sponsor for state and local governments' public safety employees—those whose duties are hazardous or dangerous and physically and psychologically demanding. The membership of such plans varies from state to state, but includes state and local government law enforcement officers and firefighters, and is likely to include corrections personnel, wildlife wardens and foresters, probation officers, some officers of courts, and members of various other protective occupations.

This report describes basic plan design and employee contribution requirements for the plans in each state that are open to new members, or in some cases will be open to new members in the near future. Like other retirement plans, plans for public safety personnel have been subject to extensive revision in recent years, and many employees belong to plans that are now closed to new enrollment. This report does not include those plans. The National Conference of State Legislatures has reported some changes to public safety retirement plans since 2009 elsewhere.[1] The report is limited to plans sponsored by state governments. Locally-administered plans are not included here.

The table that follows this introduction lists the following information for 104 state-sponsored plans for state local governments' public safety personnel:

- The names of state plans;
- Categories of employees the plans cover;
- Vesting requirements;
- Age and service requirements for normal retirement and early retirement if applicable;
- Benefit formula for normal (unreduced) service retirement;

[1] Ronald Snell, "Changes in Age and Service Requirements for Normal Retirement in State Retirement Plans, 2009–2011," March, 2012.
http://www.ncsl.org/issues-research/labor/recent-changes-in-the-age-for-retirement.aspx

- Computation of final average salary;
- Employee contribution requirements; and
- Social Security coverage.

This report includes only the newest tier in states where there is more than one. It includes changes enacted in 2011 and 2012 that will become fully effective in the future.

HOW STATES ORGANIZE THEIR PLANS

The only organizational generalization that holds across all 50 states is that there are different plan provisions for public safety employees than for general state government employees and teachers. (In this report, the term "general employees" includes both general employees and teachers.) Even when local police and firefighters are members of the same retirement plan as general state employees, in almost every case, separate plan provisions apply to police and firefighters. The plan provisions differ in these ways:

- Public safety employees can retire earlier than other employees, which responds to the physically and psychologically demands of their work.
- They are less likely than other categories of employees to be covered by Social Security. In part, the lack of Social Security coverage may reflect the likelihood plan members will retire before they would be eligible for reduced Social Security benefits, let alone full benefits.
- Whether or not public safety personnel are covered by Social Security, their retirement plans are likely to provide higher levels of salary replacement than those of public employees in other occupations .
- Public safety employees contribute more to their retirement plans as a percent of compensation than general employees and teachers.

The 104 plans discussed in this report display substantial structural differences. In many states, at least some local government employees are covered by a state-administered plan. Alaska and Maine have no independent local plans; there are none in New York except (a big exception) those in New York City, or in Wisconsin other than the Milwaukee plans. States may sponsor one system with a uniform plan for all public safety members, as in Florida and Georgia; may maintain several sets of plan provisions with shared administration, as in Montana, or may sponsor a number of separately funded and administered plans, as in Louisiana and Ohio.

States may sponsor separate statewide plans for municipal police and for firefighters, as in Oklahoma. More frequently states group municipal police and firefighters in a plan for local government protective employees, sometimes, as in Texas, along with other municipal and county employees witb a wide range of functions.

AGE OF NORMAL RETIREMENT

Retirement plans for public safety members offer retirement at earlier ages than state plans for general employees. Most public plans, regardless of membership, offer the options of normal retirement and early retirement. Normal retirement means that a member complies with specified age and service requirements (sometimes only one or the other) for benefits as calculated by a benefit formula. Many plans offer early retirement to members who are not qualified for normal retirement benefits. Early retirement reduces normal benefits by a percentage or actuarial calculation for each year the applicant is short of normal retirement age. The table that follows this introduction shows the plans that offer the option.

Plans express normal retirement qualifications in various ways. Some explicitly require minimums of age and service, such as a minimum age of 52 with 10 years of service. Some have only a service requirement, such as 20 or 25 years. One plan allows retirement when the benefit reaches 50 percent of final average compensation, based on an annual accrual rate of 2.5 percent. Most offer alternatives, such as different combinations of age and service requirements, or some number of years of service. Assuming for analytic purposes that members begin their employment at age 25, it is possible to calculate the earliest allowed age of normal retirement for 98 plans, as shown in Figure 1.

FIGURE 1. MINIMUM AGE FOR NORMAL RETIREMENT[2]

Minimum Age for Unreduced Retirement	Public Safety Plans	Plans for General Employees
45 – 49	23%	3%
50	37%	7%
51 – 54	11%	10%
55	23%	48%
56-59	2%	13%
60	4%	19%

As Figure 1 shows, three-fifths of the plans in this study—60 percent—permit normal retirement at age 50 or earlier. Of statewide plans for general employees only 10 percent allow retirement by age 50. Only 6 percent of public safety plans have a minimum age requirement higher than 55. None of them sets a minimum age higher than 60. Thirty-two percent of plans for general employees have minimum age requirements higher than the age of 55.[3]

[2]Information on plans for general employees and teachers is an NCSL compilation based on Daniel Schmidt, *2010 Comparative Study of Major Public Employee Retirement Systems* (Madison, Wis.: Wisconsin Legislative Council, 2011), 11-15.

[3] The table reports on 98 of the 104 plans in the report. The others are state-sponsored plans for local governments that provide a range of optional plans among which local employers may choose. Many plans provide for normal retirement when a person has

BENEFITS AND SOCIAL SECURITY COVERAGE

Members of the retirement plans described in this report are likely to accrue retirement benefits at a faster rate than general state employees and teachers. In almost all state defined benefit retirement plans, benefits are calculated by a formula that provides a percentage of final annual compensation for each year of service. This is the basic formula:

Years of service X Final Average Salary X Formula Multiplier = Retirement Annuity

"Final average salary" usually means the average of a member's compensation over three years (44 percent of plans) or five years (30 percent of plans). A few plans, usually for highway patrol members, base final compensation on the member's last or highest 12 months. The longest periods used are new plan provisions in Florida and Illinois that average salaries over periods of eight years. The importance of the length of the period lies in the effect of averaging: the longer the period, the lower the average compensation is likely to be.

The "formula multiplier" is the percentage of final average salary a person will receive for each year of service. The usual practice is to apply a consistent multiplier to all years of service, but some plans apply different multipliers to different periods of service. A Massachusetts plan, for example, provides a multiplier of 1.45 percent for those who retire at age 50 and increases the multiplier for each year a person delays retirement, up to a multiplier of 2.5 percent at age 57. A New Jersey plan reduces its multiplier after members have earned 25 years of service from 2.5 percent for service up to 25 years to 1 percent for subsequent service.

Figure 2 shows multipliers for 84 of the plans in this report, omitting defined contribution plans, multipliers for the defined benefit component of hybrid plans, and plans in which local governments may choose from among a variety of multipliers. For plans that offer different multipliers for different periods of service, the chart reports the multiplier for the longest period of service.

---

accrued some specified number of years of service, usually 20 or 25. For such plans, the count in Figure 1 assumes an entry age of 25 and the minimum retirement age for such plans is calculated on that basis.

FIGURE 2. FORMULA MULTIPLIERS FOR PUBLIC SAFETY RETIREMENT PLANS AND PLANS FOR GENERAL EMPLOYEES[4]

Formula Multipliers	Public Safety Plans		General Employees' Plans	
	Covered by Social Security N = 43	Not Covered by Social Security N = 41	Covered by Social Security N = 62	Not Covered by Social Security N = 14
1.0 to 1.9	26%	-	84%	-
2 to 2.49	28%	29%	14%	50%
2.5 to 2.99	35%	49%	2%	50%
3 to 3.49	5%	10%	-	-
3.5 and above	-	10%	-	-
Other	7%	2%	-	-
Average	2.20%	2.57%	1.95%	2.20%

Figure 2 shows formula multipliers for plans according to their Social Security membership because it has an effect on plan design. In all public sector occupations, the 30 percent of public employees who are not covered by Social Security are likely to benefit from higher formula multipliers than those who are covered. (As discussed below, employees outside Social Security are also likely to make higher contributions to their retirement plans).

Public safety employees are less likely to be covered by Social Security than general employees and teachers. In 41 percent of the plans in this report, all members are covered by Social Security. In another 39 percent, no members are in Social Security, and in the remainder, coverage varies by occupation or employer, usually in plans states sponsor for employees of local governments. In contrast, the members of 80 percent of state plans for general employees are covered by Social Security.[5]

When enrollment in Social Security was first made possible for state and local government employees in 1950, governments could choose whether to have employees covered by Social Security and could thereafter remove employees from coverage if they chose to do so. 1983 amendments to the Social Security Act prohibited state and local governments from terminating coverage for their employees.

[4] Figures for general employees are based on the 87 plans reported in Schmidt, *2010 Comparative Study*, 7-8, 25-28.

[5] Figures in this paragraph count plans, not the membership of plans. The U.S. Government Accountability Office estimated in 2010 that 71 percent of the earnings of state and local government employees are covered by Social Security. U.S. GAO, *Management Oversight Needed to Ensure Accurate Treatment of State and Local Government Employees* (GAO-10-938, Sep 29, 2010).

Decisions to allow public safety employees to remain outside the Social Security system may have been affected by the existence of state and local retirement plans that provided for retirement before 65 for such employees. Unreduced retirement benefits under Social Security originally were available at age 65, and are now available at ages ranging from 65 to 67, depending on when a person was born. Reduced benefits are available at 62. The retirement ages that public safely plans permit can mean long intervals between a member's retirement from covered employment and eligibility for Social Security benefits.

Figure 2 relates Social Security coverage to public plan design. For public safety plans, the lowest category of multipliers is limited to plans with Social Security coverage for members, and the highest category to plans without that coverage. In both cases, the numbers of plans at the extremes are small. Sevenry-eight percent of plans without Social Security coverage, like the 63 percent of plans that include it, have multipliers ranging from 2 percent to 3 percent. Plans for people not covered by Social Security are concentrated at the higher end of that range.

For public safety employees, the average multiplier for plans for people without Social Security is 2.57 percent, and for those with Social Security coverage, 2.2 percent. Of people with identical final average salaries and service records, a person outside Social Security would receive a pension about 17 percent higher than a person under Social Security.

Figure 2 also compares public safety plan multipliers with those of plans for general employees, both with and without Social Security coverage. For the 87 state plans for general employees, in 2011 the average multiplier for rhose covered by Social Security was 1.95 percent and for those not in Social Security, 2.2 percent.[6] On average, public safety employees would benefit from a pension differential between 13 percent and 17 percent for equivalent final salaries and service, compared to general employees with the same Social Security status.

CONTRIBUTION REQUIREMENTS

Earlier retirement ages and somewhat higher benefit packages make plans for public safety members more costly per capita than those for general employees. Public safety employees, whether or not covered by Social Security, make higher contributions to their retirement plans than general state employees, as Figure 3 indicates. As is true for other public employees, those who are not covered by Social Security are likely to face higher contributions to their retirement plans than those who are covered.

On average, public safety employees make contributions about 0.6 percentage points higher than general employees when both groups are covered by Social Security, and about 1.2 percentage points higher when both groups are not.

Employees not covered by Social Security pay, on average, higher contributions to their retirement plan than those who are covered, although the difference is not as much as they would contribute for Social Security. (The usual Social Security contribution rate is 6.2 percent for employees and employers both, for a total of 12.4 percent, although the employee rate was reduced for 2012).

[6] Schmidt, *2010 Comparative Study*, 24-25.

FIGURE 3. AVERAGE CONTRIBUTION RATES AND SOCIAL SECURITY COVERAGE[7]

	Covered by Social Security	Not Covered by Social Security
Public Safety Employees	6.30%	9.62%
General Employees	5.66%	8.86%

SOURCES AND ACKNOWLEDGEMENTS

The information in this report was taken from retirement system handbooks and other information on the systems' public websites. A list of the websites follows the table. This report is above all evidence of state retirement systems' commitment to transparency and communication.

Gratitude for their assistance with the report goes to all the following:

Todd Haggerty and Tamara Rivale of NCSL provided research assistance and data analysis for this report.

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[7] Information on contribution rates and Social Security coverage for general employees and teachers was compiled from Schmidt, *2010 Comparative Study*.

Attachment 2-C

CHECKLIST OF STATE DEFINED BENEFIT, DEFINED CONTRIBUTION AND HYBRID PLANS FOR STATE EMPLOYEES AND TEACHERS

Ron Snell
National Conference of State Legislatures

August 2012

This document lists retirement plans that cover general state employees and teachers in K-12 education. Some of the plans counted here may cover additional categories of employees. The lists exclude plans limited to public safety employees, judges, elected officials and employees of higher education, for whom many states have separate plans or provisions. In some of the states listed below, the plans cover all public employees in a state, including local government employees.[1]

- Defined benefit (DB) plans are the traditional pension plans that provide a lifelong annuity upon retirement, usually pinned to final earnings and length of service.
- Defined contribution (DC) plans provide individual retirement accounts, to which (in the public sector) employers and generally employees make contributions, and which, with accumulated investment returns, provide the basis for a retirement benefit.
- Hybrid plans combine elements of both, and in turn, take two forms in the public sector.[2]
    - In one form, members are eligible for both a DB and a DC plan. In some cases (plans found in Indiana, Oregon and Washington, for example), both components are mandatory. Employer contributions finance the defined benefit annuity and employee contributions accumulate in an individual retirement account. In the Utah version, employer contributions fund both components of the plan. In the hybrid plans created in 2008 for state employees in Georgia and in 2010 for school employees in Michigan, the defined benefit component of the hybrid plan is mandatory and the defined contribution component is optional. In the Virginia plan adopted in 2012, both components are mandatory, and employers and employees will contribute to both components of the plan.
    - Cash balance plans are a second form of hybrid plan. Like defined contribution plans, they provide each member with an individual account to which, in the public sector, both employees and employers make contributions. Funds in the members' accounts are pooled for investment purposes, members' balances are guaranteed, and members are guaranteed an annual rate of return.

Table 1 summarizes information on the kinds of statewide retirement plans. Table 2 provides information for state employee plans, and Table 3 provides comparable information for plans that cover teachers.

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[1] For membership of plans, see Wisconsin Legislative Council, *2010 Comparative Study of Major Public Employee Retirement System* (Madison, Wisconsin: December, 2011). http://legis.wisconsin.gov/lc/publications/crs/2010_retirement.pdf

[2] See *State Hybrid Retirement Plans*, National Association of State Retirement Administrators Issue Brief, November, 2011. http://www.nasra.org/resources/HybridBrief.pdf

The counts in the three charts refer to plans for people who enter plan membership. In some instances, legislation in 2011 or 2012 established new plans that will become effective for new employees in the near future. In such instances, only the new plans have been counted in the three tables. The date the new plan takes effect appears next to the name of the state in Tables 2 and 3. In most states where defined contribution plans or hybrid plans are mandatory for those who enter the workforce, defined benefit plans continue in effect for people who entered the state workforce at some earlier time.

TABLE 1. DISTRIBUTION OF DEFINED BENEFIT, DEFINED CONTRIBUTION AND HYBRID PLANS BY STATE [3]		
Plan Characteristics	State Employees' Plans	State Teachers' Plans
DB plan only	33[4]	40
DC plan only	3	1
Cash balance plan only	3	1
DB/DC hybrid only	4	5
Option: DB plan or DC plan	6	1
Option: DB plan or DB/DC hybrid	1	-
Option: DB plan or cash balance plan	-	1
Option: DC plan or DB/DC hybrid	1	2
Option: DB plan, DC plan or DB/DC hybrid	1	1

[3] The table includes information for the District of Columbia and Puerto Rico

[4] This number includes New Jersey, where, depending on amount of compensation, some employees are eligible for stacked defined benefit and defined contribution plans.

TABLE 2. DB, DC, AND HYBRID PLANS FOR STATE EMPLOYEES, BY STATE			
	Defined Benefit Plan Available to Full-time State Employees	Optional or Mandatory Defined Contribution Plan	Other
Alabama	X		
Alaska		Mandatory	
Arizona	X		
Arkansas	X		
California	X		
Colorado	X	Optional	
Connecticut	X		
Delaware	X		
Florida	X	Optional	
Georgia			Mandatory DB/DC hybrid
Hawaii	X		
Idaho	X		
Illinois	X		
Indiana		Optional	Optional DB/DC hybrid
Iowa	X		
Kansas as of 1/1/15			Mandatory cash balance plan
Kentucky	X		
Louisiana as of 7/1/13			Mandatory cash balance plan
Maine	X		
Maryland	X		
Massachusetts	X		
Michigan		Mandatory	
Minnesota	X		
Mississippi	X		
Missouri	X		
Montana	X	Optional	
Nebraska			Mandatory cash-balance plan
Nevada	X		
New Hampshire	X		
New Jersey	X		
New Mexico	X		
New York	X		
North Carolina	X		

North Dakota	X	Optional	
Ohio	X	Optional	Optional DB/DC hybrid
Oklahoma	X		
Oregon			Mandatory DB/DC hybrid
Pennsylvania	X		
Rhode Island as of 7/1/12			Mandatory DB/DC hybrid
South Carolina	X	Optional	
South Dakota	X		
Tennessee	X		
Texas	X		
Utah		Optional	Optional DB/DC hybrid
Vermont	X		
Virginia as of 1/1/14			Mandatory DB/DC hybrid
Washington	X		Optional DB/DC hybrid
West Virginia	X		
Wisconsin	X		
Wyoming	X		
Washington, DC		Mandatory	
Puerto Rico	X		

TABLE 3. DB, DC, AND HYBRID PLANS FOR PUBLIC SCHOOL TEACHERS, BY STATE (EXCLUDES HIGHER EDUCATION)			
	Defined Benefit Plan Available to Teachers	Optional or Mandatory Defined Contribution Plan	Other
Alabama	X		
Alaska		Mandatory	
Arizona	X		
Arkansas	X		
California	X		
Colorado	X		
Connecticut	X		
Delaware	X		
Florida	X	Optional	
Georgia	X		
Hawaii	X		
Idaho	X		
Illinois	X		
Indiana			Mandatory DB/DC hybrid
Iowa	X		
Kansas as of 1/1/15			Mandatory cash balance plan
Kentucky	X		
Louisiana as of 7/1/13	X		Optional cash balance plan
Maine	X		
Maryland	X		
Massachusetts	X		
Michigan as of 9/4/12		Optional	Optional DB/DC hybrid
Minnesota	X		
Mississippi	X		
Missouri	X		
Montana	X		
Nebraska	X		
Nevada	X		
New Hampshire	X		
New Jersey	X		
New Mexico	X		
New York	X		
North Carolina	X		

North Dakota	X		
Ohio	X	Optional	Optional DB/DC hybrid
Oklahoma	X		
Oregon			Mandatory DB/DC hybrid
Pennsylvania	X		
Rhode Island as of 7/1/12			Mandatory DB/DC hybrid
South Carolina	X		
South Dakota	X		
Tennessee	X		
Texas	X		
Utah		Optional	Optional DB/DC hybrid
Vermont	X		
Virginia as of 1/1/14			Mandatory DB/DC hybrid
Washington			Mandatory DB/DC hybrid
West Virginia	X		
Wisconsin	X		
Wyoming	X		
Washington, DC	X		
Puerto Rico	X		

Attachment 3-A

City of Brooksville

Pension and Retirement Plans

Pension and Retirement Plans

- Defined *Benefit* Plans (DBP)
- Defined *Contribution* Plans (DCP)
- The City participates in and funds three different retirement and pension funds.
  - Florida Retirement System (FRS)
    - FRS Pension Plan - DBP
    - FRS Investment Plan - DCP
  - Police Officer's Retirement Trust Fund (PORTF)
    - DBP
  - Firefighter's Retirement Trust Fund (FFRTF)
    - DBP

Florida Retirement System (FRS)

- Plans rules and benefits are set forth in Florida Statute Ch. 121
  - Plan benefits and requirements are established by the State.
  - No local control over contributions or benefits.
- City has elected to participate in FRS pursuant to Fla. Stat. 121.051(2)(b)(1).
- Plan participation continues until City revokes such election.

Florida Retirement System (FRS)

- As of July 1, 2011, FRS is now funded by both employer and employee contributions.

Florida Retirement System (FRS)

- Revocation of Election and Alternative Plan (Fla. Stat. 121.0511)
  - Adopt a resolution revoking election.
  - Hold a public hearing on the resolution.
  - Provide notice of public hearing and submit proof of publication to Department of Management Services.
  - Must have an actuarial report prepared and certified by an enrolled actuary illustrating the cost to the municipality and to its future employees of providing a new retirement plan.
  - Provide a copy of the proposed alternative plan to collective bargaining units.
  - Provide notice of revocation of election to the Division of Retirement Services.

Firefighters Retirement Trust Fund

- Established by ordinance of the City Council.
  - Local control subject to the minimum standards set forth in Chapter 175, Florida Statutes.
  - Board of Trustees appointed by the City Council

    Sole and exclusive administration of, and the responsibilities for, the proper operation of the retirement trust fund and for making effective the provisions of chapter 175 are vested in the board of trustees.

    However, the Trustees are not, by statute, empowered to amend the provisions of the plan without approval of the City Council.

- Fla. Stat. 175.051 - Actuarial deficits, if any, arising under the plan are not the obligation of the State; therefore, the City is responsible for funding any deficits.

Firefighters Retirement Trust Fund

- FFRTF is funded by state, employer and employee contributions.

Firefighter's Retirement Trust Fund

- Procedures for Changing Contributions & Benefits
  - Recommendation of changes by the Board ofTrustees.
  - Adoption of ordinance to amend the plan.
  - Subject to the minimum benefits required by Fla. Stat. 175.
- Termination of Plan and Distribution of Funds
  - Plan may be terminated or
  - Contributions under the plan may be permanently discontinued; however,
  - The rights of employees to benefits accrued to the date of termination or discontinuance and amounts credited to each employee's account are non-forfeitable.
  - The City shall continue to financially support the plan until all non-forfeitable benefits have been funded.

Police Officer's Retirement Trust Fund

- Established by ordinance of the City Council.
  - Local control subject to the minimum standards set forth in Chapter 185, Florida Statutes.
  - Board ofTrustees appointed by the City Council

    Sole and exclusive administration of, and the responsibilities for, the proper operation of the retirement trust fund and for making effective the provisions of chapter 185 are vested in the board of trustees.

    However, the Trustees are not, by statute, empowered to amend the provisions of the plan without approval of the City Council.
- Fla. Stat. 185.04 - Actuarial deficits, if any, arising under the plan are not the obligation of the State; therefore, the City is responsible for funding any deficits.

Police Officer's Retirement Trust Fund

- PORTF is funded by both state, employer and employee contributions.

Currently, the PORTF has a Credit Balance from which the City's contribution has funded. So, there is no current requirement to fund within the City's budget.

If the City continues the current trend of no contributions and no changes are made in other contributions or benefits, the Credit Balance will be depleted in fiscal year 2016.

As of 2016, the City would have to fund at least an estimated 25.5% of payroll annually.

Police Officer's Retirement Trust Fund

- Procedures for Changing Contributions & Benefits
  - Recommendation of changes by the Board of Trustees.
  - Adoption of ordinance to amend the plan.
  - Subject to the minimum benefits required by Fla. Stat. 185.
- Termination of Plan and Distribution of Funds
  - Plan may be terminated or
  - Contributions under the plan may be permanently discontinued; however,
  - The rights of employees to benefits accrued to the date of termination or discontinuance and amounts credited to each employee's account are non-forfeitable.
  - The City shall continue to financially support the plan until all non-forfeitable benefits have been funded.

Retirement & Pension Plan Comparisons

- The following charts are basic summaries of benefits and contribution requirements for the three retirement and pension plans.
- These charts do not capture all the benefits and obligations under the plan documents; they are merely highlights of the various benefits and obligations.

Pension Plan Benefits Summary

	FRS	PORTF	FFRTF
Eligibility	FT or PT, non-temporary (6 months+)	FT hired after January 1, 1996	FT & PT
Credited Service	Full or partial months in which salary is earned; and additional creditable service may be "bought"	Total Years & Partial Years	Total Years & Partial Years
Salary	Gross earnings including wages, overtime, vacation payouts, certain paid sick leave, tax deferred, tax sheltered and tax exempt income, but not bonuses or sick leave payouts; subject to general limit of $150,000.	W2 earnings, Tax-deferred, tax-sheltered & tax exempt, overtime compensation in excess of 300 hours per calendar year.	W2 earnings, Tax-deferred, tax-sheltered & tax exempt
Average Final Compensation	Average Salary of Best 5 years of covered employment	Average Salary of Best 5 years of last 10 years of preceding termination or retirement	Average Salary of Best 5 years of last 10 years of preceding termination or retirement

Pension Plan Benefits Summary

	FRS	Police	Fire
Vesting	8 years; 6 years; Various	100% after 6 years of Credited Service	100% after 10 years of Credited Service
Normal Retirement	Vested & age 62 32 yrs of Credited Service Vested & age 65 33 yrs of Credited Service; r Age 55 (SR) Age 52 and 25 Years of Credited Service (SR) 30 Years Credited Service (SR)	Earlier of age 55 and 6 years of Credited Service, or 20 years of Credited Service regardless of age.	Earlier of age 60, 55 and 10 years of credited service or 20 years credited service regardless of age.
Early Retirement	Vested	Age 50 and 6 years credited service	Age 50 and 10 years credited service
Normal Retirement Benefits	Yrs. Credited Service x % Value x Average Final Compensation	4.0% of Average Final Compensation x Credited Service	3.1% of Average Final Compensation x Credited Service
Early Retirement Benefits	Accrued Benefit reduced by 5% per year	Accrued Benefit, reduced by 3% per year.	Accrued Benefit, reduced by 3% per year

Pension Plan Benefits Summary

	FRS	*Police*	*Fire*
Member Contributions	3.0 % of Salary	1.0 % of Salary	3.29 % of Salary
State Contributions	None	12.9% ($123,439)	13.63% ($102,371)
City Contributions	Various rate based on classification.	Balance remaining after member & state contributions.	Balance remaining after member & state contributions.

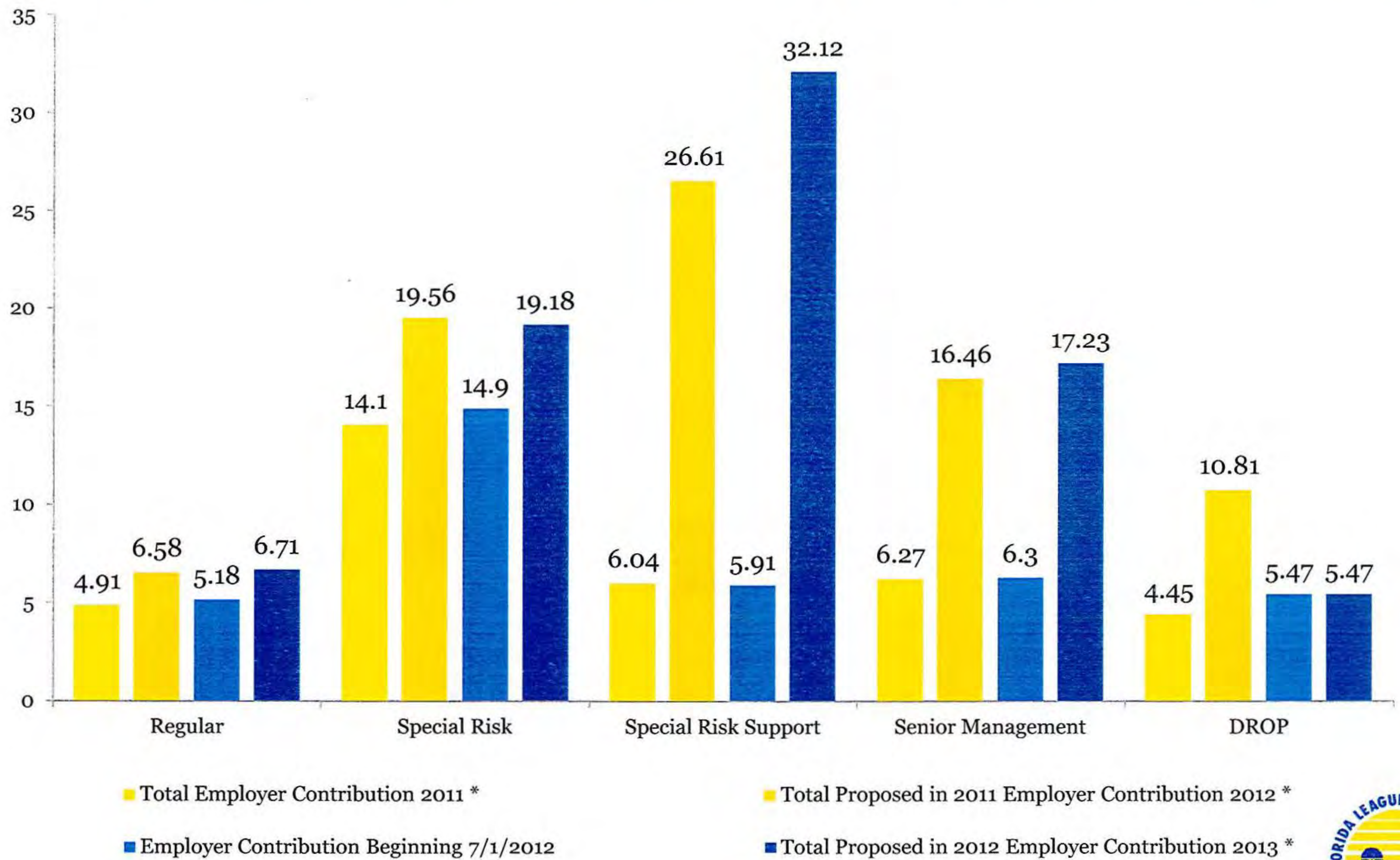
Attachment 3-B

FY 2012 - 2013

	As of July 1, 2012	*As of July 1, 2013*	*75% and 25% FY 2012-13 Rate*
Retirement			
FRS - Elected	10.23%	32.46%	15.79%
FRS - Senior Management	6.30%	16.46%	8.84%
FRS - Regular	5.18%	6.58%	5.53%
FRS - Special Risk	14.90%	19.56%	16.07%
FRS - Drop	5.44%	10.78%	6.78%
Police Pension	0.00%		5.53%
Fire Pension	24.52%		38.34%

		Budgeted Contributions for FY 2012-13	Contributions with all employees in FRS
Retirement			
FRS - Elected		$4,643	$4,643
FRS - Senior Management		$26,086	$26,086
FRS - Regular		$55,526	$55,526
FRS - Special Risk		$31,799	$31,799
FRS - Drop		$3,214	$3,214
Police Pension		$59,080	$171,633
Fire Pension		$257,499	$107,896
	Total FRS	$121,270	$400,798
	Total Police	$59,080	
	Total Fire	$257,499	
	Total	$437,849	$400,798

FRS Rates Effective July 1, 2012 & 2013



Attachment 3-C

City of Brooksville History of FRS & Firefighter Pension paid by The City

FRS	Effective date of rate 7/01/2006	Effective date of rate 7/01/2007	Effective date of rate 7/01/2008	Effective date of rate 7/01/2009	Effective date of rate 7/01/2010	Effective date of rate 7/01/2011	Budgeted Rate 2011/2012	Effective date of rate 7/01/2012
Special Risk	19.75%	19.75%	20.92%	20.92%	23.25%	14.10%	15.4650%	19.56%
Regular	8.69%	8.69%	9.85%	9.85%	10.77%	4.91%	5.3275%	6.58%
Senior Management	11.96%	11.96%	13.12%	13.12%	14.57%	6.27%	8.8175%	16.46%
City Officials	15.37%	15.37%	16.53%	16.53%	18.64%	11.14%	16.4700%	32.46%
Drop	9.11%	9.11%	10.91%	10.91%	12.25%	4.42%	6.0100%	10.78%
Total FRS								
Fire pension	Effective rate for 05/06	Effective rate for 06/07	Effective rate for 07/08	Effective rate for 08/09	Effective rate for 09/10	Effective rate for10/11	Budgeted Rate 2011/2012	Effective date of rate 10/01/2012
Fire pension	5.00%	20.80%	23.80%	23.30%	25.00%	28.51%	31.21%	38.34

City of Brooksville History of FRS & Firefighter Pension paid by The City

FRS	Amount in dollars collected 7/01/2006 to 6/30/2007	Amount in dollars collected 7/01/2007 to 6/30/2008	Amount in dollars collected 7/01/2008 to 6/30/2009	Amount in dollars collected 7/01/2009 to 6/30/2010	Amount in dollars collected 7/01/2010 to 6/30/2011
Special Risk	$22,197	$24,205	$24,642	$27,176	$29,247
Regular	$254,376	$234,893	$202,785	$197,876	$222,017
Senior Management	$56,009	$59,555	$55,503	$55,489	$59,353
City Officials	$4,862	$4,860	$4,803	$5,025	$5,480
Drop	$34,857	$19,158	$10,444	$16,620	$11,414
Total FRS	**$372,301**	**$342,671**	**$298,177**	**$302,186**	**$327,511**
Fire pension	Amount in dollars collected 7/01/2006 to 6/30/2007	Amount in dollars collected 7/01/2007 to 6/30/2008	Amount in dollars collected 7/01/2008 to 6/30/2009	Amount in dollars collected 7/01/2009 to 6/30/2010	Amount in dollars collected 7/01/2010 to 6/30/2011
Fire pension	**$135,962**	**$157,966**	**$181,196**	**$195,886**	**$222,773**
Total Pension paid by the City	**$508,263**	**$500,637**	**$479,373**	**$498,072**	**$550,284**

City of Brooksville History of FRS & Firefighter Pension paid by The City General Fund ONLY)

FRS	Amount in dollars collected 7/01/2006 to 6/30/2007	Amount in dollars collected 7/01/2007 to 6/30/2008	Amount in dollars collected 7/01/2008 to 6/30/2009	Amount in dollars collected 7/01/2009 to 6/30/2010	Amount in dollars collected 7/01/2010 to 6/30/2011	Amount in dollars Budgeted 10/01/2011 to 9/30/2012	Amount in dollars Budgeted 10/01/2012 to 9/30/2013
Special Risk	$22,197	$24,205	$24,642	$27,176	$25,521	$32,543	$41,160
Regular	$206,587	$207,014	$171,127	$168,548	$173,450	$61,923	$76,480
Senior Management	$32,028	$33,070	$34,510	$34,496	$35,035	$26,020	$48,573
City Officials	$4,862	$4,860	$4,803	$5,025	$5,032	$4,844	$9,547
Drop	$6,371	$6,250	$6,983	$7,581	$4,570	$2,931	$5,257
Total FRS	**$272,045**	**$275,399**	**$242,065**	**$242,826**	**$243,608**	**$128,261**	**$181,017**
Fire pension	Amount in dollars collected 7/01/2006 to 6/30/2007	Amount in dollars collected 7/01/2007 to 6/30/2008	Amount in dollars collected 7/01/2008 to 6/30/2009	Amount in dollars collected 7/01/2009 to 6/30/2010	Amount in dollars collected 7/01/2010 to 6/30/2011	Amount in dollars Budgeted 10/01/2011 to 9/30/2012	Amount in dollars Budgeted 10/01/2012 to 9/30/2013
Fire pension	**$135,962**	**$157,966**	**$181,196**	**$195,886**	**$222,773**	**$218,960**	**$218,960**
Total Pension paid by th	**$408,007**	**$433,365**	**$423,261**	**$438,712**	**$466,381**	**$347,221**	**$399,977**

Fire Pension History

Fire Pension Cost

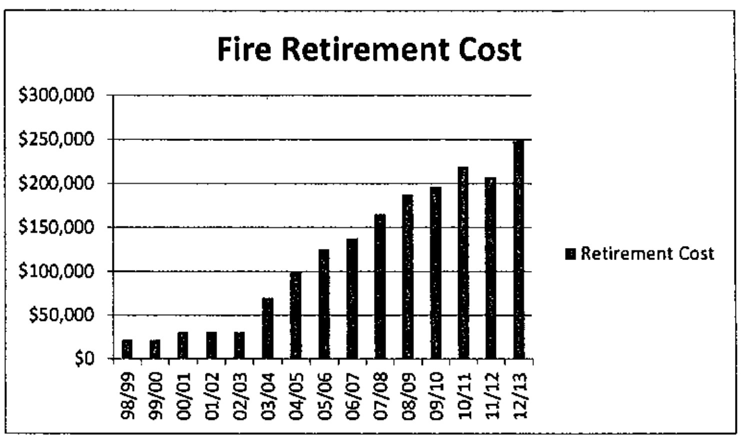
Budget Years	Total Wages	Retirement	% Retire to Wages	Actual Rate	% Increase retire prior yr	% wages increase prior yr.	
12/13	$648,441	$248,612	38.34%	N/A	19.93%	-2.37%	(1)(2)
11/12	$664,194	$207,295	31.21%	N/A	-5.46%	-14.23%	(1)(2)
10/11	$774,399	$219,270	28.31%	31.21%	11.75%	-3.24%	
09/10	$800,352	$196,222	24.52%	28.51%	4.47%	-0.71%	
08/09	$806,099	$187,821	23.30%	25.00%	13.48%	1.30%	
07/08	$795,722	$165,510	20.80%	20.80%	20.06%	2.91%	
06/07	$773,231	$137,855	17.83%	20.40%	9.50%	0.72%	
05/06	$767,706	$125,900	16.40%	19.80%	26.79%	5.86%	
04/05	$725,221	$99,297	13.69%	17.70%	41.53%	6.77%	
03/04	$679,240	$70,162	10.33%	11.30%	127.39%	-7.48%	(3)
02/03	$734,126	$30,856	4.20%	5.00%	-1.27%	10.15%	
01/02	$666,469	$31,253	4.69%	5.00%	1.77%	8.62%	
00/01	$613,589	$30,709	5.00%	5.00%	42.71%	10.96%	
99/00	$552,975	$21,519	3.89%	5.00%	-1.23%	7.22%	
98/99	$515,720	$21,788	4.22%	5.00%	0.00%	0.00%	
Total	$8,430,450	$1,118,892	13.27%		800.60%	55.19%	

(1)These two years are budgeted numbers

(2)Decrease in retirement wages is due to 2 employees are in the drop plan and we do not pay retirement on those wages

(3)New benefits went into effect

98/99	$21,788
99/00	$21,519
00/01	$30,709
01/02	$31,253
02/03	$30,856
03/04	$70,162
04/05	$99,297
05/06	$125,900
06/07	$137,855
07/08	$165,510
08/09	$187,821
09/10	$196,222
10/11	$219,270
11/12	$207,295
12/13	$248,612



(1)New benefits went into effect in 03/04 year

Attachment 3-D

Examples of governments with especially high pension costs:

The following information comes from municipal audited financial reports for fiscal year 2009.

LEROY COLLINS INSTITUTE

CORAL SPRINGS

Plan	Annual Pension Cost (APC)	Covered Payroll	Cost as Percent of Covered Payroll
General Employees Retirement Plan	$408,053	$420,000	97.15%
Firefighters' Retirement Plan	$2,889,610	$10,527,000	27.45%
Police Officers' Retirement Plan	$7,014,635	$11,346,000	62.82%

See pages 70 & 71 of the Coral Springs FY2009 Audited Financial Report.

TOWN OF MEDLEY

Plan	Annual Pension Cost (APC)*	Covered Payroll*	Cost as Percent of Covered Payroll
General Employees Retirement Plan	$1,397,378	$2,400,099	58.22%
Police Officers' Retirement Plan	$1,653,252	$2,411,734	68.55%

See pages 33 & 46 of Medley's FY2009 Audited Financial Report.

* Covered Payroll is from 2008 (most recent data).

PENSACOLA

Plan	Annual Pension Cost (APC)	Covered Payroll	Cost as Percent of Covered Payroll
General Pension and Retirement	$7,094,735	$13,546,000	52.38%
Firefighters' Relief and Pension	$3,704,687	$5,513,000	67.20%
Police Officers' Retirement	$3,189,523	$7,601,000	41.96%

See pages 88 & 87 of Pensacola's FY2009 Audited Financial Report.

FORT MYERS

Plan	Annual Pension Cost (APC)	Covered Payroll	Cost as Percent of Covered Payroll
General Employees' Pension Plan	$5,568,800	$27,501,914	20.25%
Police Officers' Retirement System	$5,297,500	$10,581,863	50.06%
Municipal Firefighters' Pensions Trust Fund	$3,798,438	$7,376,175	51.50%

See pages 84 & 96 of Fort Myers's FY2009 Audited Financial Report.

JACKSONVILLE

Plan	Annual Pension Cost (APC)	Covered Payroll	Cost as Percent of Covered Payroll
General Employees Retirement Plan	$29,491,000	$276,257,000	10.68%
Police and Fire Pension Plan	$67,993,368	$155,558,000	43.71%
Correction Officers' Retirement Plan	$5,268,000	$27,661,000	19.04%

See pages 116, 120, 157 & 158 of Jacksonville's FY2009 Audited Financial Report

Attachment 4-A

City of Naples

JOHN F. SOREY III
MAYOR

March 16, 2012

The Honorable Rick Scott
Governor
Plaza Level 05, The Capitol
400 South Monroe Street
Tallahassee, Florida 32399-0001

Subject: Voluntary Pension Reform and Loss of Premium Tax Revenue Paid by City of Naples Taxpayers

Dear ~~Governor~~ Scott: Rick

As Mayor of the City of Naples, I am writing to tell you about how City of Naples taxpayers are being penalized for offering sustainable retirement benefits to City of Naples police officers and for reducing the future cost of police pensions.

The City of Naples and Naples police officers represented by the Fraternal Order of Police, recently entered into a ***voluntary*** collective bargaining agreement reducing future pension benefits to levels similar to those earned by law enforcement officers who joined the Florida Retirement System (FRS) after July 1, 2011. This ***voluntary*** agreement between the City and our police officers is projected to save our taxpayers *$34 million over the next 30 years.*

But because of an interpretation of the Florida Division of Retirement, the police pension changes will result in the loss of future premium tax revenues paid by City taxpayers – which currently amount to $553,720 per year. In essence, City taxpayers are being penalized for the City and police union taking responsible action to reduce future pension benefits and make the pension plan more sustainable. I am advised by our attorneys that the Division of Retirement's interpretation is not in state statute or rule, but is "non-rule policy" invented by the agency. Since this is an agency under your direction and control, I am asking that you have your staff review the Division's position, and take appropriate action to correct this situation.

735 EIGHTH STREET SOUTH • NAPLES, FLORIDA 34102-6796
TELEPHONE (239) 213-1000 FAX (239) 213-1010 CELL (239) 248-1550
EMAIL: Mayor@Naplesgov.com

According to the Division of Retirement, if any pension benefit for police officers is reduced below the level in place on March 12, 1999, the plan will not be in compliance with Chapter 185, and the City will lose all future insurance premium tax funding. The premium taxes are taxes paid by City taxpayers on their casualty insurance premiums, which are refunded to the City to help pay for police pensions. But under the Division of Retirement's interpretation, City taxpayers will still be required to pay the premium tax, but the tax revenues will no longer be able to be used to help pay for police pensions – even though those pensions will continue to cost the City more than a million dollars every year. As a result, City taxpayers will be penalized by the loss of the premium tax funding even though the City, and our professional police officers, ***voluntarily agreed*** to reduce benefits to FRS levels that have been previously approved by the State Legislature and are now in effect for law enforcement officers throughout the State.

The Legislature failed to correct this inequity during the legislative session by failing to approve SB 910 and similar legislation. The taxpayers of Naples urge you to exercise your leadership to right this wrong and allow cities and public safety employees reaching voluntary agreement on sustainable pension benefits to continue to use premium tax revenue paid by our residents, to fund our public safety pension plans.

Thank you for considering the point of view of the taxpayers on this important public policy issue. We would be pleased to provide additional information concerning this situation at your request.

Sincerely,

John F. Sorey III
Mayor

cc: Representative Denise Grimsley
Representative Matt Hudson
Representative Jeanette Nunez
Representative Kathleen Passidomo
Representative Trudi Williams
Senator Larcenia Bullard
Senator Garrett Richter
Senator Don Gaetz
Representative Will Weatherford
Michael Sittig, Florida League of Cities
Kraig Conn, Florida League of Cities

RICK SCOTT
Governor

DEPARTMENT OF MANAGEMENT
SERVICES

CRAIG J. NICHOLS
Secretary

August 14, 2012

The Honorable John F. Sorey III
Mayor of the City of Naples
735 Eighth Street South
Naples, Florida 34102-6796

Dear Mayor Sorey:

Thank you for your letter of March 16, 2012, concerning the voluntary pension reform and potential loss of premium tax revenues for the City of Naples Police Officers' Retirement Plan.

In light of the concerns outlined in your letter, the Department of Management Services (Department) reviewed the statutory provisions regarding the use of the premium tax revenues. Section 185.35(2), Florida Statutes, states:

> (2) The premium tax provided by this chapter shall in all cases be used in its entirety to provide extra benefits to police officers, or to police officers and firefighters if included. However, local law plans in effect on October 1, 1998, must comply with the minimum benefit provisions of this chapter only to the extent that additional premium tax revenues become available to incrementally fund the cost of such compliance as provided in s. 185.16(2). If a plan is in compliance with such minimum benefit provisions, as subsequent additional tax revenues become available, they shall be used to provide extra benefits. Local law plans created by special act before May 27, 1939, shall be deemed to comply with this chapter. For the purpose of this chapter, the term:
>
> (a) "Additional premium tax revenues" means revenues received by a municipality pursuant to s. 185.10 which exceed the amount received for calendar year 1997.
>
> (b) "Extra benefits" means benefits in addition to or greater than those provided to general employees of the municipality and in addition to those in existence for police officers on March 12, 1999.

Previously, the Department had interpreted this law to mean that in order for Naples to receive any state premium tax revenues it must provide chapter minimum benefits and must preserve benefits in place on March 12, 1999. However, upon receiving your letter and reviewing the law again, this interpretation appears inaccurate. The law actually states that local law plans in effect on October 1, 1998, like the City of Naples Police Officers' Retirement Plan, "must comply with the minimum benefit provisions of this chapter *only to the extent that* additional premium tax revenues become available to incrementally fund the cost of such compliance." The phrase "only to the extent that" qualifies the law's requirement that local law plans "comply with the minimum benefit provisions" of chapter 185.

Please direct all correspondence to:

Division of Retirement
Municipal Police Officers' & Firefighters' Trust Funds' Office
PO Box 3010
Tallahassee, Florida 32315-3010
Toll Free: 877.738.6737/Tel: 850.922.0667/Fax: 850.921.2161

www.frs.MyFlorida.com

This qualification means that, for local law plans in effect on October 1, 1998, the law compels them to provide chapter minimum benefits *only to the extent that* such benefits can be funded with "additional premium tax revenues." Additional premium tax revenues are defined as revenues "which *exceed* the amount received for calendar year 1997." Thus, for local law plans in effect on October 1, 1998, the law states that chapter minimum benefits must be provided only to the extent that they can be funded with premium tax revenues received in excess of the amount received for calendar year 1997. Once there are sufficient "additional premium tax revenues" to fund the chapter minimum benefits, the law states that any "*subsequent* additional tax revenues" must be used to fund "extra benefits," as defined above. This subsequent additional tax revenue is the only amount earmarked for "extra benefits" for local law plans in effect on October 1, 1998.

Because the City of Naples Police Officers' Retirement Plan was in effect on October 1, 1998, the law allows Naples to provide benefits below the chapter minimums and below those in effect on March 12, 1999, if there is insufficient "additional premium tax revenues" to fund chapter minimum benefits and insufficient "subsequent additional tax revenue" to fund extra benefits. If the City of Naples received enough additional premium tax revenues to provide chapter minimum benefits, or an incremental portion thereof, the law requires Naples to use the revenues for such benefits. Once Naples has sufficient additional premium tax revenues to provide all chapter minimum benefits, any subsequent additional premium tax revenues must be used for extra benefits.

Based on the proposed ordinance, it appears that there are three changes being proposed that require additional information. These changes include raising the normal retirement date to age 60 with eight or more years of service; raising the average final compensation to the highest eight years of service; and reducing benefits by 5% for each year the police officer retires prior to age 60 or 30 years of service. In order for the Department to determine if these proposed changes can be approved, the plan actuary must demonstrate that there are not enough "additional premium tax revenues" to fund the minimum chapter benefits.

Thank you for your interest and concern in communicating with our office. If you have any questions, or if we can be of assistance in any way, please let me know.

Sincerely,

Keith Brinkman

Keith E. Brinkman, Chief
Bureau of Local Retirement Systems

cc: Representative Denise Grimsley
Representative Matt Hudson
Representative Jeanette Nunez
Representative Kathleen Passidomo
Representative Trudi Williams
Representative Will Weatherford
Senator Larcenia Bullard
Senator Garrett Richter
Senator Don Gaetz
Michael Sittig, Florida League of Cities
Kraig Conn, Florida League of Cities
Joseph Whitehead, Chairman

MEMORANDUM

To: Michael Sittig, Executive Director

From: Kraig Conn, Legislative Counsel KC

Subject: Department of Management Services Interpretation of Extra Benefits Law Passed in 1999

Date: August 17, 2012

As you are aware, the Florida League of Cities has been working closely with Governor Scott's office for the past year on numerous police and fire pension matters. We have brought to their attention various unfair determinations made by the Department of Management Services ("DMS") relating to police and fire pension plans in numerous cities, including, the City of Naples.

On August 14, 2012, the DMS released a very positive letter to the City of Naples ("Naples Letter"), which addresses how the city may use insurance premium tax revenues for its police pension plan (attached). In the Naples Letter, the **DMS acknowledges that its previous interpretation of the law on the use of insurance premium tax revenues "appears inaccurate."**

Naples Letter

To fully understand the impact of the Naples Letter, a brief review of the DMS's prior interpretation of the law on the use of insurance premium tax revenues is beneficial.

DMS Interpretation Prior to Naples Letter

In summary, for a city to be eligible to receive insurance premium tax revenues for a police pension plan under Chapter 185, Florida Statutes (and a fire pension plan under Chapter 175, Florida Statutes), the plan had to provide the specified chapter minimum benefits and it had to preserve benefits in place on March 12, 1999. A city was permitted to use insurance premium tax revenues up to the "base-year" amount (amount received for 1997) for any police (or fire) pension costs, but was required to use **any amount over the "base-year" amount only for "extra benefits"** (benefits greater than those provided to general employees of the city and in addition to benefits existing as of March 12, 1999). This is no longer the case!

New Interpretation in Naples Letter

The Naples Letter provides a substantially different, and beneficial, interpretation of the 1999 law. The interpretation in the Naples Letter follows the precise language in the statutes. While not stating this directly in the Letter, the DMS basically provides that insurance premium tax revenues are to be divided into three separate "pots."

Pot 1: The amount of insurance premium tax revenues a city received for 1997 (the "base-year" amount), which is to be used for any police (or fire) pension plan expense.

Pot 2: The amount of insurance premium tax revenues in excess of the "base-year" amount ("additional premium tax revenues"), which is to fund the chapter minimum benefits. If there are insufficient additional premium tax revenues to fund the chapter minimum benefits, the plan may provide a benefit level that falls below the minimum benefits level and also falls below the benefit levels provided on March 12, 1999.

Pot 3: The amount of insurance premium tax revenues in excess of the additional premium tax revenues required to fund the chapter minimum benefits ("subsequent additional tax revenues"), which must be used to provide "extra benefits." Very few, if any, cities would be required to provide "extra benefits" under this interpretation.

The Naples Letter will generate police and fire pension discussions throughout the state and it will likely lead to further interpretation questions to the DMS. **As part of the League's Annual Conference in Hollywood, there will be a pension related workshop on Friday, August 24 between 11:15 a.m. – 12:15 p.m. to review the Naples Letter.**

While the Naples Letter did not specifically address fire pension plans under Chapter 175, Florida Statutes, I assume the DMS will provide the same guidance as in the Naples Letter to a requesting city. Also, please note that police and fire pension benefits are typically covered under collective bargaining agreements, which can be negotiated at various times as provided under collective bargaining laws.

DMS also released a very positive letter to the City of Largo on April 4, 2012, which clarifies the use of up to 300 hours of overtime for police and fire pension purposes (attached). Additionally, the DMS has provided favorable consideration to the cities of Winter Park and Dunedin regarding various police and fire pension matters.

LEWIS LONGMAN & WALKER | P.A.

ATTORNEYS AT LAW

REPLY TO: TALLAHASSEE

MEMORANDUM

TO: Local Government Clients

FROM: Jim Linn and Glenn E. Thomas

DATE: August 20, 2012

RE: Police / Fire Pension Plans – Change in Division of Retirement Interpretation Concerning Eligibility for Chapter 175/185 Premium Tax Revenues

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Last week the Florida Division of Retirement issued a letter to the City of Naples concerning the City's eligibility for future premium tax revenues under Chapter 185, Florida Statutes. The Naples letter reflects a significant change in the Division's longstanding position concerning a city's eligibility to receive premium tax revenues. For the past 12 years the Division has taken the position that if a city reduced any pension benefit below the statutory minimum benefits or below the plan benefits in effect in 1999, the city would be ineligible for future premium tax revenues. In the Naples letter, the Division of Retirement acknowledges that its prior interpretation "appears inaccurate." A copy of the Naples letter is attached.

Background: The City of Naples entered into a collective bargaining agreement with the FOP containing a number of changes to the police pension plan. Among the changes were a reduction in the benefit multiplier from 3.63% to 3%, changing final average compensation from the best 3 years of service to the best 8 years of service, and eliminating the 3% cost of living adjustment for future service. The normal retirement age was also increased for employees hired after the effective date of the changes, to age 60 with 8 years of service or 30 years of service regardless of age. Early retirement prior to the new normal retirement date is allowed, with a 5% benefit reduction for each year that early retirement precedes the normal retirement date. All of the changes reduced benefits below the level in effect in 1999, and three of the changes were below the Chapter 185 minimums – but they conformed to the 2011 changes to the Florida Retirement System (the change in final average compensation, the new normal retirement age, and the early retirement reduction). The plan actuary calculated that the plan changes would reduce the City's required contributions by more than $34 million over the next 30 years – even with the loss of more than $500,000 in future annual premium tax revenues.

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After the pension changes were negotiated, the Division of Retirement advised the City that it would no longer be eligible for Ch. 185 premium tax revenues. Naples Mayor John Sorey wrote a letter to Governor Scott questioning the Division of Retirement's interpretation. The Division's letter of August 14, 2012 was in response to Mayor Sorey's letter.

The Naples Letter: The letter begins by quoting section 185.35, Florida Statutes – the statute concerning use of premium tax revenues. The letter points out that the Division's previous interpretation of this section "appears inaccurate." The letter then states that for local law plans in effect on October 1, 1998 (the vast majority of police and fire pension plans), chapter minimum benefits must be provided only to the extent they can be funded with premium tax revenues in excess of the amount received for 1997. Once there are sufficient additional premium taxes to fund the chapter minimum benefits, any subsequent additional premium tax revenues must be used to provide extra benefits.

As applied to Naples, the new interpretation allows the City to provide benefits below the chapter minimums and below the benefits in effect in 1999, <u>if</u> there are insufficient additional tax revenues to fund extra benefits.

In essence, the Naples letter appears to be saying that if a city can demonstrate through actuarial calculations that the current value of the chapter minimum benefits as applied to current plan members and data (which would presumably include a portion of the plan's unfunded actuarial accrued liabilities) is greater than the current amount of additional premium taxes received by the city, the city is not required to provide the chapter minimum benefits. If the current value of the chapter minimum benefits is less than the current amount of additional premium taxes, the city is required to provide the chapter minimum benefits plus extra benefits up to the amount of additional premium taxes. But a city is not required to provide the level of benefits in effect in 1999 to be eligible for future premium taxes.

Implications: The Naples letter appears to open the door to pension reform for many Florida cities, without the threat of loss of all future premium taxes. Each city will need to obtain an actuarial analysis to determine the extent to which the Division's new interpretation will be beneficial.

We would be pleased to answer any questions you may have concerning the Naples letter and its potential impact on you plan(s).

August 23, 2012

Honorable Peter Bober
Mayor, City of Hollywood
Post Office Box 229045
Hollywood, Florida 33022-9045

Re: Firefighters' Pension Fund & Police Officers' Retirement System
(Ordinance Nos. 0-2011-26 & 0-2011-27)

Dear Mayor Bober:

This is to acknowledge receipt of an e-mail dated September 23, 2011, from Ms. Gail Reinfeld, Director, Office of Human Resources and Risk Management Office, with attached final Ordinance No. 0-2011-26, amending the Firefighters' Pension Fund, and final Ordinance No. 0-2011-27 amending the Police Officers' Retirement System.

We also received an actuarial impact statement dated July 20, 2011, for the Police Officers' Retirement System, and an actuarial impact statement dated August 29, 2011, for the Firefighters' Pension Fund, that were prepared by the city's actuary, Michael Tierney. In addition, we received a copy of the September 1, 2011, actuarial impact statement prepared by the board's actuary, Jose Fernandez, for the Police Officers' Retirement System. We did not receive an actuarial impact statement prepared by the board's actuary for the Firefighters' Pension Fund; however, on August 13, 2012, the plan actuary provided a copy of the 10/1/2010 actuarial valuation (revised as of 1/30/2012) for the Hollywood Firefighters' Pension Plan. The plan actuary confirmed that this valuation includes the cost impact of Ordinance No. 0-2011-26.

Section 185.35(2), Florida Statutes, states:

> (2) The premium tax provided by this chapter shall in all cases be used in its entirety to provide extra benefits to police officers, or to police officers and firefighters if included. However, local law plans in effect on October 1, 1998, must comply with the minimum benefit provisions of this chapter only to the extent that additional premium tax revenues become available to incrementally fund the cost of such compliance as provided in s. 185.16(2). If a plan is in compliance with such minimum benefit provisions, as subsequent additional tax revenues become available, they shall be used to provide extra benefits. Local law plans created by special act before May 27, 1939, shall be deemed to comply with this chapter. For the purpose of this chapter, the term:

(a) "Additional premium tax revenues" means revenues received by a municipality pursuant to s. 185.10 which exceed the amount received for calendar year 1997.

(b) "Extra benefits" means benefits in addition to or greater than those provided to general employees of the municipality and in addition to those in existence for police officers on March 12, 1999.

A similar provision is found in section 175.351(2), Florida Statutes, pertaining to the Firefighters' Pension Trust Fund.

Previously, the Department had interpreted this law to mean that in order for Hollywood to receive any state premium tax revenues it must provide chapter minimum benefits and must preserve benefits in place on March 12, 1999. However, upon reviewing the law again, this interpretation appears inaccurate. The law actually states that local law plans in effect on October 1, 1998, like the City of Hollywood Police Officers' and Firefighters' Retirement Plan, "must comply with the minimum benefit provisions of this chapter *only to the extent that* additional premium tax revenues become available to incrementally fund the cost of such compliance." The phrase "only to the extent that" qualifies the law's requirement that local law plans "comply with the minimum benefit provisions" of chapters 175 and 185. This qualification means that, for local law plans in effect on October 1, 1998, the law compels them to provide chapter minimum benefits *only to the extent that* such benefits can be funded with "additional premium tax revenues." Additional premium tax revenues are defined as revenues "which *exceed* the amount received for calendar year 1997." Thus, for local law plans in effect on October 1, 1998, the law states that chapter minimum benefits must be provided only to the extent that they can be funded with premium tax revenues received in excess of the amount received for calendar year 1997. Once there are sufficient "additional premium tax revenues" to fund the chapter minimum benefits, the law states that any "*subsequent* additional tax revenues" must be used to fund "extra benefits," as defined above. This subsequent additional tax revenue is the only amount earmarked for "extra benefits" for local law plans in effect on October 1, 1998.

Because the City of Hollywood Police Officers' and Firefighters' Retirement Plans were in effect on October 1, 1998, the law allows Hollywood to provide benefits below the chapter minimums and below those in effect on March 12, 1999, if there are insufficient "additional premium tax revenues" to fund chapter minimum benefits and insufficient "subsequent additional tax revenue" to fund extra benefits. If the City of Hollywood received enough additional premium tax revenues to provide chapter minimum benefits, or an incremental portion thereof, the law requires Hollywood to use the revenues for such benefits. Once Hollywood has sufficient additional premium tax revenues to provide all chapter minimum benefits, any subsequent additional premium tax revenues must be used for extra benefits.

Based on Ordinance Nos. 0-2011-26 & 0-2011-27, it appears that there are a number of changes that have been enacted that reduce benefits below those that were in effect on March 12, 1999, but it does not appear that any of the benefit changes are less than the minimum chapter benefits. In order for the Department to determine if these changes can be approved, the plans' actuary must either confirm that the minimum chapter benefits are being maintained, or else demonstrate that there are not enough "additional premium tax revenues" to fund the minimum chapter benefits.

Thank you for your cooperation and assistance in this matter. Please let me know if you have any questions or if this office can be of assistance in any way.

Sincerely,

Keith E. Brinkman
Bureau Chief
Local Retirement Systems

KB:pfs

cc: Mark F. Butler, Chairman, Firefighters' Pension Fund
David Strauss, Chairman, Police Officers' Retirement System
Jennifer Kerr, Administrator, Firefighters' Pension Fund
Dave Williams, Administrator, Police Officers' Retirement System
Jose I. Fernandez, Plan Actuary
Stephen H. Cypen, Plan Attorney
Matthew Lalla, Finance Director

Attachment 4-B

CENTER FOR STATE & LOCAL GOVERNMENT EXCELLENCE

ISSUE BRIEF

Legal Constraints on Changes in State and Local Pensions

August 2012

The fiscal stress in many state and local governments has led to unprecedented changes in local and state pension plans.

From 2009–2011, 43 states enacted major changes in state retirement plans, according to the National Conference of State Legislatures. Seven more states enacted major structural changes in their pension plans for new employees in the first six months of 2012.

The Center's 2012 survey of human resources managers http://slge.org/publications/state-and-local-government-workforce2012-trends found that 37 percent of governments had made changes in their retirement plans in the last year. The most common change was to increase the retirement contribution for both new and current employees.

What has been striking about this period of time is that a few states have made changes that affect retirees as well as future benefits available to current employees. All such changes have been challenged in court.

This issue brief describes existing legal protections for pensions and reviews recent court decisions that have separated core benefit accruals from cost of living adjustments (COLAs). So far, courts have upheld adjustments to the COLA formula in Colorado, Minnesota, New Jersey, and South Dakota. Reductions in the COLA formula have led to an immediate reduction in the unfunded liabilities of those pension plans.

As state and local governments adjust their compensation plans, they also face a wave of retirements due to the age of their workforce. Government officials have the dual challenge of managing tight budgets while also taking a strategic approach to their workforce so that they can attract, develop, and retain the people they need for essential services.

The Center for State and Local Government Excellence gratefully acknowledges the financial support from the ICMA Retirement Corporation to undertake this research project.

Elizabeth K Kellar

Elizabeth K. Kellar
President and CEO
Center for State and Local Government Excellence

Legal Constraints on Changes in State and Local Pensions

By Alicia H. Munnell and Laura Quinby*

Introduction

State and local government pension reform has become a front-burner issue in the wake of the economic crisis, which sharply reduced funded ratios for most plans. Policymakers have responded primarily by raising employee contributions for all workers and/or reducing benefits for new workers. One option that has largely been off the table is reducing *future* benefits for current workers. The reason is that many states face legal constraints on their ability to make such changes. These constraints not only tie the hands of pension reformers but also accord public employees greater protections than their private sector counterparts.

This *brief* provides a comprehensive overview of the legal environment in which state and local plans operate with respect to benefit protections for current workers. The analysis relies on a thorough review of secondary sources and consultations with plan legal counsels.

The *brief* is organized as follows. The first section covers the major types of legal protections that apply to public pension benefits. The second section suggests an approach for increasing the flexibility of plan sponsors to alter benefits. The final section concludes that it may be less difficult to make such changes than the conventional wisdom suggests.

* Alicia H. Munnell is the director of the Center for Retirement Research at Boston College (CRR) and the Peter F. Drucker Professor of Management Sciences at Boston College's Carroll School of Management. Laura Quinby is a research associate at the CRR. The authors wish to thank David Blitzstein, Keith Brainard, Elizabeth Kellar, Ian Lanoff, Nathan Scovronick, and Lisa Soronen for helpful comments.

Pension Protections for Current Workers

The existing legal constraints on changing future benefits for current workers were a reaction to a period when pensions were viewed as a gratuity that the state could withdraw or change at any time. Since federal laws regulating pensions do not apply to public sector plan changes, states were responsible for determining their own benefit protections for public sector workers.[1] The legal approaches to protect public pensions vary across states.

Most states protect pensions under a contracts-based approach. The Federal Constitution's Contract Clause and similar provisions in state constitutions prohibit a state from passing any law that impairs existing public or private contracts. To determine whether a state action is unconstitutional under the Contract Clause, the courts apply a three-part test. First, they determine whether a contract exists. This process determines when the contract is formed and what it protects. Second, the courts determine whether the state action constitutes a substantial impairment to the contract. If the impairment is substantial, then the court must determine whether the action is justified by an important public purpose and if the action taken in the public interest is reasonable and necessary. This approach sets a high bar for changing future benefits, presenting a serious obstacle to pension reform.

A handful of states that protect pensions under the contract theory also have state constitutional provisions that expressly prevent the state from reducing benefits that participants expected at the time of employment. Illinois and New York have such a provision. Alaska has language that specifically applies only to accrued benefits, but the courts have interpreted the provision to protect all benefits from the time participants enroll. Arizona's language is less clear, but prior court rulings suggest that the protection extends to future as well as accrued benefits. In these states, changing benefits for existing employees is virtually impossible without amending the state constitution. In contrast, Hawaii, Louisiana, and Michigan have constitutional provisions that have been interpreted as protecting only benefits earned to date.

Table 1 categorizes the states by the extent to which core benefit accruals are protected and the legal basis for that protection.[2] It is necessary to separate core benefits from the cost-of-living adjustment (COLA) because recent court decisions suggest that the two components merit different treatment. Most states that protect core benefits under the contract theory do not have a state constitutional provision, but rather have statutes that expressly adopt the contract theory or judicial decisions that have ruled the relationship to be contractual. Interestingly, for 13 states the protections apply only once benefits are vested.[3] Eight states protect benefits only once the employee is eligible for retirement.[4] While New Jersey and Rhode Island have been classified in Table 1 as states where future benefits may be protected, they have changed future core benefits for current employees and have court cases pending regarding these changes.

California and several other states that fall in the contract group have attempted to introduce some flexibility by expanding the interpretation of the third part of the three-part test for Contract Clause constitutionality—that the change be "reasonable and necessary." Under the expanded test, the change could be reasonable and necessary either if it achieves an important public purpose—the conventional test—or if the disadvantages are accompanied by new advantages. In the end, however, the ability to modify pensions in these states hinges on when the contract is deemed to exist. States where the contract is found to exist at the time a worker is hired have little freedom to change benefits. States where the contract is found to exist at retirement have considerably more flexibility.

Six states have adopted a property-based approach for protecting pensions. To the extent that pension benefits are considered property, they cannot be taken away without due process according to the Fifth and Fourteenth Amendments to the Constitution. Most of the challenges to state action have not been successful. Courts have generally found amendments to public pension plans to be "an adjustment to the benefits and burdens of economic life" rather than the taking of private property without just compensation.[5] Thus, state officials have much more freedom to adjust pensions in states that have taken the property-based approach to pension rights.

For the vast majority of states, however, changing future benefits for current employees is extremely difficult. The exception, as noted above, appears to be the COLA. In four cases—Colorado, Minnesota, New Jersey, and South Dakota—a modification of the COLA was challenged in court, and the court upheld the change. The early decisions in Colorado and Minnesota laid out the rationale for allowing COLA suspensions.[6] In Colorado, where the decision is currently under appeal, the judge found that the plaintiffs had no vested contract right to a specific COLA amount for life without change and that the plaintiffs could have no reasonable expectation to a specific COLA given that the General Assembly changed the COLA formula numerous times over the past 40 years. In Minnesota,

Table 1. *Legal Basis for Protection of Public Pension Rights under State Laws*

Legal basis	Accruals protected			
	Past and future	Past and maybe future	Past only	None
State constitution	AK, IL, NY	AZ	HI, LA, MI	
Contract	AL, CA, GA, KS, MA, NE, NV, NH, ND, OR, PA, TN, VT, WA, WV	CO, ID, MD, MS, NJ, RI, SC	AR, DE, FL, IA, KY, MO, MT, NC, OK, SD, UT, VA	
Property	ME, WY	CT, NM, OH	WI	
Promissory estoppel[a]	MN			
Gratuity				IN, TX[b]

[a] Promissory estoppel is the protection of a promise even where no contract has been explicitly stated.
[b] This gratuity approach applies only to state-administered plans. Accruals in many locally-administered plans are protected under the Texas constitution.
Sources: Cloud (2011); Monahan (2010); National Conference on Public Employee Retirement Systems (2007); Mumford and Pareja (1997); Reinke (2011); Staman (2011); Simko (1996); and consultations with plan legal counsels when accompanied by a decisive court ruling.

the judge ruled both that the COLA was not a core benefit and that the COLA modification was necessary to prevent the long-term fiscal deterioration of the pension plan. Both these decisions clearly imply that core benefits are protected.

Expanding the Flexibility to Change Pension Benefits

The protection of future accruals of core benefits serves to lock in any benefit expansions, limiting policymakers' ability to respond to changing economic conditions. For example, employees covered by the California Public Employees' Retirement System (CalPERS) will continue to earn full benefits at age 55, an age introduced in a benefit expansion during the heady days of the 1990s. Few argue that core benefits earned to date based on such an age should be changed. Current workers accepted public employment with the understanding that they were accruing pension benefits at a certain rate, and remained employed with that understanding. But future benefits, much like future payroll, should be allowed to vary based on economic conditions. That is, public officials should be able to change future benefits for current CalPERS workers.

More flexibility to change public pensions could make reforms fairer.

Such increased flexibility for public employers would accord their employees the same protections as workers in the private sector. The Employee Retirement Income Security Act of 1974 (ERISA), which governs private pensions, protects accrued benefits but allows employers to change the terms going forward.[7]

In Illinois and New York, such a change would require a constitutional amendment. In other states, the challenge is to narrow the definition of the contract. Here the burden would fall on the legislature and the courts. First, enacting legislation that the contract is created when the employee performs the service, would establish an ERISA-type standard.[8] Second, if this legislation is challenged, the courts would then need to be persuaded to adopt a more flexible standard in light of changed conditions, just as they once abandoned the gratuity theory in favor of a contract-based approach. In fact, adopting a more flexible version of the contract approach would be less dramatic than shifting theories.

As noted above, New Jersey and Rhode Island have taken the first step by passing legislation that reduces core benefits for current workers. But the courts have yet to rule on the legality of these changes. A failure to permit such changes, however, would have serious consequences. First, limiting pension reductions to new workers reduces pension costs only slowly over time. Second, exempting current workers from cuts creates a two-tiered compensation system under which workers doing similar jobs would receive different amounts based solely on when they were hired. Such an outcome could undermine morale among employees and raise challenges for managers. Finally, allowing public employees to enjoy greater protections than their private sector counterparts is perceived by many as unfair.

Conclusion

Currently, policymakers grappling with underfunding in state and local pension plans are constrained in their ability to fairly share the burdens of reform, with sacrifices falling much more heavily on new workers than on current workers. Changing the status quo will likely require both legislative action and legal argument. In many states, a key challenge is narrowing the current definition of the employer-employee contract to establish that the contract is created when the employee performs the service. Such a standard would be much clearer than the morass of provisions that currently exists across the states, would enable state officials to undertake needed reforms, and would put public sector workers on an even footing with those in the private sector.

Establishing an ERISA-type standard, which would need to happen on a state-by-state basis, should be achievable because the protection accorded pension benefits is less embedded in state constitutions and more open to interpretation than commonly perceived. At a minimum, when sponsors institute changes for new employees, they should adopt the ERISA approach to cover these employees going forward.

Endnotes

1 The Employee Retirement Income Security Act of 1974 (ERISA), which governs plans in the private sector, does not cover state and local plans at all. While the Internal Revenue Code does specify—for public plans as well as private plans—the requirements that plans must meet to qualify for favorable tax treatment, it specifically exempts state plans from the "anti-cutback" rule, which precludes amendments that would decrease benefits already accrued.

2 The sources of information used to classify each state in Table 1 appear in the Appendix. In some cases, the sources provide conflicting guidance on how to classify a given state. To offer a clear standard for the reader, the hierarchy among the sources is as follows. Preference was given to information provided by a plan's legal counsel when accompanied by a decisive court ruling. If no information was provided, Monahan (2010) was the primary source. For states not covered in Monahan and where no information was received from the plans, the National Conference on Public Employee Retirement Systems' (NCPERS) 2007 analysis was the primary source. The only exception was New Hampshire, where recent developments suggest the NCPERS information is now outdated (see *The Associated Press* 2012).

3 The 13 states that protect only vested benefits are: Alabama, Alaska, California, Connecticut, Florida, Indiana, Louisiana, New Hampshire, New Mexico, North Carolina, Ohio, Oklahoma, and Tennessee. Vesting usually occurs within five years. In Indiana, protections apply only to the state's voluntary contributory plans; accruals under the state's mandatory non-contributory plans are not protected since they are viewed as a gratuity.

4 The eight states that protect benefits only once the employee is eligible for retirement are: Arkansas, Delaware, Iowa, Kentucky, Missouri, Montana, Utah, and Virginia.

5 *Pineman v. Fallon*, 842 F.2d 598 (2nd Cir. 1988).

6 In Colorado, 2010 legislation reduced the COLA for 2010 from 3.5 percent to the lesser of 2 percent or the average of the CPI-W for the 2009 calendar year (which resulted in a zero COLA for 2010) and a maximum of 2 percent thereafter (linked to investment returns) for current and future retirees. In Minnesota, in 2010 the state reduced the COLA for the State Employees' Retirement Fund from 2.5 percent to 2 percent and for the General Employees' Retirement Plan from 2.5 percent to 1 percent. The COLA for the Teachers' Retirement Association was suspended between 2011 and 2012, and reduced from 2.5 percent to 2 percent thereafter.

7 The Pension Protection Act of 2006, which amended ERISA, allows multi-employer plans that are severely underfunded to modify certain types of previously accrued benefits that are not part of the core pension benefit (such as early retirement subsidies and disability benefits not yet in pay status). These types of ancillary benefits are outside the scope of this *brief*.

8 The ERISA standard is appealing because it would make the protections in the public sector consistent with those in the private sector. But currently accrued benefits could be protected in many ways (see Schieber 2011). For example, benefit credits earned to date could be applied to a worker's projected final salary rather than his salary at the time that the plan is terminated or the formula changed.

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Appendix. Sources Used to Classify States by Legal Protection for Pensions

State	Source(s)
AL	NCPERS
AK	Mumford and Pareja; NCPERS; Staman
AZ	Monahan; NCPERS; Staman
AR	Monahan; plan legal counsel (consistent)
CA	Monahan; Mumford and Pareja; Staman
CO	Cloud; Monahan; NCPERS; Reinke
CT	NCPERS; Reinke
DE	NCPERS
FL	NCPERS
GA	NCPERS; plan legal counsel (decisive)
HI	NCPERS; Staman
ID	NCPERS
IL	NCPERS; Staman
IN	Monahan; Mumford and Pareja; NCPERS; Staman; plan legal counsel (decisive)
IA	NCPERS
KS	Monahan; Mumford and Pareja
KY	NCPERS
LA	Monahan; NCPERS
ME	Monahan; NCPERS
MD	NCPERS
MA	Monahan; NCPERS
MI	Monahan; NCPERS; Staman
MN	NCPERS; Reinke
MS	NCPERS
MO	NCPERS
MT	NCPERS
NE	Monahan; NCPERS
NV	Mumford and Pareja; NCPERS; plan legal counsel (decisive)
NH	The Associated Press; NCPERS
NJ	Method; NCPERS
NM	Monahan; NCPERS; Staman
NY	Monahan; Mumford and Pareja; NCPERS; Staman
NC	Monahan; NCPERS
ND	Mumford and Pareja; NCPERS
OH	Monahan; NCPERS; Staman
OK	Monahan; Mumford and Pareja; NCPERS
OR	Monahan; NCPERS
PA	NCPERS; Simko; plan legal counsel (decisive)
RI	NCPERS
SC	NCPERS
SD	NCPERS
TN	NCPERS
TX	Monahan; plan legal counsel (decisive)
UT	NCPERS
VT	Monahan; NCPERS
VA	NCPERS
WA	Monahan; NCPERS; Simko
WV	Monahan; NCPERS
WI	NCPERS
WY	NCPERS

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Helping state and local governments become knowledgeable and competitive employers

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The Center's five research priorities are:

- Retirement plans and savings
- Retiree health care
- Financial education for employees
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WK12-001

Attachment 5-A

NATIONAL CONFERENCE *of* STATE LEGISLATURES

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State Cash Balance, Defined Contribution and Hybrid Retirement Plans

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July 2012

This report describes state retirement plans that depart from the traditional public sector model of defined benefit (DB) plans. The overwhelming majority of statewide retirement plans for public employees and for teachers are DB plans. These provide a guaranteed life-time retirement benefit based on an employee's years of service and final salary. Although most state plans require employee contributions, the amount of benefit is not based on contributions. The plans may include post-retirement benefit adjustments, disability and life insurance, and retiree health insurance, although not all do so.

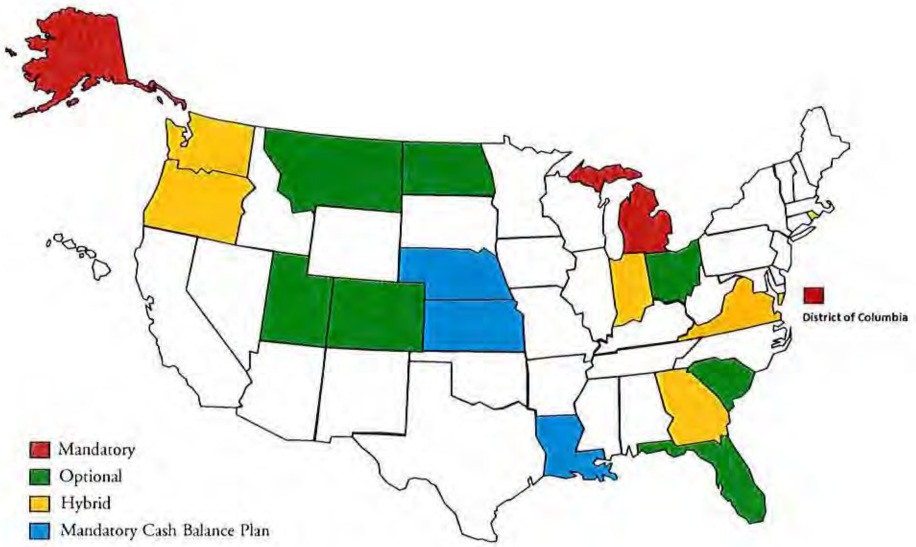
Other models have existed for a long time and have attracted increasing attention in recent years. As long ago as 1967, Nebraska established a defined contribution (DC) plan for state and county employees, similar to 401(k) plans in the private sector. Indiana's public retirement plans have long been what is sometimes called a hybrid plan, in which each member has both a DC and a DB retirement plan.[1] A third model is a cash-balance plan, in which members have individual accounts that carry a guaranteed rate of return and do not require the member to manage investments. Nebraska replaced its DC plan with a cash balance plan in 2002 and Kansas and Louisiana adopted new cash balance plans in 2012.

This report lists state governments plans designed as primary coverage for a state employees or state teachers or both. Primary coverage indicates a plan that eligible employees are required to join, or that is one of two or three alternative plans that employees choose among. Details on the different structures of cash balance, defined contribution and hybrid plans are included below in the discussion of individual state plans. The maps on the following pages indicate where such plans exist.

This report does not include optional deferred compensation plans, like Section 457 plans, which all states offer employees and teachers as a means of augmenting primary pension coverage. Many states have offered defined contribution plans to higher education faculty; this report is not intended to include all such plans.

See National Association of State Retirement Administrators, *NASRA Issue Brief: State Hybrid Retirement Plans* (November, 2011) at
http://www.nasra.org/resources/HybridBrief.pdf

Figure 1. Cash Balance, Defined Contribution and Hybrid Plans for General State Employees



Notes to figure 1:

In most states in the chart, the mandatory or optional plan indicated applies to employees who entered a retirement system after some specified date. Employees hired previously may be under other retirement plan designs. See the state plan descriptions in this document for details.

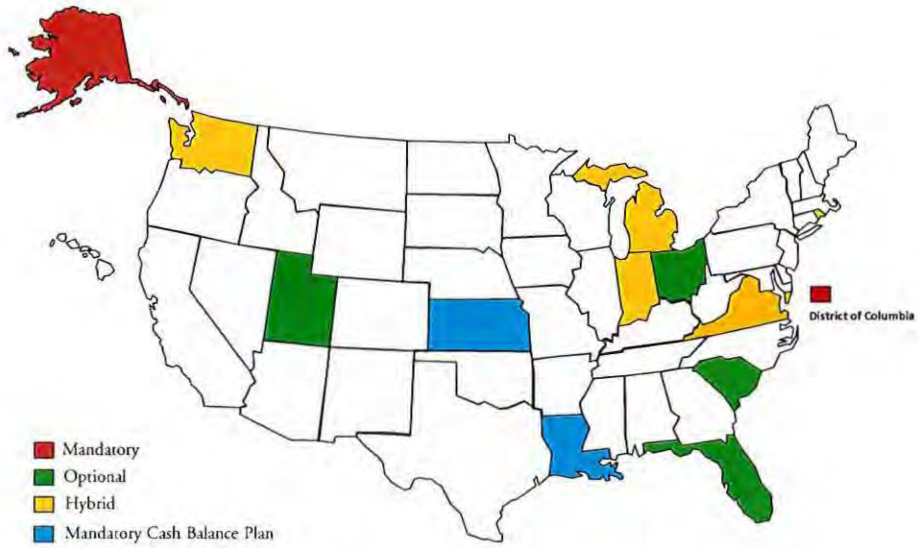
Indiana added an optional DC plan for state employees in 2011.

Kansas in 2012 enacted legislation to create a cash balance plan mandatory for most members of the Kansas Public Employees' Retirement System whose plan membership begins on or after January 1, 2015.

Louisiana in 2012 enacted legislation to create a cash balance plan mandatory for most state employees and post-secondary members of the Teachers' Retirement System whose plan membership begins on or after July 1. 2013. Membership is optional for other members of the Teachers' Retirement System.

Virginia in 2012 enacted legislation to create a hybrid plan for state and local government employees and teachers to include all new employees entering the Virginia Retirement System, other than hazardous duty and law enforcement members, as of January 1, 2014.

Figure 2. Cash Balance, Defined Contribution and Hybrid Plans:
Statewide Teachers' Plans, April, 2012



Notes to Figure 2:

In most states in the chart, the mandatory or optional defined contribution plans and hybrid plans cover employees who entered a retirement system after some specified date. Employees hired previously may be under other plan designs. See the state plan descriptions in this document for details.

Kansas in 2012 enacted legislation to create a cash balance plan mandatory for most members of the Kansas Public Employees' Retirement System whose plan membership begins on or after January 1, 2015. This plan includes teachers.

Louisiana in 2012 enacted legislation to create a cash balance plan that is mandatory for post-secondary members of the Teachers' Retirement System whose plan membership begins on or after July 1. 2013. Membership is optional for other members of the Teachers' Retirement System.

Virginia legislation of 2012 created a hybrid plan for teachers and state and local employees, other than hazardous and law enforcement members, who enter the Virginia Retirement System on or after January 1, 2014.

West Virginia: A West Virginia defined contribution plan for teachers was open for enrollment of members from 1999 to 2005, and has been closed to new members since that time. It is not shown on the map.

Part 1. Cash Balance Plans as Primary Plans

A cash balance plan is a form of hybrid plan that combines elements of DB and DC plans in one plan. In a cash balance plan:

- Each member has an individual account.
- Employees and employers both contribute to the account.
- The member cannot choose how the money is invested.
- Members' accounts are managed in one commingled fund, and members are guaranteed a specified return on their accounts.
- If investment return makes it possible, member accounts can receive additional returns.
- In public plans, upon retirement, the member receives an annuity based on the account balance and may have additional benefit options.

Kansas. In 2012, Kansas enacted legislation to replace its defined benefit plan for most state and local government employees, including education employees, with a cash balance on January 1, 2015. Members will contribute 6 percent of salary to their account.

Employers will contribute amounts ranging from 3 percent to 6 percent depending on how long the member has been employed. The Public Employee Retirement System will direct investments. Members are guaranteed an annual return of 5.25 percent on their accounts. Employees who leave before retirement may withdraw their contributions and the interest on them, but not the employer contributions. At retirement, members' accumulated balances will be converted to annuities, with additional options available.

See Chapter 171, Laws of 2012 (House Bill 2333)

Louisiana. Louisiana enacted legislation in 2012 to create a cash balance plan for most state employees and for post-secondary members of the Teachers' Retirement System of Louisiana, mandatory for those whose membership begins on or after July 1, 2013. It is available as a optional plan to specified other teachers and public employees.

Employee contributions will be 8 percent of salary. Each member account will receive an employer credit of 4 percent of salary annually as well as interest on the account, which will be pinned to the actuarial rate of return on investments of the Louisiana State Employees' Retirement System, but which will not fall below zero. Members of five years' standing who leave the system may withdraw their total balance, including the interest earnings, or leave it with the system. When members reach retirement age, they may convert the account to an annuity or choose among a variety of cash benefits.

See Chapter 483, Laws of 2012 (House Bill 61)

Nebraska. The primary Public Employee Retirement System plan was a defined contribution plan from 1967 to 2002. It was closed to new employees on January 1, 2003, and replaced with a cash balance plan. Members of the DC plan were allowed to transfer to the cash balance plan at the time, and enrollment has periodically been reopened to DC plan members since that time.

Employees contribute 4.8% of salary to the plan. Employer contributions are set at 156 percent of the employee contribution (7.488 percent) of salary. Members are guaranteed an annual return of at least 5% a year. The account can receive a higher return, depending on the federal mid-term rate and on investment earnings. At retirement, the employee may buy an annuity, or withdraw the balance in a lump sum or in installments.

See *Nebraska Statutes* Sections 84-1301 through 84-1333 and Buck Consultants. *Benefit Review Study of the Nebraska Retirement Systems.* August 2000 http://nlc1.nlc.state.ne.us/docs/pilot/pubs/nebraska_benefit_review_study.pdf

Part 2a. Defined Contribution Plans as Primary Plans

These plans are the government's primary, mandatory retirement plan for the designated class of employees.

Alaska. In 2005, the Legislature voted to close its defined benefit plans for public employees and teachers to new enrollment and to replace the defined benefit plans with defined contribution plans, effective July 1, 2006. Nonvested employees of the defined benefit plans for public employees and for teachers were permitted to transfer to the new defined contribution plans.

See Senate Bill 1, First Special Session of 2005, *Alaska Statutes*, chapter 14.25. http://www.legis.state.ak.us/basis/statutes.asp?title=14#14.25

The District of Columbia. In 1987, the District closed its defined benefit plan to new employees and replaced it with a defined contribution plan and Social Security membership.

See *District of Columbia Official Code* Title 1, Chapters 7 and 8.

Michigan. A state defined contribution plan has been mandatory for new state employees since March 31, 1997. Members of the closed defined benefit plan were allowed to transfer to the new DC plan if they chose. The state contributes 4% of salary to each employee's account. Employees may choose whether to contribute at all, but may contribute as much as 12% of salary. The state will match an additional 3% above its 4% basic contribution, for a maximum 7% employer contribution. Employer contributions go into a 401(k). Employee contributions above the initial 3% may go into the 401(k) or into a 457 plan.

See Public Act 487 of 1996 (House Bill 6229) as compiled at *Michigan Compiled Laws*, Chapter 38, sections 1 – 69. http://legislature.mi.gov/doc.aspx?mcl-Act-240-of-1943

2011 legislation required active members of the closed defined benefit plan for state employees to begin making a contribution of 4 percent of compensation toward pension costs beginning April 1, 2012, or freezing the service credit they have earned in the DB plan and converting to the DC plan for furure service. Those who fail to make an explicit choice will be enrolled in the DC plan.

See Public Act 264 of 2011 (House Bill 4701).

Minnesota. The Defined Contribution Plans (DCP) administered by the Public Employees' Retirement Association are tax deferred retirement savings programs established by the Minnesota Legislature in Minnesota Statutes, Chapter 353D. The DCP is exclusively for physicians, elected local governmental officials, city managers, and governmental volunteer ambulance service personnel.

Members of the DCP designate a percentage of total contributions to be placed in one or more of seven accounts of the Minnesota Supplemental Investment Fund. Employee and employer contributions are combined and used to purchase shares in the accounts selected by the employee. Upon termination of service a DCP member is entitled to a lump-sum payment of the values of shares held, with interest or dividends that have accrued. No monthly retirement benefits are available. Contribution rates vary by member classification.

See http://www.mnpera.org/index.asp?Type=B_BASIC&SEC={8219D0EF-DA92-4EB9-B225-A9B5B8A2965C}

Utah. Legislation enacted in 2010 provided a defined contribution plan as one option available to state and local government employees hired on or after July 1, 2011. The alterative option is a hybrid plan, described below in this report. The defined contribution plan will provide individual employee accounts to which employers will contribute 10% of employee compensation for public employees, legislators and the governor. The contribution rate will be 12% for public safety and firefighter members. Employees are not required to contribute but may do so, either to the same DC plan or to any other DC plan the employer offers. Employee contributions (if any) are immediately vested. Employer contributions will be vested after four years' covered employment. Employees may direct the investment of their contributions and the investment of employer contributions after those are vested.

See Chapter 266, laws of 2010 (Senate Bill 63)

West Virginia. In 1991, the state created a defined contribution plan for teachers and closed its defined benefit plan to new enrollment. In 2005, the defined contribution plan was closed to new enrollment. In 2006, the members of the defined contribution plan voted to merge it with the state's defined benefit plan for teachers. Various legal challenges ensued, which were resolved in May 2008 through legislation that allowed individual members of the defined contribution plan to choose whether to transfer each person's membership to the West Virginia Teachers Retirement System (a defined benefit plan).

See *West Virginia Code*, Chapter 18, Article 7B. and PlanSponsor Magazine, "State Plan Sponsor of the Year: A Lesson in Funding" (December 2009). http://www.plansponsor.com/MagazineArticle.aspx?id=4294990027

A Number of States in recent years have created defined contribution plans as the primary coverage for elected officials and political appointees. To some degree these plans are a response to term limits for legislators and other elected officials. Such states include Colorado, Louisiana, Nevada, Utah, Vermont and Virginia. In Colorado, legislative staff hired after July 1, 1999, have had the choice of a defined contribution retirement plan. 2008 legislation extended the Utah optional defined contribution plan to some legislative staff.

Part 2b. Defined Contribution Plans as an Optional Primary Plan

In the states listed below, new employees may elect to be members of a defined benefit plan or a defined contribution plan, but must be a member of one or the other. Under current law in these states, both kinds of plan remain open to new members, and limited transfer between them is available.

Colorado. In 2004, Colorado created a defined contribution plan as an option for state employees, effective January 1, 2006. On the same date, Colorado opened its existing defined contribution plan for elected officials to general membership, giving new employees one defined benefit and two defined contribution plans among which to choose. Chapter 73, Laws of 2009, closed the elected officials' plan to new members, but the defined contribution plan created in 2004 remains as a option for new state employees.

Florida. In 2000, the state established a defined contribution plan (the Florida Retirement System Investment Plan) as an optional alternative to its defined benefit plan. Existing DB members could join the new plan. Existing members also were given a third option of transferring to a hybrid plan (described below) that combines features of DB and DC plans. The third option is not available to employees who joined the workforce after the creation of the alternative plans.

Indiana. In 2011, Indiana established a defined contribution (DC) plan as an option for new state employees. A state employee who does not make an explicit choice to become a member of the DC plan becomes a member of the Public Employees' Retirement Fund (PERF), which is a hybrid plan, described below.

The bill requires the PERF Board of Trustees to establish the same investment options for the DC plan that are available for the investment of a PERF member's annuity savings account. It provides that a member's contribution to the Plan is 3% of the member's compensation and is paid by the state on behalf of the member. It also provides that the state's employer contribution rate for the Plan is equal to the state's employer contribution rate for PERF. It also provides that the amount credited from the employer's contribution rate to the member's account shall not be greater than the normal cost of PERF with any amount not credited to the member's account applied to PERF's unfunded accrued liability.

The bill establishes a minimum state employer contribution of 3% of plan members' compensation.

The bill establishes a five-year vesting schedule for employer contributions, and requires a member who terminates state employment before the member is fully vested to forfeit amounts that are not vested. It establishes provisions for the withdrawal of amounts in member accounts. The bill also authorizes rollover contributions to the plan.

See Public Law No. 22-2011 (Senate Bill 524).

Montana. In 2002, the state created an optional defined contribution plan for state, local, university, and school district employees other than teachers. Current members of the defined benefit plan were allowed one year to transfer to the new plan.The plan covers eligible employees of the state, university system, local government and certain employees of the school districts that elect the defined contribution plan. All new hires initially are members of the Public Employee Retirement System defined benefit pan, and have a 12 month window in which they may make an irrevocable choice between the defined contribution plan and the DB plan. The defined contribution plan provides retirement, disability and death benefits to plan members and their beneficiaries. Employees contribute 7.17% of salaries, and employers contribute 7.37% of salaries to the plan.

See Montana Codes Annotated Title 19, chapters 2 and 3.

North Dakota. In 1999, the state created an optional defined contribution plan for "exempt" or non-classified state employees, 75% of whom are employees in the higher education system.

Ohio. From 1998 through 2002, the state created optional defined contribution plans for education employees, teachers and general state and local government employees. Employees not yet vested in the state defined benefit plan had the option of moving to the new plan. As noted below, Ohio also offers a third optional plan, a hybrid plan with both defined benefit and defined contribution features.

South Carolina. In 2000 and 2002, the state created optional defined contribution plans for existing and new state and local government employees and teachers.

Part 3. Hybrid Plans

These plans provide features of both defined contribution and defined benefit plans. One form of hybrid plan is the cash balance plan. A somewhat more common form in state government provides each member with both a defined benefit plan and a defined contribution account.

As a general rule, these plans maintain a defined contribution plan for employee contributions and a defined benefit plan for employer contributions. The Georgia plan created in 2008 and the Michigan teachers' plan of 2010 differ from this general rule in that employees may continue in the defined benefit portion of the plan but terminate their participation in the defined contribution component.

Florida. In 2000, when the state established its optional defined contribution plan, members of the existing DB plan were given a third option of transferring to a hybrid plan. The third option has not since been available to new employees.

Georgia. Act 757 of 2008 (Senate Bill 328) created a hybrid retirement plan for Georgia state employees. The "Georgia State Employees' Pension and Savings Plan" (GSEPS) provides a defined benefit plan (DB) and 401(k) plan for new hires on and after January 1, 2009 and an opt-in to those employees who belonged to the Employee Retirement System (ERS) on December 31, 2008. The ERS Board of Trustees will administer the new plan.

People who first or again become an employee entitled to membership in ERS on or after January 1, 2009 will be required to join GSEPS. The DB formula will be 1% for each year of service times the average of the highest 24 consecutive calendar months of salary while a member. The formula can be increased in the future up to 2% by the board of trustees provided funds are appropriated by the General Assembly. Vesting in the DB is 10 years.

GSEPS members will be automatically enrolled in the 401(k) plan and will have a one-time 90 day window to opt out of the 401(k) and receive a refund of the account balance at that time. Participating members can stop and start 401(k) participation at any time thereafter. However, funds in the 401(k) must remain in the fund until separation. Participation in the 401(k) requires a mandatory employee contribution of 1% of compensation with voluntary elective contributions after the first 1%. Each employer will match the first 1%, plus a 50% match for each percent above the first 1% up to a total 3% employer match. Participants may contribute up to the IRS maximum limit each year. Employee contribution are vested when made, and employer contributions are vested over five years at a rate of 20% per year.

Indiana. For decades, retirement plans for state employees and teachers have consisted of an Annuity Savings Account (a defined contribution component) made up of employee contributions and a defined benefit funded by employer contributions. The state employee plan was created in 1945; the teachers' plan was instituted in 1921.

Michigan. Act 75 of 2010 (SB 1227) created a hybrid retirement plan for members of the Public School Employees Retirement System.

Employees first hired on or after July 1, 2010, will be placed in a new "hybrid" pension plan, with a blending of defined benefit (DB) and defined contribution (Tier 2) components. A person under this plan will not be able to receive pension payments until age 60, and will be required to have worked at least 10 years as a public school employee. The purchase of service credit by these employees is prohibited, and cost-of-living adjustments to the pension are not provided. An employee will have to contribute $510 annually plus 6.4% of salary above $15,000, in addition to the Tier 2 contributions described below.

An employee under this plan will have to contribute 2.0% of salary to his or her Tier 2 account, unless affirmatively electing not to contribute or to contribute a lesser amount. The employer will have to match 50% of the employee's first 2.0% of salary contribution, for a maximum total employer payment of 1.0% of salary deposited into the Tier 2 account. This is in addition to the employer cost for the DB pension of this employee. The employee will be allowed to contribute more than 2.0% of salary, but the employer will not match more than 1.0%, unless choosing to do so under a locally negotiated agreement. An employee described here is immediately vested in his or her own contributions, and will vest in employer contributions as follows: 25% after two years of service, 75% after three years of service, and 100% after four years of service.

The defined benefit side of this hybrid plan will use a five-year period on which to calculate the final average compensation (FAC), likely generating a lower FAC than is in current law. (For Basic Plan members, the time frame is five years; for MIP members, the time frame is three years.) Also, under this plan, the actuary will be required to assume a 7.0% rate of return on the investments in the portfolio (rather than the 8.0% rate under current law). The actuary may determine a different employer contribution rate for these members.
See Act 75 of 2010 (SB 1227).

Ohio. The retirement plan revisions from 2000 through 2002 that created an optional defined contribution plan for Ohio teachers and other employees also created the third option of a hybrid defined-benefit/defined contribution plan.

Oregon. The public employee retirement plan (which includes teachers and other education personnel) created in 2003 consists of a defined benefit program called "the pension program" funded by employer contributions and a defined contribution program called the "individual account program," funded by employee contributions.

Rhode Island. Legislation enacted in 2011 provided for closing the defined benefit plan of the Rhode Island Employee Retirement System (ERS) on July 1, 2012, and created a hybrid plan for all existing members of ERS as of that date as well as new members of the system, except for judges and some public safety members. The hybrid plan will consist of a reduced defined benefit plan and an individual account for each members.

Members are required to contribution to the defined contribution component and may not opt out of it. For most members, contributions are unchanged from the total amount required for the former DB plan, although the allocation of the contributions has been changed.

See Chapter 408, Public Laws of 2011 (Senate Bill 1111) and the website of the Rhode Island Employee Retirement System:
http://www.treasury.ri.gov/secure-path-ri/legislation.php

Virginia. Act 702 of 2012 provided a hybrid retirement plan for state and local employees and teachers, other than law enforcement personnel, who enter the Virginia Retirement

System on or after January 1, 2014. It includes mandatory defined benefit and defined contribution components.

- For the DB component of the hybrid plan, the vesting, age and service requirements for normal and early retirement and calculation of average final compensation are the same as for Plan 2 DB members. Vesting is at five years; normal retirement is at a person's Social Security age with five years of service or at the Rule of 90. Early retirement is available at the age of 60 with five years of service. Average final compensation is the average of the highest 60 months.
- The hybrid plan DB multiplier will be 1.0%
- Each member of the hybrid plan will be required to make contributions to both the DB and DC component. The employee contribution to the DB component will be 4%. The mandatory employee contribution to the DC component will be 1%, and employees may contribute up to 5% of salary to earn an additional partial employer match.
- The legislation includes a provision to increase an employee's contribution automatically by 0.5% of compensation every three years until members reach the maximum contribution rate. Matches will apply to the increased contribution as described below. Employees may opt out of the automatic increase in the employee contribution rate.
- Employer contributions for the DB plan will be actuarially determined at the rate set for the legacy defined benefit plans. Employer contributions to each employee's DC account will be as follows:
    - For the 1% mandatory employee contribution, 1% of salary.
    - For the first 1% voluntary employee contribution, 1%.
    - 0.5% for each additional 1% voluntary contribution, up to the full 5% that is subject to match.
    - The total possible employer contribution would be 3.5% on a 5% employee contribution.
- Vesting of employer contributions will begin at 25% after an employee has participated continuously in the program for one year, increasing at 25% a year until the employee is fully vested in the employer contribution after four years of continuous membership.

See Chapter 702, Laws of 2012 (House Bill 1130)
http://leg1.state.va.us/cgi-bin/legp504.exe?ses=121&typ=bil&val=hb1130

Utah. Legislation enacted in 2010 provided a hybrid retirement plan as one option available to state and local government employees hired on or after July 1, 2011. The other option is a defined contribution plan described earlier in this report.

The hybrid plan (§29) includes a defined benefit and a defined contribution component.

- For the DB component, employers will pay up to 10 percentage points of an employee's compensation toward the amount that is required to keep the plan actuarially sound. The employee will contribute any additional amount required to make up the actuarial requirement.

- For the DC component, employers will contribute 10% of employee compensation less the amount the employer contributes to the DB component. The employer contribution will be deposited in a 401(k) plan to which the member may choose, but is not required, to make additional contributions. Employer contributions will vest after four years' membership in the plan; employee contributions vest immediately. The member may direct the investment of his or her contributions immediately, and those of the employer after they are vested.

See Senate Bill 63 of the 2010 Utah legislative session.

Washington. The 1998 Teachers' Retirement Plan Tier 3 consists of defined contribution and defined benefit elements, funded respectively by employee and employer contributions. This plan is mandatory for teachers hired since the plan's inception. Legislation in 2000 created a similar but optional Public Employee Retirement System Plan 3 for state and local government and higher education employees. State and local employees who do not select the hybrid plan are enrolled in a defined benefit plan.

Sources
In addition to the sources listed in the text, this report is based on NCSL's series of annual summaries of state legislation concerning state pension and retirement plans. The summaries are available on the NCSL website at http://www.ncsl.org/default.aspx?tabid=13399 Other information has been taken from the websites of the retirement systems mentioned in the text.

Attachment 5-B

Hybrid Pension Plans Attracting More States, Cities

Unable to continue making payments on traditional retirement benefits, officials are trading in the old model and looking for a more efficient option.

BY: Carol Anderson | August 2012

Riled-up citizens in San Diego and San Jose, Calif., have spoken: This spring, they voted overwhelmingly to shrink retirement benefits for current city employees as well as new hires.

Fiscally worried state officials have taken action too. As of July 1, Rhode Island cut retirement benefits for all state workers, including retirees.

And crisis-wary legislators are working to preclude potential disaster. Last year, Utah's legislators not only set up a hybrid for new employees, but also capped the state's contribution to their defined-benefit plan. If the plan's costs are higher than the cap, employees make up the difference.

There's a public pension crisis out there. Defined-benefit (DB) plans -- the stalwart of public pension systems -- are in trouble, both financially and politically. The $757 billion in unfunded liabilities that the plans now carry are a threat to the well-being of states and localities and their taxpayers. Meanwhile, the private sector has been shedding its DB plans for decades, replacing them with defined-contribution (DC) plans in the form of 401(k)s. That has left those employees with pension envy. As voters, they are no longer willing to bankroll benefits for public employees that they no longer get themselves.

To address the growing problem, jurisdictions have implemented or proposed a number of changes. Some are revising the defined-benefit plan itself -- raising the retirement age or suspending cost-of-living adjustments. Some are looking at a more radical approach: doing away with the defined-benefit plan for new hires and offering them a defined-contribution plan only. But the middle ground -- and a trend that seems to be growing -- is to have a little of both: a defined-contribution plan backed up by a lower-level defined-benefit plan. Alternatively, some are opting for a cash balance program that combines aspects of both defined-benefit and defined-contribution approaches.

These are hybrid plans. While the trend may be fairly new, hybrids have been around for years. Indiana has had one since the 1950s. At last count, about a dozen states and a handful of cities have joined Indiana's ranks, offering their employees -- usually just their new hires -- hybrid plans.

The main impetus is to keep costs in check. States and localities see the unfunded liabilities of traditional defined-benefit plans as a threat to their budgets and credit ratings. If their employees had defined-contribution accounts instead -- a version of 401(k)-style plans -- they would eventually be relieved of that burden.

But a DC plan alone raises uncomfortable questions about retirement security for employees. Depending on how they are structured, DC accounts may have the same pitfalls as 401(k) plans have had in the private sector. Individuals are left to navigate the perils of the investing world on their own and could end up retiring in a down market, losing a big chunk of their nest egg. "We need to think of pensions not as wealth accumulation, but as old-age poverty insurance," says Keith Brainard, research director of the National Association of State Retirement Administrators.

It is a point Richard Hiller, senior vice president of the government market for the financial services organization TIAA-CREF, makes as well. In fact, Hiller objects to equating DC plans with 401(k)s in the first place. That "scares people who saw the losses suffered in 401(k) plans during the recession," he says. "But a properly designed DC plan should protect itself from those kinds of wild swings."

By "properly designed," he means one that provides a limited menu of low-cost investment choices that focus on generating adequate retirement income. Some of those choices would be annuities and life-cycle funds whose allocation changes over time as the member ages.

A proper DC plan also distributes income differently than a 401(k), he notes. Payouts can be designed to last for life rather than taken in a lump sum. In that way, it is "much more tightly designed to be a true retirement plan," Hiller says. Consequently, "the emphasis is on income replacement rather than on asset accumulation."

However well the DC plan is designed, there is still a need for a DB plan that provides a predictable level of retirement income -- albeit one that is less generous than today's traditional plans. Maintaining a DB plan as part of a hybrid plan is particularly important in the public sector, Hiller notes. "When the government is the plan sponsor, what you don't want is people getting to retirement without adequate assets -- then looking to the state to be their safety net."

A cash balance plan is an alternative to maintaining both DB and DC plans. It combines elements of both in a single plan. Like a traditional DB plan, contributions from employees and employers are pooled and professionally managed. But unlike a DB plan, the benefit is based on the amount accumulated in the account -- not on a formula based on salary and years of service. Members get a guaranteed rate of return, but it's likely to yield lower yearly payouts than a traditional DB plan. In effect, the cash balance plan eventually converts the savings in the individual's account into an annuity, with a minimum rate of return guaranteed by the employer. Though they are on the hook for guaranteeing the return, the cash balance approach greatly lowers future liability.

Nebraska, which started out with a DC plan for most state workers (teachers and some other public employees are in DB plans), switched to cash balance in 2003. The plan is mandatory for new hires and optional for existing employees.

Where some states see a cash balance plan as downsizing their pension plans, Nebraska "improved our benefit by going from a DC to a cash balance plan," says Phyllis Chambers, who runs Nebraska's Public Employees' Retirement System. For Nebraska, cash balance is a necessary improvement over the straight DC system.

"Cash balance offers a good, stable retirement income with a guarantee," Chambers says, "so nobody's benefit goes down." After all, investing is not only tricky -- even for the expert -- it also leaves the person about to retire at the mercy of the market. With a DC "it's all about timing," Chambers points out, and timing was terrible for workers who wanted to retire in 2008-09. A number of Nebraska's DC members were forced to postpone retirement, Chambers says, because their account values had plunged by half. But that didn't happen to participants in the cash balance plan who receive a guaranteed 5 percent minimum return. When investment returns are above 5 percent (as they were for the first five years of the plan), members get a dividend. When returns drop below 5 percent (as in recent years), the state makes up the difference.

Even with the state on the hook for that guarantee, it adds up to a much lower potential liability than the teacher's defined-benefit plan. In order to meet those payouts now and in the future, the pension plan operates on the premise of an 8 percent assumed rate of return. When the portfolio doesn't meet that return, the shortfall becomes an obligation of the state.

All in all, Chambers says the cash balance form of a hybrid plan has worked out well for fiscally frugal Nebraska. Recently Louisiana and Kansas decided to follow suit and adopt cash balance plans for future employees.

Most hybrids are so new that it's hard to tell how well or poorly they're working -- especially since they apply only to new hires in most states.

But Indiana has a long hybrid history. Its combination plan has changed little since its inception in 1955. It includes a modest DB component funded by the employer. On the DC side, employees (alone or in combination with the employer) must contribute at least 3 percent of their salary, with the option to kick in more. Employees, who also participate in Social Security, choose how to invest the DC funds from a limited number of options and assume the investment risk.

There is one unusual feature to the lineup of investment options available to employees: They can opt to invest their money with the state's defined-benefit portfolio. "They get what the DB portfolio earns, and that is a higher rate of return than they could get in any other plan," says Teresa Ghilarducci, a former public trustee with the Indiana fund (and currently chair of economic policy analysis in the Department of Economics at The New School for Social Research).

Although the system is healthy (the plan is 81 percent funded), the state wants to add a non-hybrid, DC-only option for new state employees. The state's objective, according to Steve Russo, executive director of Indiana's public employees' retirement fund, is to improve the management of risk and offer workers more choice. "We're keeping an eye on the future," Russo says. "We're trying to prevent a crisis so we don't have to act out of desperation."

Under the proposed DC-only option, the state would contribute funds into each employee's account equal to what would have gone into the DB portion of the hybrid. But members would assume all the investment risk and there would be no DB backup. New hires may prefer the DC-only option, Russo says, because the existing DB piece has a 10-year vesting period.

One of the selling points of a DC-only option is to give employees more leeway in choosing plans and investment options. "Giving people a choice is always better," Russo says. "But along with that comes the obligation to educate them before they make those choices."

He is referring to helping new employees choose between the state's current hybrid plan and the optional DC-only plan that the state hopes to implement. But the "obligation to educate" also applies to helping workers in a DC plan figure out how to invest.

As officials in Nebraska can attest, many employees are unsophisticated in that department and often make inappropriate or poor choices. Plan administrators can't dispense investment advice, so they may work with financial professionals by arranging seminars, webinars and individual counseling sessions as well as by providing general information in print and on websites.

The education effort is uncharted territory for many systems that are just getting started with the DC component of their plans. "It's so new -- that's part of the problem," says David Daly with the National Pension Education Association. "Everybody's trying to decide how to handle it." To that, Daly adds that educating members "is something we'll certainly be looking at as more systems switch to hybrids and DC plans."

Ready or not, like it or not -- hybrids are coming. Many state and local officials consider them a decent -- even good -- compromise for sharing the pain of the current era.

Attachment 5-C

BEST PRACTICE

Essential Design Elements of Hybrid Retirement Plans (2008) (CORBA)

Background. In its Best Practice (BP), *Developing a Policy for Retirement Plan Design Options* (2007), the Government Finance Officers Association (GFOA) recommends that public sector employers or plan sponsors have a policy statement that will guide their plan design decisions. Once a pension plan design decision has been made, GFOA members can refer to this BP on *Essential Design Elements of Hybrid Retirement Plans* to review the essential elements of offering a hybrid retirement plan or incorporating a hybrid feature.

Separate best practices have been adopted for the *Essential Design Elements of Defined Benefit Retirement Plans* and the *Essential Design Elements of Defined Contribution Retirement Plans*. These best practices should be consulted accordingly.

The emergence of hybrid plans in recent years, offering a combination of defined benefit and defined contribution plan features shows how the public retirement benefits environment is changing. Hybrid plans may be offered as a primary, optional or supplemental plan.

(A) Hybrid Account Balance Plans

There are a growing number of hybrid plans that express future retirement benefits as account balances. The key difference between defined contribution plans and hybrid plans is that defined contribution plans establish an actual funded account for each participant, which contains employer and employee contributions and investment gains and losses, while hybrid plans establish "accounting" or notational accounts for each participant. The participant's balance in a hybrid plan continues to grow throughout employment, and the benefit is defined by the current value of the account.

The most common hybrid account balance plans are:

1. Cash Balance Plans - In cash balance plans, the employer sets aside a percentage of an employee's salary each period and the balance set aside earns interest at a set rate. In other words, the employer promises to make a contribution to an account, usually with a specified percentage of pay (also referred to as a credit to the employee's account), and to credit the account with interest, usually a specified rate of return or a rate based on the yield of a particular benchmark. The employer invests the funds, retaining all investment income and bearing all the risks. The plans generally provide participants the option of receiving their vested account balances as an annuity or as a lump-sum.

2. Pension Equity Plans – In a pension equity plan, the balance in the employees' account equals a given percentage of the employees' final average salary for each year of service. Some plans increase the percentage with additional years of service. Pension equity plans have various flexible features, which should be analyzed before a plan is selected. The plans generally provide participants the option of receiving their vested account balances as an annuity or as a lump-sum.

(B) Plans with Hybrid Features

1. Defined Benefit Plan (DB) with Defined Contribution (DC) features - Public sector plans have options under section 401(a) of the IRC to add a defined contribution feature to a defined benefit plan. There are several variations of DB plans with defined contribution features. Some of these are referred to as blended plans or combination plans. Although not considered a traditional hybrid plan or feature, another common approach is to simply offer a defined benefit plan and a separate voluntary defined contribution plan such as a 457, 403(b) or 401(k) plan.

2. Defined Contribution Plan (DC) with Defined Benefit (DB) features – Defined contribution plans may seek ways to allow members to manage the risk of outliving their money. This could include the purchase of an annuity contract, or allowing a transfer out of the DC plan into an appropriate DB plan where the employee can annuitize this transferring DC balance.

Recommendation. Should an employer choose to provide a hybrid retirement benefit plan, the GFOA recommends that retirement system administrators and finance professionals consider the following before adopting hybrid plans or combining hybrid features with defined benefit or defined contribution plans:

1. Whether the hybrid plan will serve as the primary income replacement vehicle or will a hybrid feature be added to supplement a defined benefit or defined contribution plan.

2. Whether the plan will replace a current defined benefit plan or defined contribution plan, become part of a blended plan, or be offered as an alternative to all employees or to new employees at the time of hire.

3. The purpose of the hybrid plan; is the hybrid plan intended to:

   (a) Reduce the employer's cost by utilizing hybrid plan cost control features including how investment risk is allocated between the employer and employee.

   (b) Enhance the employer's ability to recruit and retain employees, including older employees and/or younger more mobile employees, by offering retirement plans providing:

      1) predictable and/or guaranteed benefits, including adequate disability, survivor benefits and other ancillary benefits.

      2) portable benefits upon termination or retirement.

      3) benefits which are easily communicated to the participant.

4. Whether the hybrid plan or feature under consideration achieves the employer's stated purpose for changing, supplementing or replacing the current plan.

5. Whether there are projected short and long-term costs and/or savings of changing the plan or feature and will the plan or feature be sustainable long-term. Evaluation of costs and/or savings should include not only direct pension costs but also an estimate of the impact on other benefits and on total compensation costs. Consideration should also be given to the possible increased cost of administering additional plans or more complex plan features. For example, does the internal plan staff have the knowledge and skills to administer a hybrid plan or will additional consulting services be required?

6. Plan conversions or implementing new plans should be undertaken with competent professional advice and assistance. Conversion of a defined benefit plan to a hybrid plan should be undertaken with careful consideration and with legal assistance. Consider whether the hybrid plan or plan feature complies with

the Pension Protection Act of 2006 and its implementing regulations. Particular attention should be paid to issues regarding age discrimination.

7. Whether the relevant plan or features comply with GFOA Recommended Practices for Defined Benefit and/or Defined Contribution Retirement Plans, as appropriate.

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