City of Atlanta Pension Reform

THE PROBLEM

- By 2009, Atlanta's pension plans were **underfunded by $1.5 billion**
  - 53% of total liability funded
- Annual pension costs comprised 22% of the City's annual budget
  - 40% of total personnel expense
- Growing pension costs put the city on a **path to bankruptcy**
- Pension reform was part of Mayor Kasim Reed's campaign platform prior to his 2009 election
- City faced 3 budget shortfalls in a row
  - Outside inflation, pension was only budget increase

THE APPROACH

- Mayor Reed created **Pension Review Panel** to assess the situation and identify options
  - Chaired by John Mellott
  - Credibility and technical skill
- **Balanced panel** across key stakeholders
  - 1/3 employees/unions, 1/3 politicians, 1/3 businesspeople
  - Professional experts (consultants, lawyers, accountants and actuaries)
- Panel provided **fact base and options** to Mayor and City Council
  - Bain support provided for initial factbase development and option development

THE RESULTS

- With union endorsement, Atlanta's City Council **voted 15-0** for pension reform
  - Existing employees keep defined benefit plan; new employees go into a hybrid system
  - Existing employees increase cash contribution and share in investment risk
- Reform reduced pension liability by **>$500M** and annual cost by **$25M**
- End-to-end process took approximately **18 months**

Review: Pension Panel Charter

What the Panel will do:

- Delineate the facts – Where are we.
- Identify our options – What we could do.
- Describe the relative path forward of each option – How we could get there.

What the Panel will NOT do:

- Audit and investigate the past
- Recommend, endorse, or champion any single option

Key insights from Atlanta Pension Reform

It's all about process and stakeholder management

- Get commitment from decision makers up front
  - Risk of becoming another "task force" or "study group"
  - Pension issues create political risk for elected/appointed officials
- Find the right Chairman
  - Must be neutral, independent and credible in the community
  - Able and willing to face the community and take criticism
- Get the right stakeholders and experts to the table
  - Employees/unions, academics, politicians, businesspeople
  - Independent consultants, lawyers, accountants and actuaries
- Be open and transparent
  - Open records, open meetings, open data
  - Everyone working from the same fact base
- Clearly define scope and charter for the panel
  - Panel provides facts and options; decision makers own the solution
  - Forward looking; no evaluation of the past
- Communicate to your advantage
  - Create a burning platform to get political momentum for change
  - Simplify complicated issues
  - Make friends with the media

Key panel activities

- Analyzed baseline financial information
- Engaged professional services firms to conduct deeper analysis and create a range of benefit design options
  - -Lawyers, actuaries and consultants
  - -Paid for with private sector funds
- Illustrated employer and employee perspective
- Defined healthy pension system
- Benchmarked Atlanta vs. peers
- Outlined in detail 17 different pension options and presented 7
  - -Annual cash contribution/savings
  - -Implementation/Administration index
  - -Salary replacement percentage – current and future employees

Getting the panel composition and charter right was critical

Panel composition

Included major stakeholders as well as others who could provide expertise

- Chairman
- Employee reps and union leaders
- Elected officials
- Non-government business leaders and experts (accountants, lawyers, actuaries)

Panel charter

Explicit discussion on what the panel would and wouldn't do mitigated political risks of early discussions and placed decision-making in the mayor's hands

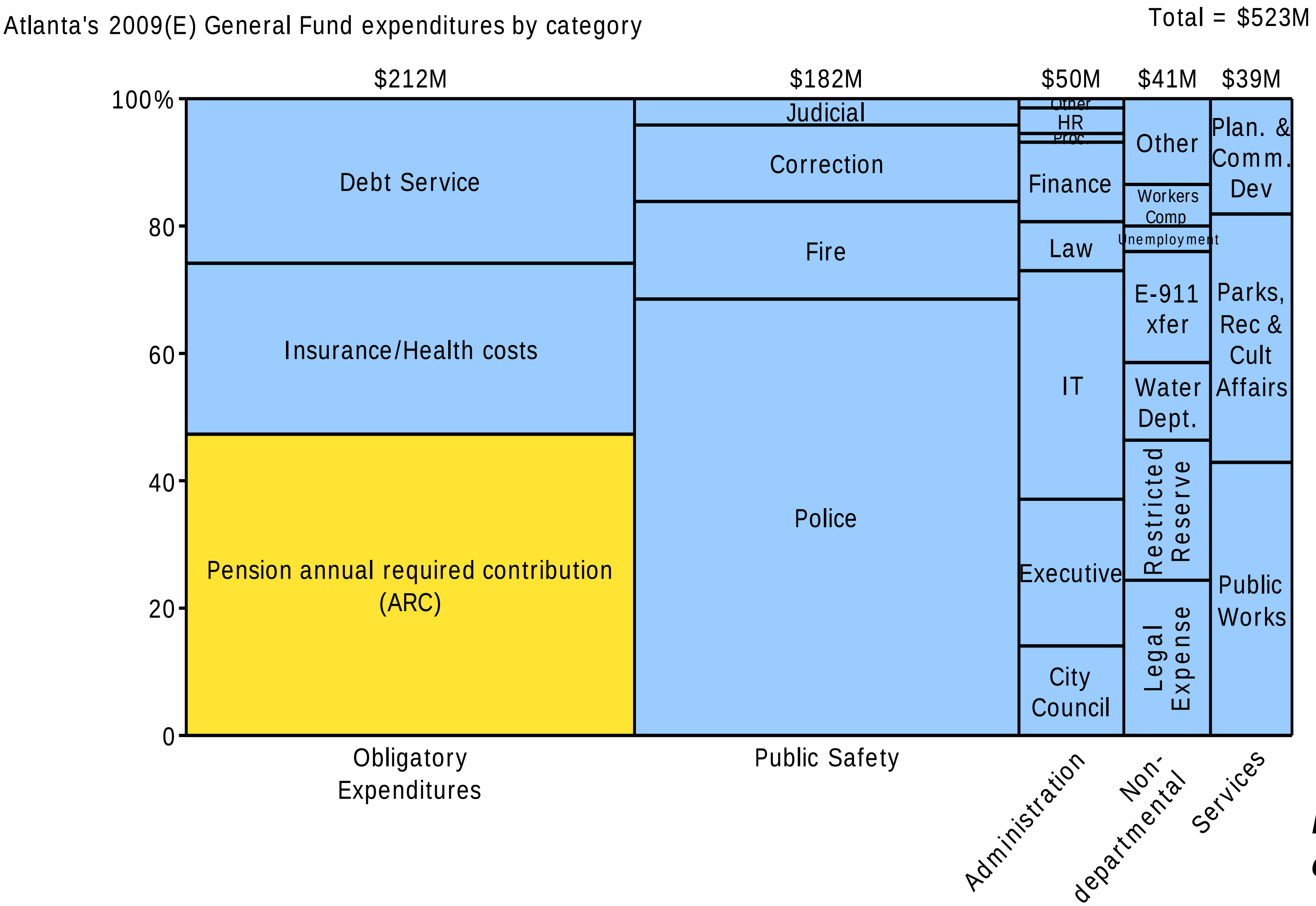
WHAT THE PANEL WOULD DO

- Describe the facts
  - Current and future financial outlook for pension plan (ARC, UAAL
  - Legal context
- Identify the set of logical options
- Define a relative path forward, i.e. how to execute against those options

WHAT IT WOULDN'T DO

- No audit or reconstruction of the past to avoid fixing blame
- No recommendations or endorsement of specific options
  - Can't transfer decision-responsibility to a civilian panel

‘09 pension costs took up ~20% of the City’s general fund budget, second only to Police



Additional context

- City faced 3 budget shortfalls in a row
- Already undertaken RIFs – little left to cut
- ARC found to be the only increasing budget item (outside inflation)

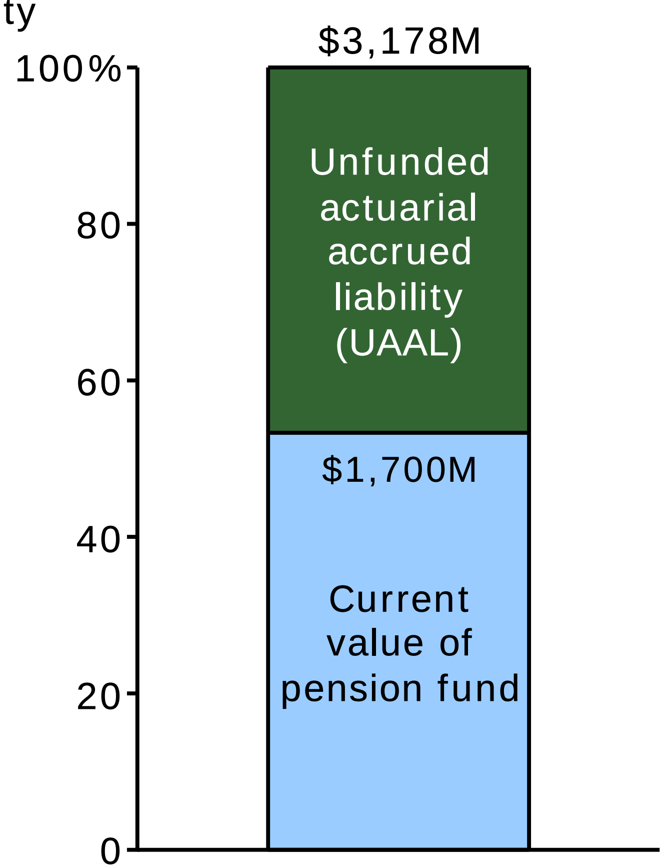
Burning platform created “political will” to fix the pension

Source: Office of the CFO

The payment on the City's unfunded liability was ~70% of the annual pension cost

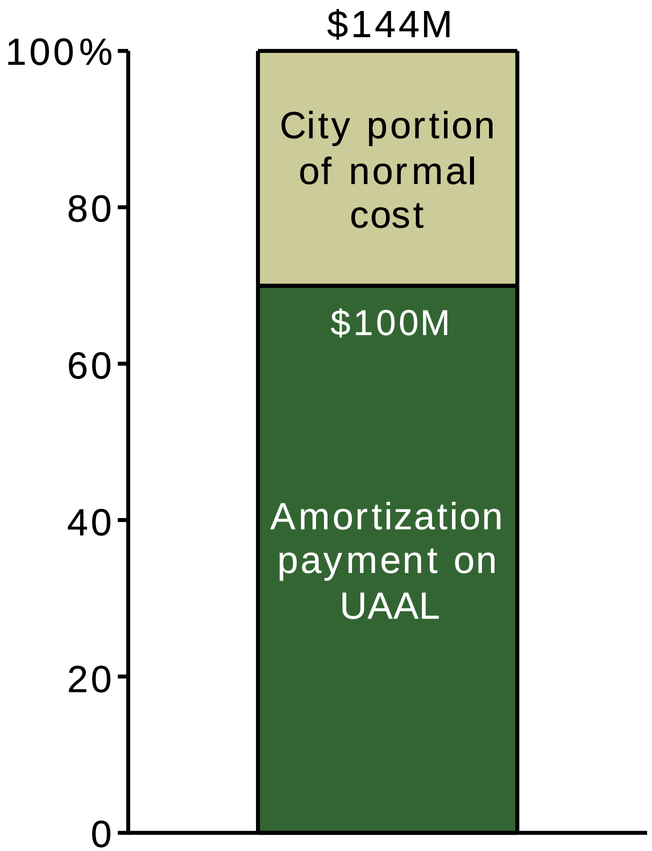
In FY09 the City had funded ~53% of their total pension obligation…

2009 estimated actuarial liability



…which is why the payment against the UAAL is ~70% of the pension cost

FY09 ARC



Source: Office of the CFO, Segal, SAS, Towers Perrin

Options to reduce annual costs included plan design changes and/or reducing the UAAL

Required pulling three levers, singularly or in combination, to design new plans:
1) Modify defined benefits
2) Enter Social Security System
3) Expand use of DB plan

Plan changes

	Single-tier plan	**Two-tier plan**
Eliminate current plan	Create single new plan for all employees	Create two new plans, one for new hires and one for current employees
Maintain current plan	No change to plan design	Create new plan for new hires, keep old plan for current employees

Required finding add'l funding sources (e.g. revenue/ taxes, cutting services/cost, increasing employee contribution)

UAAL

Potential options to address UAAL

- Address retroactivity
- Bond off liability
- Lump sum payout

Pros / cons for modifying current plan options

Plan changes

	Single-tier plan	Two-tier plan
Eliminate current plan	• Pros - Most flexibility to impact cost - Has immediate impact - Reduced complexity of two systems - Reduces employee exposure to single payer risk • Cons: - May require legislation - May be challenged through litigation - May accelerate UAAL amortization	• Pros: - Lessens impact on current employees - Has immediate cost impact - Reduces employee exposure to single payer risk • Cons: - May require legislation - May be challenged through litigation - Takes some time to realize full cost impact - May accelerate UAAL amortization - Hurts recruiting & retention
Maintain current plan		• Pros: - Does not require legislation - Does not accelerate UAAL amortization • Cons: - Has only minimal impact on cost in near-term - Takes multiple years before impact is seen - Hurts recruiting & retention

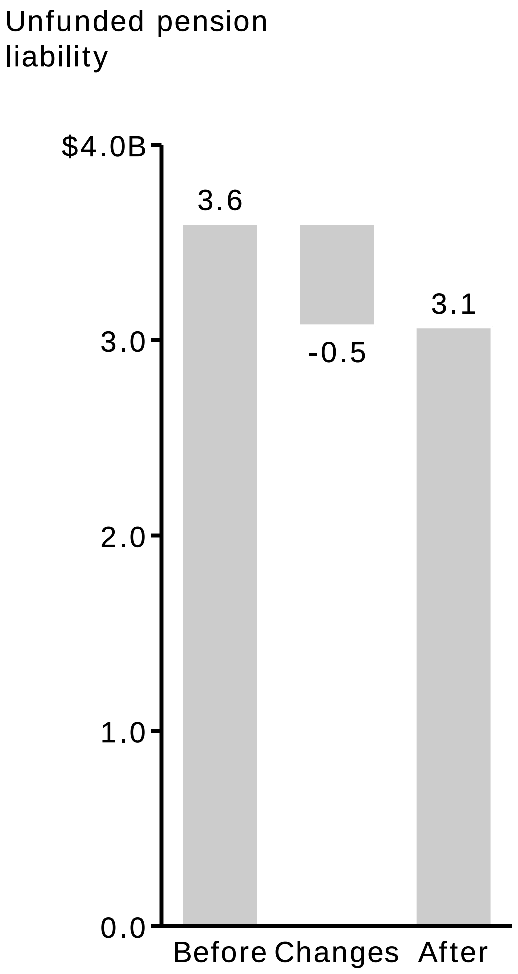
Actual changes mostly affected new employees

AFFECTED GROUP	FINAL PLAN
Current Retirees	• No change
Current employees	• Traditional pension plan retained • Additional contribution of 5% of compensation to retain current benefits for employees hired after 1984
New employees	• Hybrid plan with pension and 401K • Pension plan: - 1% DB multiplier and 8% employee contribution - 15-year vesting period • 401K plan: - Mandatory 3.75 employee contribution with 100% city match; additional optional 4.25% - 5-year vesting period • Increase retirement age by 2 years (police/fire dept from 55 to 57; other employees from 60 to 62)
Other	• Cap on City contributions

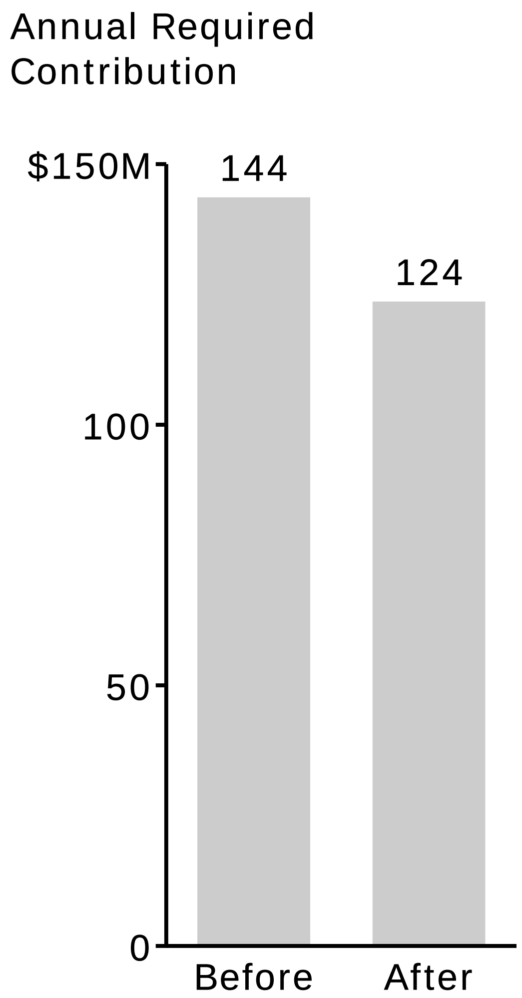
Results

Need to confirm numbers

REDUCED THE PENSION LIABILITY BY 14%



REDUCED ANNUAL CONTRIBUTION BY 14%



- Unanimous approval from City Council
- Broad stakeholder acceptance of plan
- Closed 50% of the annual budget gap
- First major metropolitan city with significant pension reform

Backup

The complex legal environment provided constraints on potential solutions

- 1984 Georgia law regulates municipal pensions
  - Case law follows, regulatory boundaries become unclear
- Law requires 100% funding of ARC
- Minimum benefits established by State
- Plans can be improved by governments
  - Reduction in benefits may require approval of plan participants
- No clear and orderly remediation process exists
  - Litigation is a possibility
- Maneuverability is limited under current Georgia law

Legislative relief potentially a necessary course

There were three main options for addressing the UAAL

	Description	Pros	Cons
Address retroactivity	• Remove, in part or in whole, the retroactive aspects of the plan changes	• Reduces the UAAL	• May require legislation • May not be constitutional • May be challenged through litigation
Lump-sum payout	• Provide discounted lump-sum payout of pension benefits to employees	• Eliminates UAAL for employees that select this option	• May require legislation • Effect is a reduction in employee benefits • May be challenged through litigation
Bond off the liability	• Issue municipal bonds to pay off UAAL	• Eliminates variability in debt obligation • Possibility to arbitrage against fund performance	• Does nothing to reduce obligation • Requires significant financial discipline to manage