



MEMORANDUM

TO: Jacksonville City Council Members
FROM: Patrick "Joey" Greive, CFA, CFP, Treasurer
RE: Actuarial Analysis of Retirement Reform Agreement
DATE: Tuesday, May 28, 2013

Mayor Brown, the Jacksonville Police and Fire Pension Fund (JPPF), and public safety employees recently announced a landmark retirement reform agreement projected to save more than \$1 billion over the next 30 years. The purpose of this memorandum is to share the confirmation of those savings and highlight key findings from the actuarial analysis.

Robert Dezube of the Milliman Group is the City's actuary for purposes of analyzing the JPPF. Enclosed for your review is his final actuarial analysis on the retirement reform agreement. While I know that you will review the analysis in detail, I wanted to highlight some of the key findings.

- **ACTUARIAL CONFIRMATION OF \$1.2 BILLION SAVINGS**

I know that some of you have been eager to have actuarial confirmation of the long-term savings that we reported when announcing this retirement reform agreement. As you will see on page 7 of his analysis, Mr. Dezube has concluded that the retirement agreement will save the City of Jacksonville approximately \$1.2 billion over the next 30 years. But for this agreement, the JPPF would have implemented assumptions and benefits that would have resulted in the City spending approximately \$6.02 billion over 30 years. This agreement will result in the City spending \$4.82 billion over 30 years.

As you know from your review of the agreement, it is "predicated on the Trust's actuary and the City's actuary consulting and reaching consensus on the long-term financial savings of this agreement on or before May 31, 2013." JPPF actuary Jarmon Welch of Pension Board Consultants has agreed that Mr. Dezube's findings are reasonable.

- **IMPACT OF RETIREMENT BENEFIT CHANGES VS. ACTUARIAL ASSUMPTION CHANGES**

Since the retirement reform agreement was announced, I have heard concern that the long-term savings are mainly attributable to differences in the assumed rate of return. As Mr. Dezube demonstrates on page 7, that is not the case.

As you know, the baseline valuation that the JPPF tentatively adopted in March 2013 lowered the assumed rate of return from 7.75% in Fiscal Year (FY) 2012-13 to 7.0% in FY 2013-14 and beyond. This agreement utilizes a "stair-step" approach that is in keeping with best practices from other jurisdictions. It maintains a 7.75% assumed rate of return for FY 2013-14 and 2014-15, but lowers the assumed rate to 7.5% in FY 2015-16 and lowers it again to 7.25% in FY 2016-17.

Mr. Dezube concludes on page 7 that nearly 83% of the long-term savings are attributable not to this difference in the rate of return but rather to the significant retirement benefit changes for new public safety employees who are starting on or after October 1, 2013. As you may know, these changes are comparable to and in some ways more far-reaching than benefits for new Florida Retirement System (FRS) Special Risk (police and fire) employees. Most Florida counties have their police and fire employees in the FRS Special Risk plan.

- **ASSESSMENT AS TO CURRENT EMPLOYEES**

Some have wondered whether this agreement should have achieved more savings from current employees. But as Mr. Dezube observes on page 3, the potential savings from current employee benefit changes had limitations.

The 2011 actuarial valuation that JPFPF actuary Jarmon Welch of Pension Board Consultants prepared showed the Plan's total liabilities (funded and unfunded) at \$2.4 billion. Approximately 70% of that liability – or \$1.7 billion -- was attributable to Plan retirees and those employees in DROP whose benefits may not be modified by law according to the Office of General Counsel and our outside attorneys. The remaining 30% -- approximately \$700 million -- relates to current employees not yet retired or in DROP. However, the City's ability to impact and generate savings through the remaining 30% of liability is limited by its legal inability to modify benefits for those PFPF members who are still working but have already become eligible for retirement, its legal inability to modify any benefits that current employees have already accrued, and the relatively limited police and fire hiring that has occurred in recent years.

Mr. Dezube has estimated that increased pension contributions from current employees will save a significant amount.

- **LONG-TERM FINANCIAL PROJECTIONS**

Mr. Dezube's charts included several charts that help to demonstrate the impact of the retirement reform agreement on the City's annual contribution and the PFPF's funded status over time. First, as to the City's annual contribution, you will note that the retirement reform agreement significantly reduces the amount that the City would have contributed under the plan tentatively adopted by the JPFPF in March 2013. Please see the attached charts as to City Contribution and Cumulative Savings. These charts reflect the \$1.2 billion in savings that Mr. Dezube has confirmed in his analysis.

Second, this agreement also helps to improve the funded status of the plan. In December 2012, JPFPF investment consultant Summit Strategies reported that as of October 1, 2011, the Plan was only 38% funded. As a result of the agreement, funded status will increase to 71% by the time this agreement expires at the end of FY 2029-30.

Please be advised that any long-term investment gains above the long-term assumed rate of return (7.25% for FY 2016-17 and beyond) will lower the City's annual contribution and increase the funded status of the Plan.

Third, some of you may review these charts and note that the City's contribution continues to increase despite reform. This is largely due to benefits owed to current retirees and employees that by law cannot be modified. However, please note that reform significantly reduces the rate of increase. Additionally, medium-term savings options like the use of City real estate, the potential reform of the police and fire disability system, or the increased rate for purchase of service should provide assistance with the annual City pension contribution if implemented. And despite recent financial challenges, future economic growth may help to mitigate long-term City pension contributions.

Fourth, you may look at the charts wonder why the City's pension contribution under retirement reform grows to \$330 million in FY 2035-36 before falling sharply to \$68 million in FY 2036-37. This decline represents the full payment of the Plan's unfunded liability. Because we want to ensure equitable treatment of taxpayers, we are exploring a variety of amortization methods that would smooth the City's contributions over time. The final chart is an example of one such method. Under that option, the City's pension contribution would peak at \$206 million in FY 2026-27 and then decline much more gradually than the standard amortization method described above. While this process does not require Council involvement or approval, we wanted you to be aware of our considerations in this area.

Please let me know if you have any questions or concerns.



1921 Gallows Road
Suite 900
Vienna, VA 22182
USA

Main +1 703 917 0143
Fax +1 703 827 9266

milliman.com

May 28, 2013

Mr. Joey Greive, CFA, CFP
Treasurer
City of Jacksonville
117 West Duval Street, Suite 300
Jacksonville, FL 32202

**Re: Revised Mediation Proposal for Settlement Regarding Jacksonville Police
and Fire Pension Fund**

Dear Joey,

As requested, by the Office of General Counsel, we have prepared the following actuarial analysis of the revised Mediation Proposal for Settlement (MPS). In general, we have estimated the City's expected contribution over the next 30 years to fund the City of Jacksonville Police and Fire Pension Fund (Plan) assuming adoption of the MPS and compared the result to the baseline projections. Specifically we have prepared 30 year projections under three scenarios;

1. Baseline projections based on current plan provisions using the proposed assumptions, from the draft October 1, 2012 valuation report prepared by Pension Board Consultants, Inc.
2. Current plan provisions and assumptions used in (1) but with a modified investment return assumption of 7.75% for the October 1, 2011, October 1, 2012 and October 1, 2013 valuations, 7.50% for the valuation as of October 1, 2014 and 7.25% for the actuarial valuations as of October 1, 2015 and later.
3. MPS provisions and assumptions used in (2).

The revision primarily reflects a change to the amount of benefits payable at early retirement for those members retiring with either 25 or 26 years of service and the related change to the assumed rates of retirement.



These projections are based on Milliman's match of the October 1, 2011 actuarial valuation for the Plan. Our baseline results, as of October 1, 2011, are reasonably close to the official October 1, 2011 actuarial valuation performed by the Plan's actuary Pension Board Consultants, Inc results. Milliman's determination of the overall actuarial liability is within 1% of the liability in the October 1, 2011 actuarial valuation completed by Pension Board Consultants, Inc. Since the actuarial liabilities are offset by the actuarial value of assets in determining the actuarial contribution, Milliman's determination of the overall contribution is proportionately higher, by 2.4%, than that shown in the October 1, 2011 actuarial valuation. Based on this replication, we believe our analysis provides a reasonable estimate of the impact of the proposed plan and assumption changes. The actual impact of the MPS will be determined by Pension Board Consultants, Inc. in their actuarial valuations. Recently, a draft of the October 1, 2012 actuarial valuation has been released.

This analysis assumes the effective date of the plan design changes is October 1, 2013, per the MPS. Actual costs will differ based on the actual effective date as well as emerging experience.

The following MPS Assumptions details the assumptions and methods used in the baseline and the MPS projections.

	Proposed Assumptions/Methodology 10/1/2012 Valuation (Baseline)	Proposed Assumptions/ Methodology (Mediation Settlement Agreement)
Discount Rate	7.00%	7.75% ²⁾ /7.25% ²⁾
Salary Scale	4.00%	4.00%
Mortality Table	1)	1)
Payroll Growth Rate	3.25%	3.25%
Expense Load	\$4,500,000	\$4,500,000
Asset Value Method	Market	Market
Amortization Method	Level Percent, Closed	Level Percent Closed
Remaining Amortization Period As of October 1, 2012	23	23

1) The RP-2000 combined Healthy Mortality Table for Males and Females projected by Scale AA to the valuation date.

2) 7.75% for valuations dated October 1, 2011, October 1, 2012 and October 1, 2013; 7.50% for valuation dated October 1, 2014 and 7.25% for valuations dated October 1, 2015 and thereafter.

MPS Provisions

The MPS did not modify any plan provisions for all current employees, except for an increase in the employee contribution rate. Therefore, all current employees as of September 30, 2013 are considered "grandfathered".

The City's General Counsel opinion is that benefits may not be modified for current retirees, current active members who have DROPPed and those Police and Fire members who are still working but have become eligible for retirement (i.e. have at least 20 years of service) or benefits for all other active members that have already been accrued. We note that the results of the 2011 valuation prepared by Pension Board Consultants, Inc. measured the Plan's total actuarial liabilities (funded and unfunded) at approximately \$2.4 billion. Nearly 70% of that liability, about \$1.7 billion, was attributable to Plan retirees and those active members who have DROPPed. The remaining liability attributable to current active employees, who are not in DROP, is approximately \$717 million or only about 30% of the Plan's total actuarial liability. This percentage is reduced further if the values of any accrued benefits or members currently eligible to retire are eliminated. Thus the City's ability to generate significant savings by modifying the benefits of current active members was fairly limited.

The employee contribution rate for the current active participants will be increased from 7% of earnings to 9% with the timing of the increase dependent on actual salary increases. Salary levels must first be increased back to previous levels as of September 30, 2010 for fire and as of December 31, 2011 for police. This requires a 2% salary increase for fire and 3% for police. After these salary increases, the increase in the employee contribution rate is 50% of any salary increases.

Solely for purposes of our modeling we assumed that the employee contribution rate would increase to 8% effective October 1, 2015 and 9% effective October 1, 2016.

The MPS modified the plan provisions for all employees hired on or after October 1, 2013. These changes are:

- The employee contribution rate will be 10% of earnings each year for the employee's career (i.e. contributions will not cease at any point). Currently, the employee contribution rate is 7%.



- Cost-of-living adjustments (COLAs) will equal the increase in Social Security COLA capped at 1.5% commencing the third January 1 following termination of employment. After subsequent conversations with the City, it has been determined that commencement of benefit should be used versus termination of employment. For example, a member terminated October 1, 2030 and commences a pension on October 1, 2050 at age 62. The first COLA would apply January 1, 2053. For members who decide to Back-DROP the COLA would first apply on the third January 1 following termination, i.e. COLAs would not apply during the Back-DROP period. We recommend the details of the application of the COLA be incorporated into the appropriate plan documents. Currently, the COLA is a fixed 3% and commences as early as 3 months after DROP.

Final Average Compensation (FAC) will be based on the last 60 months of service. Currently, it is based on the last 24 months. Compensation includes shift and differential pay, except that it may not exceed 125% of the shift pay earned during the five years prior to the FAC period. For this analysis, no adjustment to the FAC was made for the shift pay maximum.

- Upon completion of 25 years of service, the accrual rate is 2.5% per year of service, up to a maximum of 75% which occurs at 30 years of service. Prior to completion of 25 years of service, the accrual rate is 2% per year of service. Currently, the accrual rate is 3% for the first 20 years and 2% for the next 10 years for a maximum benefit of 80%. The accrual rate applies to a member's FAC to determine the benefit amount.
- Normal Retirement Date (NRD) will be upon the completion of 30 years of service. Benefits will commence at NRD. Currently, NRD is upon completion of 20 years of service or when 20 years would have been completed.
- Early Retirement will be available upon the completion of 25 years of service with the total accrual rate reduced by 3% for each year short of 30 years. Note that is a reduction in the accrual rate; not a traditional early retirement penalty. The resulting early retirement accrual rate may not be less than 53.5%. The following table compares the early retirement accrual rates under this agreement with the current system.

Years of Service	Normal Accrual Under Current System	Normal Accrual Under Agreement	Early Retirement Under Agreement
30	80%	75.0%	75.0%
29	78%	72.5%	69.5%
28	76%	70.0%	64.0%
27	74%	67.5%	58.5%
26	72%	65.0%	53.5%*
25	70%	62.5%	53.5%*

* Would have been 53.0% and 47.5% at 26 and 25 years of service, respectively, without the 53.5% floor.

Currently, there is no early retirement available since NRD is set at 20 years.

- Members will become vested in an employer-provided benefit upon completion of 10 years of service with benefits deferred to age 62 and based on an accrual rate of 2.0% per year. Currently, members become vested upon completion of 5 years of service.
- The current DROP program will be replaced with a Back-DROP. The Back-DROP will be available for up to five years upon reaching 30 years of service. The Back-DROP interest rate will be based on trust fund earnings but, not less than 0%, and not greater than 10%. If Back-DROP includes years of service less than 30 years, the total accrual rate based on total years of service minus Back-Dropped years of service is reduced by 2% for each of service less than 30 (versus the early retirement penalty of 3%.) FAC is based on the 60 months ending at the selected prior date (actual termination date less years Back-Dropped.)

For example, a member retiring at 30 years of service elects the Back-DROP effective at 25 years of service. The total accrual rate of 62.5% (30 years in total less 5 Back-DROP years for 25 years x 2.5%) less a 10% accrual rate penalty (5 years short of 30 years x 2%) results in a final accrual rate of 52.5%. Please note that the 53.5% floor does not apply. The FAC is based on the 60 months ending at the completion of 25 years of service.

- The benefit amount, as of October 1, 2013, will be limited to \$99,999.99 indexed to Social Security inflation (CPI-U) with a maximum annual increase of 1.50%. We have assumed the cap would apply to the member's benefit at retirement. The benefit is not assumed to increase in the intervening years after retirement and prior to the commencement of the COLA. Furthermore, the 75% survivor percentage is assumed to apply to the capped member's benefit. We recommend the details of the application of the cap be incorporated into the appropriate plan documents.
- A disability benefit will be provided equal to 50% of earnings base. Members becoming disabled after attaining eligibility for early retirement are assumed to elect the larger of the early retirement and disability retirement benefits. Currently, the disability benefit is 60% of earnings base.
- The MPS does not explicitly reference the pre-retirement surviving spouse benefit. The current benefit is determined assuming the member has completed no less than 20 years of service, which are the required years of service for attaining Normal Retirement Age (NRA). Since the MPS changes the definition of NRA we have assumed this change would impact the calculation of the pre-retirement surviving spouse benefit. In this analysis, we have assumed the pre-retirement surviving spouse benefit is determined assuming the member has completed no less than 30 years of service to be consistent with the attainment of NRA. No other elements of the pre-retirement surviving spouse benefit was assumed to be changed, including the spouse's percentage of 75%, child benefit of \$200 per month until age 18 (22 in college) and \$400 per minimum. We recommend the details of this benefit provision be reviewed and incorporated into the appropriate plan documents.

In estimating the impact of the MPS, we modified the assumed rates of retirement for post-September 30, 2013 hires due to changes in the retirement conditions including DROP as follows.

<u>Years of Service</u>	<u>Rate</u>
25	15%
26	3%
27-29	5%
30	70%
31-34	10%
35	100%

Also, all members are assumed to retire upon attainment of age 65.

Results

Attached are two charts displaying the projected employer contribution rates for the next 30 years based on the two scenarios described below. Please note that these projections are based on the 2011 actuarial valuation and do not reflect the significant decrease in payroll from the 2011 valuation to the 2012 valuation. This results in contribution rates that would be slightly higher than those shown in the 2012 valuation but dollar amount of contributions would be comparable.

As requested below is the sum of the cash contributions over the next 30 years. The results are as follows:

<u>Scenario</u>	<u>Total dollars over the next 30 years²⁾</u>	<u>Increase/(Reduction) from Baseline</u>
1. Baseline (Proposed Assumptions/ Methodology)	\$6.02 (billion)	N/A
2. MPS	\$4.82(billion)	\$(1.20) billion ^{1) 3)}

¹⁾Approximately \$0.21 billion of the reduction is attributable to the change in the discount rate mandated by the MPS from the current actuary's recommendation of 7% to the graded assumption of 7.75% phasing down to 7.25%.

²⁾Total dollars exclude expected employee contributions, State Chapter Funds allocation (i.e premium-tax refunds) and expected court fines and penalties. State laws make the City responsible for funding the difference between the actuarially determined contribution and these amounts.

³⁾This letter, as required by the MPS, was shared with Jarmon Welch, of Pension Board Consultants, Inc. the Jacksonville Police and Fire Pension Fund Actuary. While we do not want to misquote Mr. Welch, we believe that he agrees with the 30 year nondiscounted savings if the Council adopts the pension changes stated in this letter.

These results assume contributions to the plan from the State due to premium tax refunds and expected court fines and penalties are 4.58% of pay per year.

Note, the total dollars are not discounted to reflect the time value of money.

Also, note that the majority of the reduction in cash contributions due to the proposed assumptions occurs in the first 10 years whereas the majority of savings of the plan provision changes of the MPS occurs in the last 10 years of the projection.

In addition, we have included two additional charts showing the amount of the Unfunded Actuarial Liability under each scenario and the Funded Status (Actuarial Value of Assets divided by the Actuarial Liability) for only the MPS scenario. Results are shown for the next 30 years.

As noted on page 2, the charts are based on a closed 23-year amortization period from July 1, 2012 with the amortization payments increasing 3.25% annually. "Closed" means that amortization period decreases by one each year. Other amortization methods are possible such as a "10 year minimum" meaning that the 23 year amortization period may not decrease to a period of less than 10 years. While the "10 year minimum" method would smooth the impact on the City's budget of the UAL amortization beginning 13 years from now, we note it may not be consistent with the State's policy on amortization methods. We are currently looking into this and other possible "smoothing" amortization methods.

Projection Assumptions and Methodology

Our projections assume that the number of active members remains constant. Individual pay increases and patterns of termination, disability and mortality are consistent with the most recent valuation assumptions. The retirement assumptions for the "MPS request" projections were modified for future hires as noted above. We have also assumed that the City always pays the Annual Required Contribution beginning Fiscal 2012 and future years. For fiscal years 2013-2015 we have assumed the reported rates of contribution provided by you, based on the Plan's actuarial valuation reports. We have not assumed any future plan changes, assumption changes, funding method changes, or liability gains or losses during the forecast period.

Terminating and retiring members are replaced by new active members with the same age and gender characteristics as members who were hired during the past few years. Future entrants were assumed to join the Plan to maintain a stable active population. New entrant profiles are traditionally based on relevant recent hires into a Plan. Since only a few new participants entered this Plan in 2010-11, our modeling is based on members joining the plan on or after October 1, 2009. (there were 91 such members). An average pay raise of 1.5% was assumed between 2009 and 2011 for these members and future new entrant salaries were assumed to increase 4.00% from the prior year.

It is important to note that the projections were completed assuming a determination scenario where the market value of investments was assumed to earn the valuation interest rate of 7.75% (or 7.50% or 7.25%) each and every year of the projection period starting with the 2012-13 fiscal year. The October 1, 2012 asset value is the actual market value as reported in the draft October 1, 2012 valuation report. In addition we assumed the annual expenses paid by the Plan would increase 2.5% per year, and that the calculated actuarial asset values would continue to be reduced by the reserve account balance and the Senior Staff plan assets. The offset amount is approximately \$31.8 million as of October 1, 2012 and was assumed to increase at an annual rate equal to the discount rate. Per the MPS, \$20 million will be transferred from the reserve account balance to the trust for pension benefits as of October 1, 2013. The City's

contribution for 2013-2014 will be reduced by \$20 million. In addition, per the MPS 1% of payroll from October 1, 2013 to September 30, 2014 for police and to September 30, 2015 for fire will be allocated to the pension trust instead of the Enhanced Benefit Account. The City's contribution is reduced by the same percentage.

In general, valuation results are completed as of one date but are not reflected in the City's contribution until a year later. This procedure, in combination with an increasing contribution rate is a source of constant actuarial losses. For purposes of this analysis we have assumed that valuations would be performed annually beginning in 2014. This means the City contribution rate will change from year to year, beginning with the 2015-16 fiscal year.

In general, we have assumed the following for City Contributions:

	<u>Baseline</u>	<u>Mediation Settlement Agreement Request</u>
Fiscal year 2012-13	110.85%	81.91%
Fiscal year 2013-14	110.85%	81.91%
Fiscal year 2014-15	110.85%	81.91%

In addition, besides employee contributions, 4.58% of payroll is contributed to the Plan from expected Court Fines and Penalties and State Chapter Fund allocations.

Finally, for contribution purposes the projected contribution percentages of both the Current Plan and Plan Change scenarios are based on projections of the Current Plan pensionable compensation.

Basis for Analysis

We used demographic and economic assumptions consistent with those used in the October 1, 2011 and October 1, 2012 valuations, with the modifications discussed above.

Actual costs will be based on actual experience of the Plan. Please note that the cost impact of the proposed changes may be higher or lower than the study estimates depending upon rates of retirement actually experienced by the Plan. A realistic estimate of retirement rates is critical to determining the actual future impact on plan costs. If the Plan Change scenario is adopted, it is possible that members would postpone retirement until later ages, which will affect the projections shown in this study.

The calculations are based on data and other information provided to us by the City of for our proxy October 1, 2011 actuarial valuation and supplemented for purposes of this

study. We have not audited or verified this data and other information. If the underlying data or information is inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete.

We performed a limited review of the data used directly in our analysis for reasonableness and consistency and have not found material defects in the data. If there are material defects in the data, it is possible that they would be uncovered by a detailed, systematic review and comparison of the data to search for data values that are questionable or for relationships that are materially inconsistent. Such a review was beyond the scope of our assignment.

This analysis is based on methods and assumptions believed to be used in the October 1, 2011 actuarial valuation and the October 1, 2012 draft actuarial valuation, and the additional assumptions discussed earlier in this letter. The data was based on the October 1, 2011 proxy actuarial valuation database. The results of our study depend on future experience conforming to those actuarial assumptions. It is certain that actual experience will not conform exactly to the assumptions used in this analysis. To the extent future experience deviates from those assumptions, the results of this analysis could vary from the results presented here.

Milliman's work product was prepared exclusively for the internal business use of the City of Jacksonville for a specific and limited purpose. It is a complex technical analysis that assumes a high level of knowledge concerning the Plan's operations, and uses City's data, which Milliman has not audited. To the extent that Milliman's work product is not subject to disclosure under applicable public record laws, Milliman's work may not be provided to third parties without Milliman's prior written consent. Milliman does not intend to benefit or create a legal duty to any third party recipient of its work product. Milliman's consent to release its work product to any third party may be conditioned on the third party signing a Release, subject to the following exceptions:

(a) The City may provide a copy of Milliman's work, in its entirety, to the Plan's or the City's professional service advisors who are subject to a duty of confidentiality and who agree to not use Milliman's work for any purpose other than to benefit the System.

(b) The City may provide a copy of Milliman's work, in its entirety, to other Governmental entities, as required by law.



Mr. Joey Greive
May 28, 2013
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No third party recipient of Milliman's work product should rely upon Milliman's work product. Such recipients should engage qualified professionals for advice appropriate to their own specific needs.

The consultants who worked on this assignment are pension actuaries. We have not explored any legal issues with respect to the proposed plan changes. We are not attorneys and cannot give legal advice on such issues. We suggest that you review this proposal with counsel.

I, Robert Dezube, am a consulting actuary for Milliman, Inc. I am a member of the American Academy of Actuaries, and meet their Qualification Standards to render the actuarial opinion contained herein.

Please call if you would like to further discuss this project.

Sincerely,

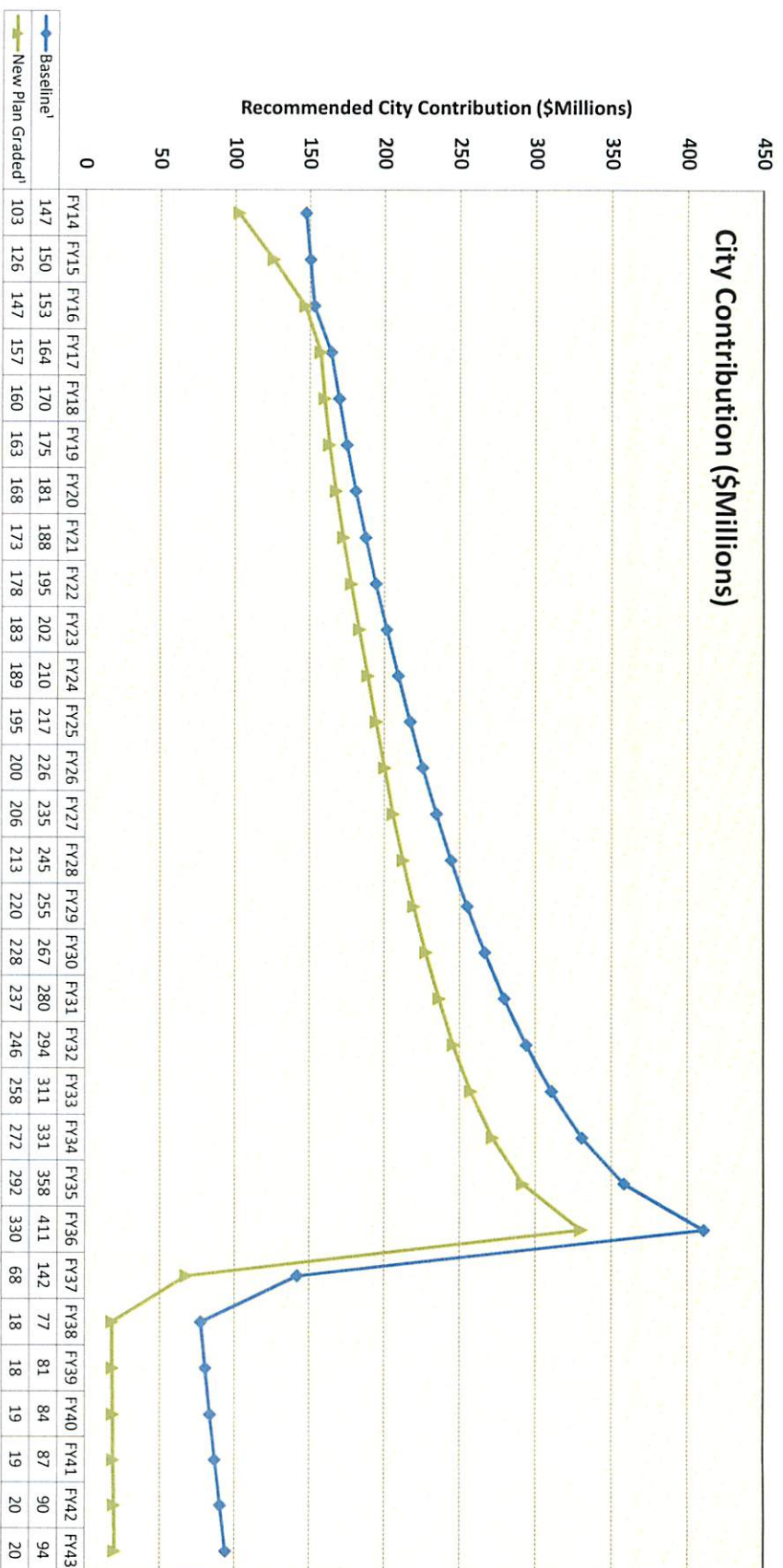
A handwritten signature in black ink, appearing to read 'R. Dezube'.

Robert S. Dezube, FSA
Consulting Actuary

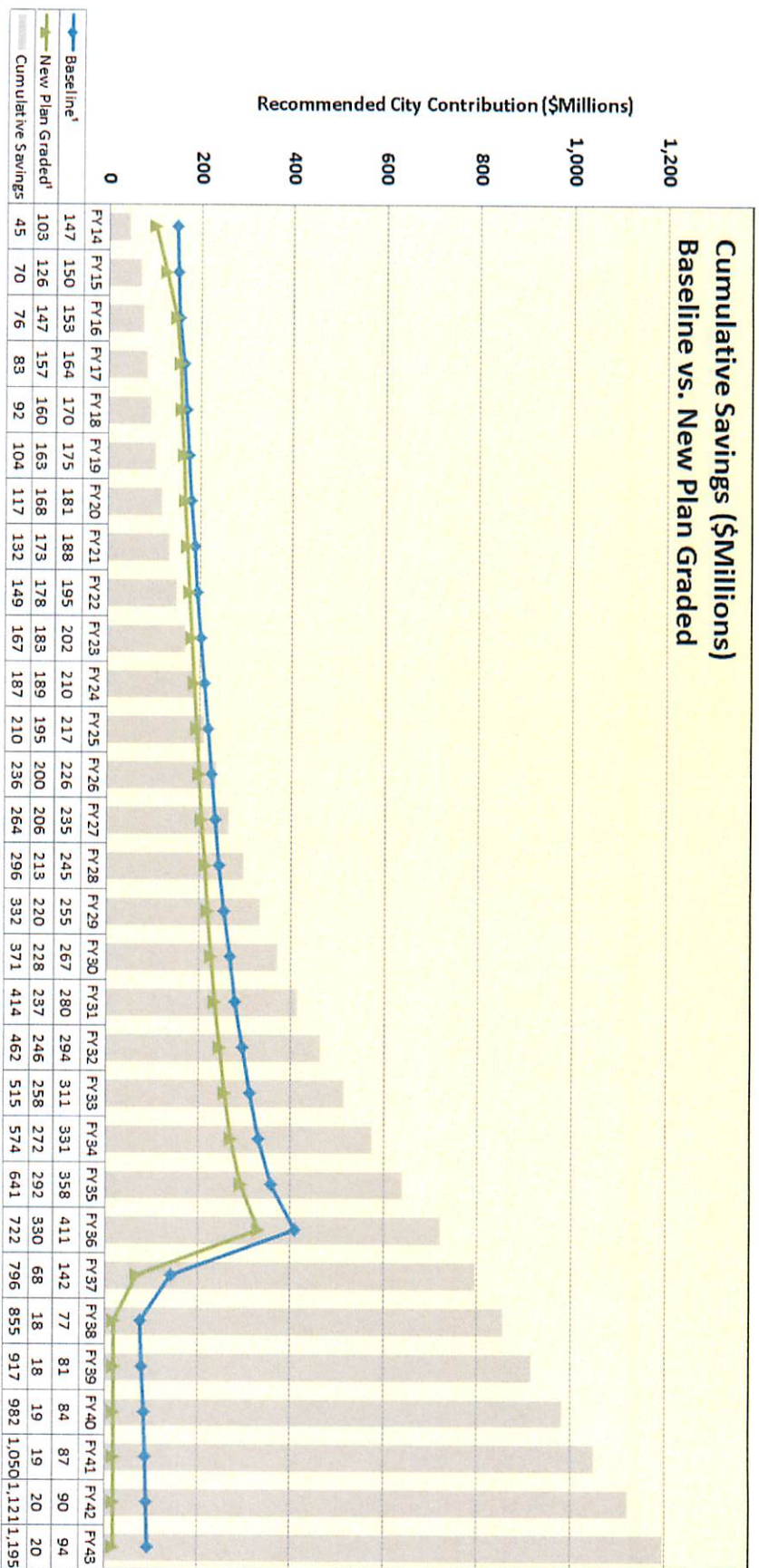
Enclosures

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Chris Hand (w/enclosures)

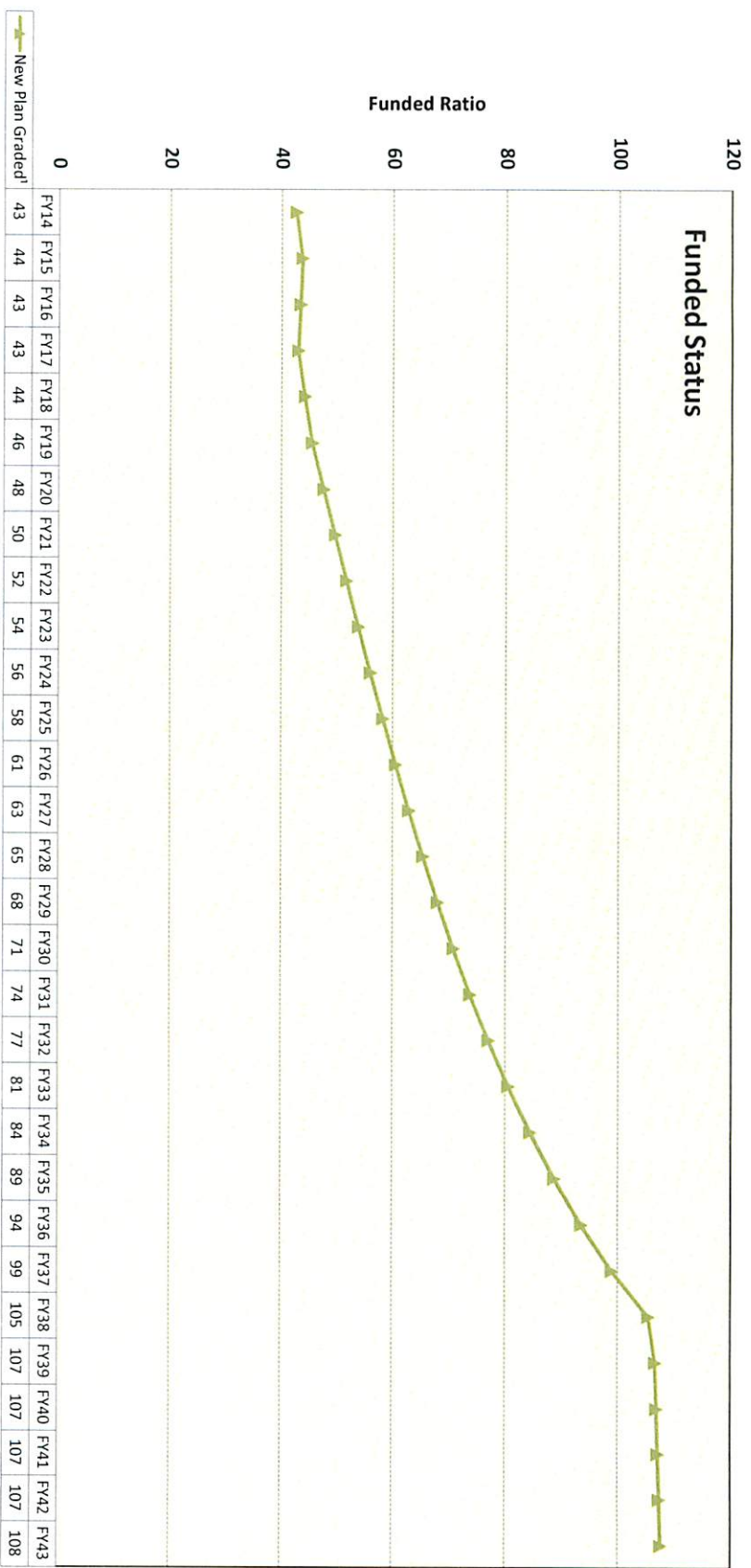
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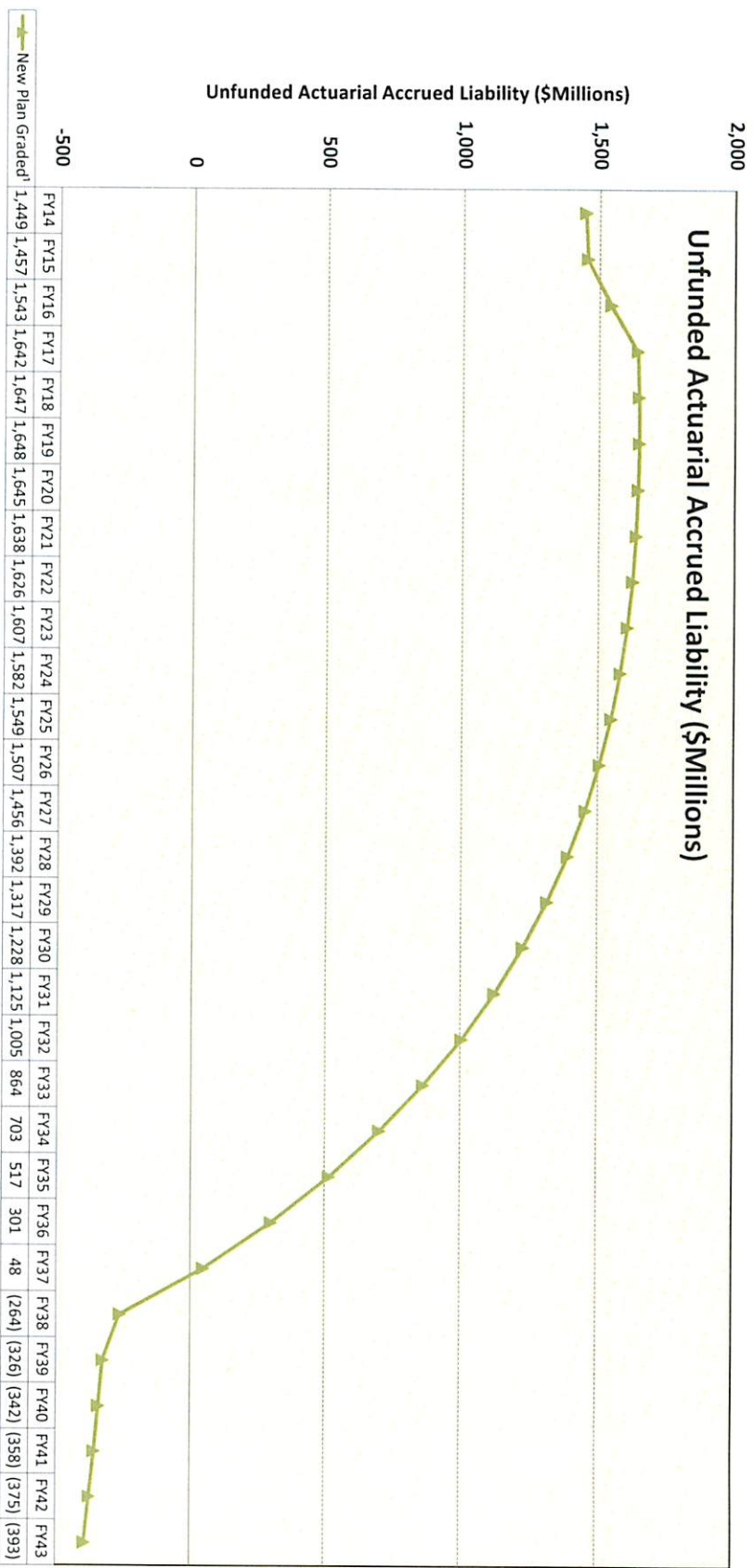
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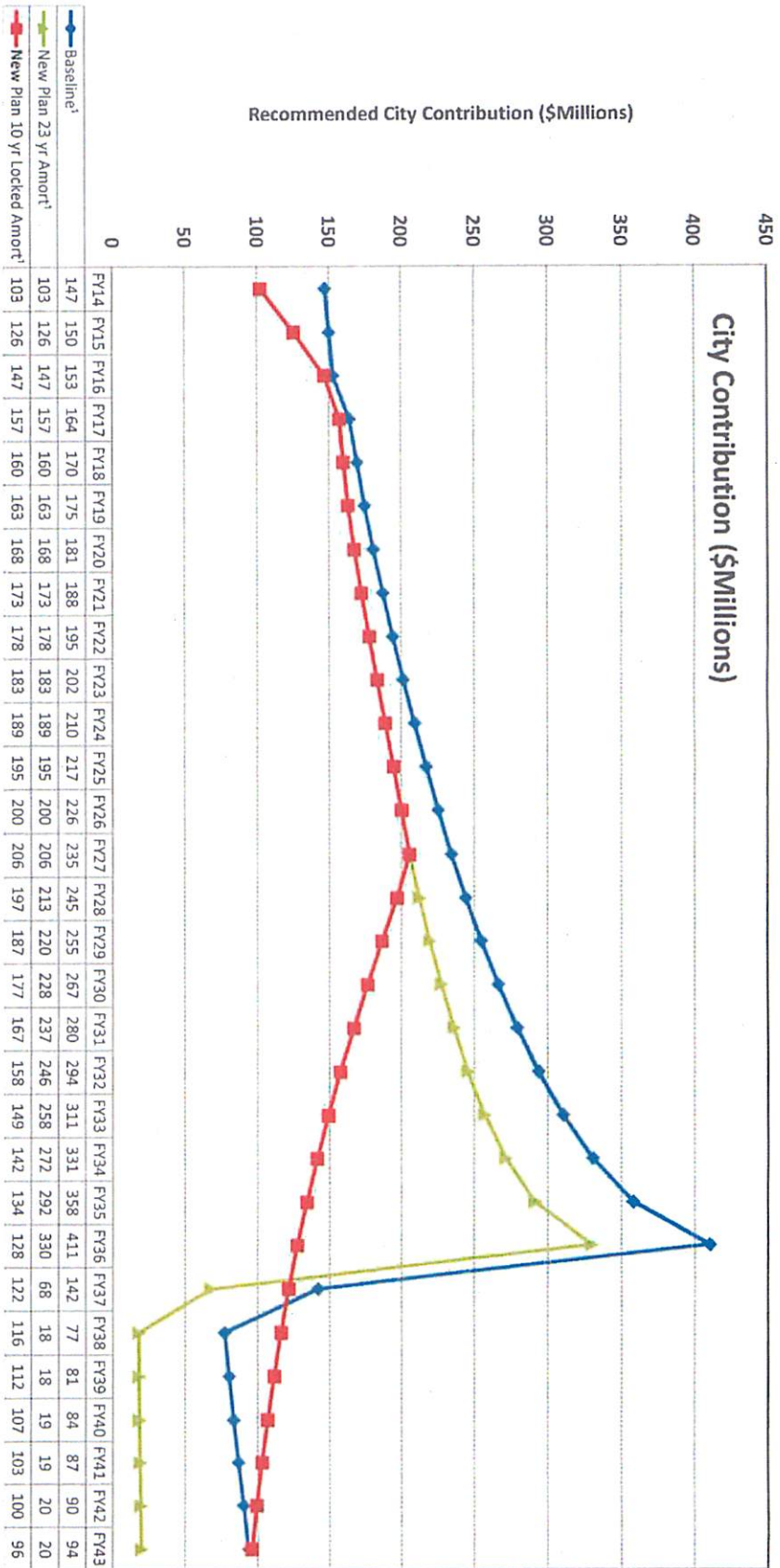
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