THE PEW CHARITABLE TRUSTS

Presentation to the Jacksonville Pension Reform Task Force

February 12, 2014

ljaf laura and john arnold foundation™

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Three Areas of Focus

1. *Paying down Jacksonville's pension debt*
2. *Considering new plan designs for the Jacksonville Police and Fire Pension Fund*
3. *Governance and investment practices*

This presentation will largely cover plan design in order to help the Task Force deliberate on benefits offered to new employees and what, if any, benefit changes to make to current police officers and firefighters.

Designing a Pension Plan for New Workers

Any good plan will help put workers on a secure path to retirement while keeping costs affordable and sustainable for the employer. The Jacksonville Task Force has reviewed multiple plan designs to try to identify the pension benefit that will best fulfill those goals.

The Task Force has requested analysis on two plans—a final average salary defined benefit plan that was developed as part of the Mediated Settlement Agreement and a hybrid pension plan that includes both a smaller defined benefit along with an individual defined contribution account.

Plan Parameters: Final Average Salary Defined Benefit from the Mediated Settlement Agreement

Normal Retirement: Age 62 or 30 years of service
Early Retirement: 25 years of service
Vesting Eligibility: 10 years of service
Benefit Multiplier Per Year of Service:

- 2.5 percent with 30 or more years of service
- Between 25 and 30 years of service: 2.5 percent, reduced by an early retirement factor
- 2 percent with fewer than 25 years of service

Final Average Salary: Last five years
Employee Contribution: 10 percent of pay
COLA:

- Begins after three years in retirement
- Indexed to the Consumer Price Index
- Cap of 1.5 percent

Other Notes:

- DROP is replaced with a Back-DROP plan that does not include a guaranteed return.
- Annual benefits are capped at $100,000 or 75% of final average salary.

Plan Parameters: Stacked Hybrid Plan

Retirement Eligibility: Age 60 or 30 years of service
Vesting Eligibility: 5 years of service
Benefit Multiplier: 1 percent
Final Average Salary: Last 5 years
Contributions:

- Defined Contribution
  - Employee – 10 percent
  - Employer – 4 percent

COLA:

- No COLA is provided for the DB benefit.
- The annuity options for the DC benefit can include appropriately priced COLAs.

Other Notes:

- Benefit is based on the defined benefit formula and the defined contribution account.
- The provisions regarding COLAs, vesting, retirement eligibility, and salary calculation are based on the benefits offered to new public safety workers enrolled in the Florida Retirement System pension plan.
- The defined contribution plan should offer a limited set of professionally managed, low fee investment options and should provide workers with appropriately priced annuities.

Cost and Benefit Uncertainty

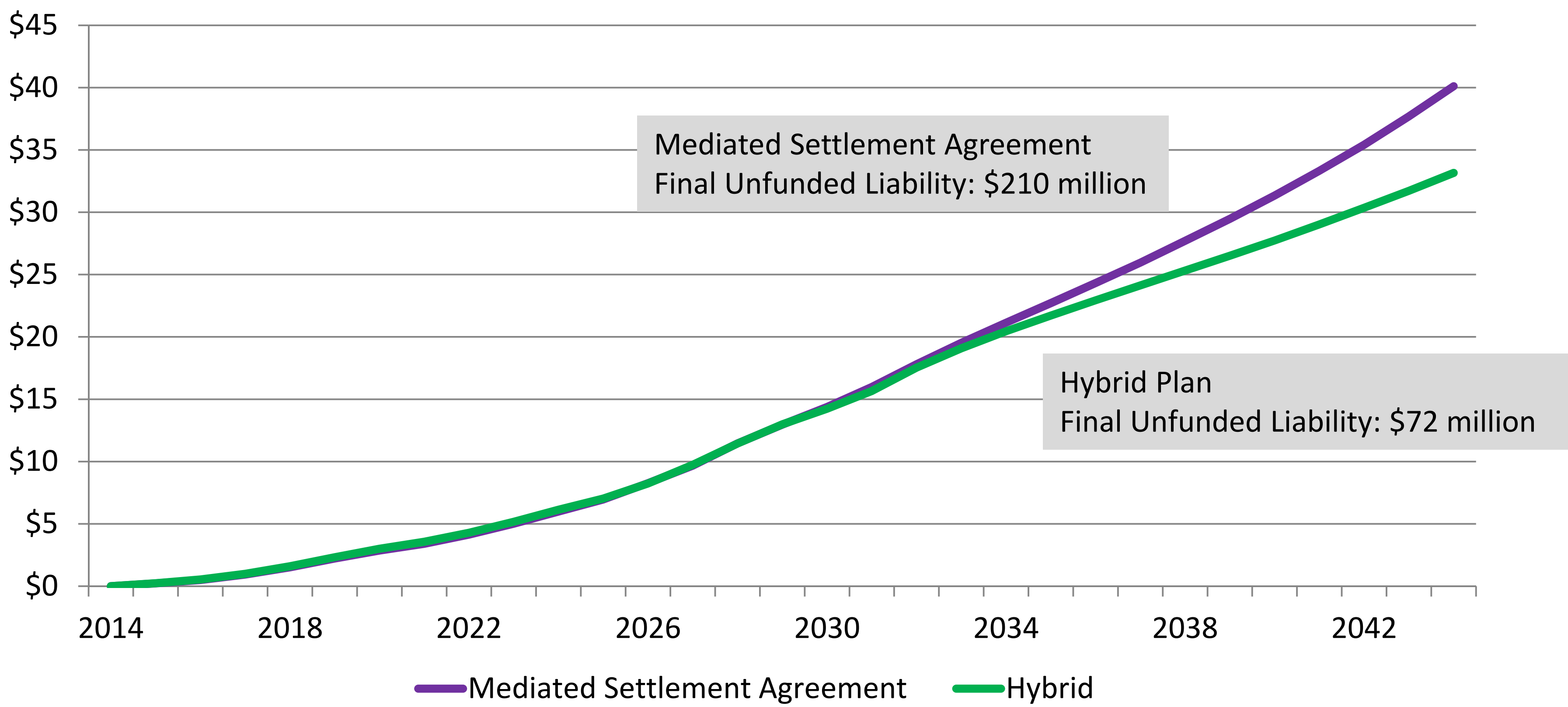
- Planning for retirement is fundamentally uncertain—it relies on making predictions for what will happen decades in the future. There is no way to have complete certainty in both benefits and in costs.
- Some risks, particularly longevity risk, are best borne by the employer. All well-designed pension plans will give workers access to annuities so retirees can have a lifetime benefit that will never run out.
- Investment returns are a major risk factor for public pension plans—investment returns are hard to predict and have a big impact on plan costs.
- Traditional defined benefit designs often lack an explicit plan to deal with investment uncertainty—that can leave the taxpayer facing large bills or public employees facing layoffs, salary cuts, or reductions in pension benefits if the unexpected occurs. In a stacked hybrid design, part of employees' benefits depend on investment returns so workers bear some of the costs of investment losses and get some of the gains from good performance. Cost-sharing can also be built into final average salary defined benefit designs.
- Most of the cost uncertainty for the Jacksonville Police and Fire Pension Fund is for existing benefits promised to current employees and retirees—as a result shifting new employees to a hybrid plan would not majorly change the plan's risk profile in the short- or medium-term.

Modeling Cost and Benefit Uncertainty

- The proposed defined benefit and hybrid plan designs have similar costs under plan assumptions. The question is what happens if assumptions don't match reality.
- We modeled projected costs if returns were just 5.4 percent annually instead of the assumed 7 percent rate of return.
- The model only includes the cost of new benefits as the new plan designs would not include current employees and retirees.
- All told, if returns fall short then the proposed hybrid plan would cost $36 million less in employer contributions from 2014 through 2044—a reduction of about 7.5 percent. The city's pension debt in 2044 would be about $130 million less under the proposed hybrid plan than under the Mediated Settlement Agreement plan in this return scenario.
- These reductions in costs are explicitly shared with workers in the hybrid plan who end up with reduced benefits—workers also gain if investments over-perform. Investment or other actuarial losses in the defined benefit plan are factored into contribution rates, which can result in tax increases, spending cuts, or benefit reductions. Policymakers have to decide which is the right way for Jacksonville to manage uncertainty and share costs.

Annual Employer Pension Costs For New Hires Only, 5.4% Returns

Payments owed by the City of Jacksonville



Source: The Terry Group, 2014

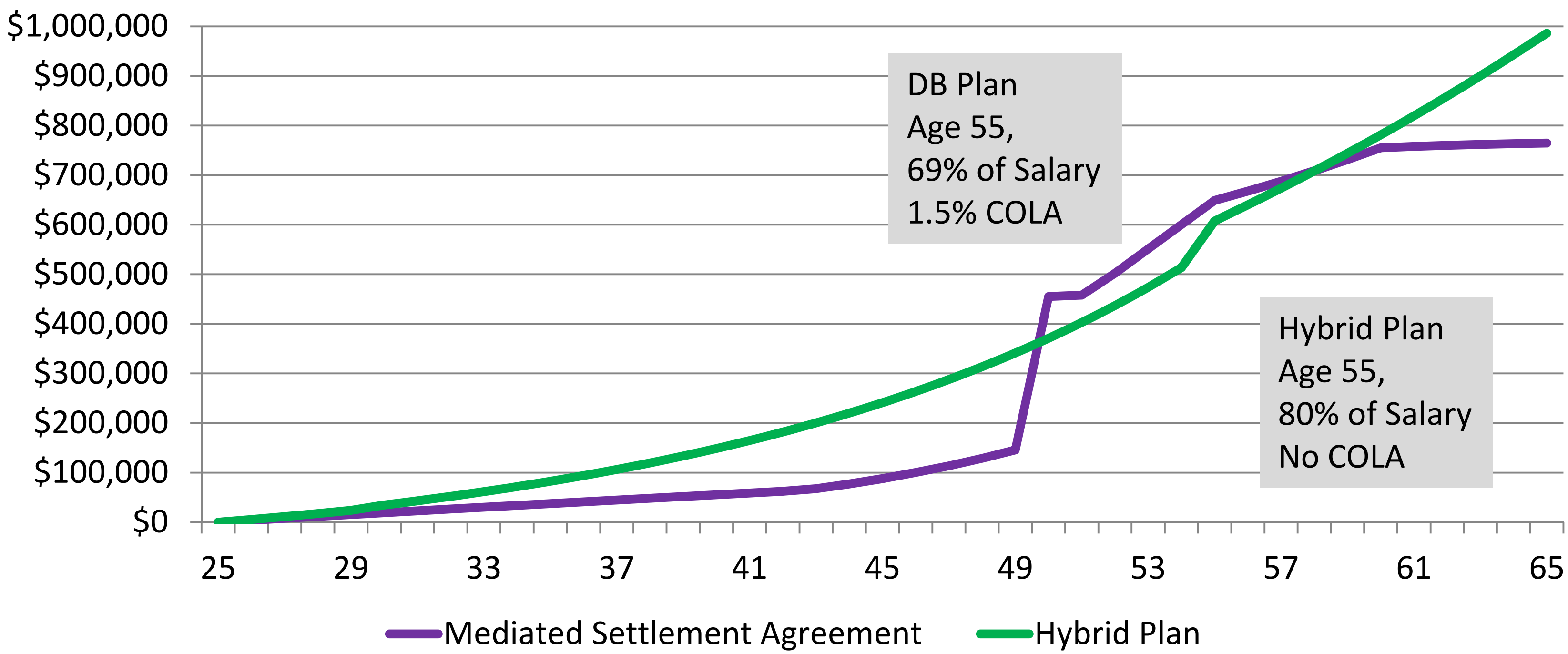
Millions of Dollars,
Not Adjusted for Inflation

Designing a Benefit that Meets Workforce Needs

- State and local governments should have two goals when designing their retirement plans:
  - Place workers on the path to a secure retirement
  - Offer workers deferred compensation as part of an attractive total compensation package
- Pensions are just one part of total compensation, and policymakers need to balance salaries, health insurance, and retirement benefits to make sure the compensation package is meeting workforce needs.
- Under the proposed defined benefit plan, benefits are reduced until workers reach 25 years of service, providing firefighters and police officers with a strong incentive to stay until they reach that threshold. This may align with the City's stated workforce goals, but it means that many workers will end up with a relatively low retirement benefit.
- The hybrid plan offers a better benefit to workers who don't stay at least 25 years, and a slightly lower but comparable benefit thereafter.
- The defined benefit plan will also discourage police officers and firefighters from working more than 30 years as benefits is capped at 75 percent of pay.
- The hybrid plan allows workers to continue accruing benefits after 30 years of service.

Retirement wealth accrual over a career under potential plan designs

The value of earned retirement benefits

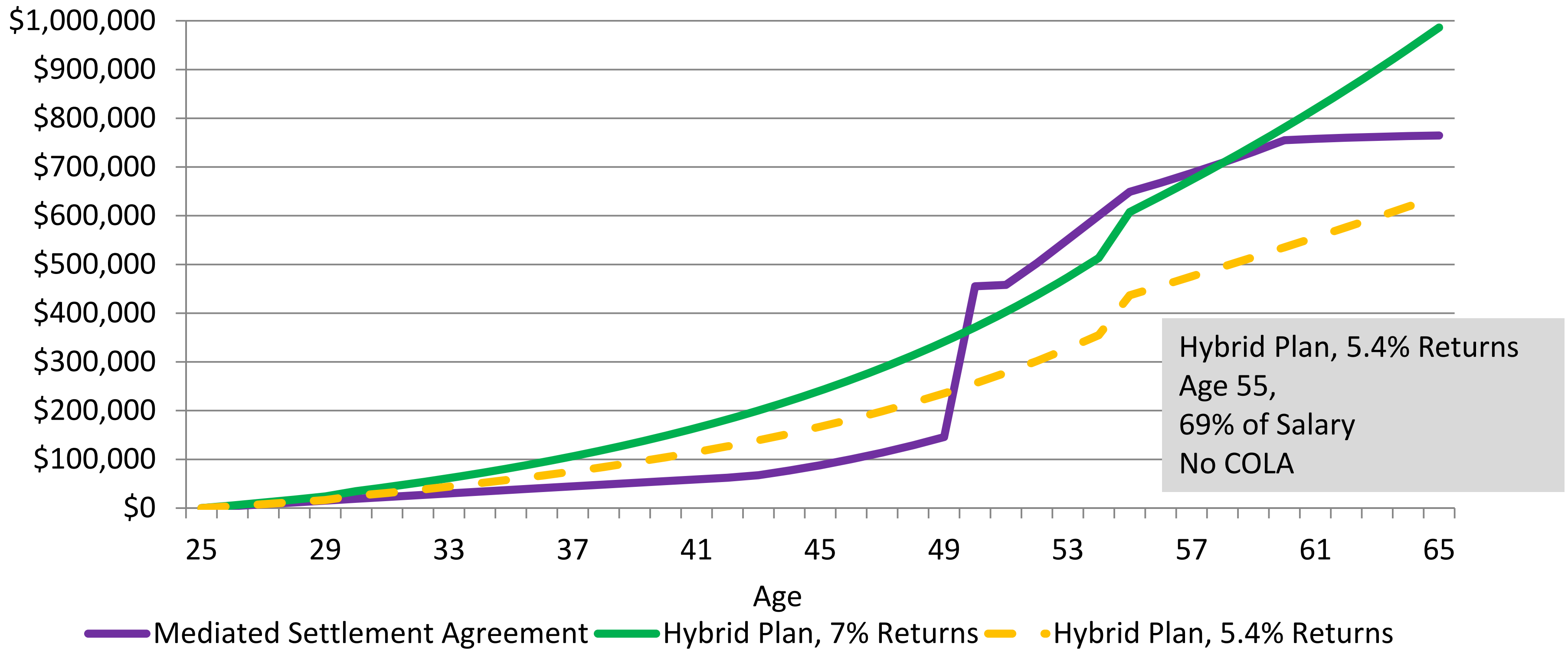


Source: The Terry Group, 2014
Analysis based on new employee entering at age 25
and is based on plan assumptions, including 7 percent investment returns
Hybrid benefits include both the defined benefit and defined contribution components

Adjusted for Inflation

Retirement wealth accrual over a career under potential plan designs

The value of earned retirement benefits

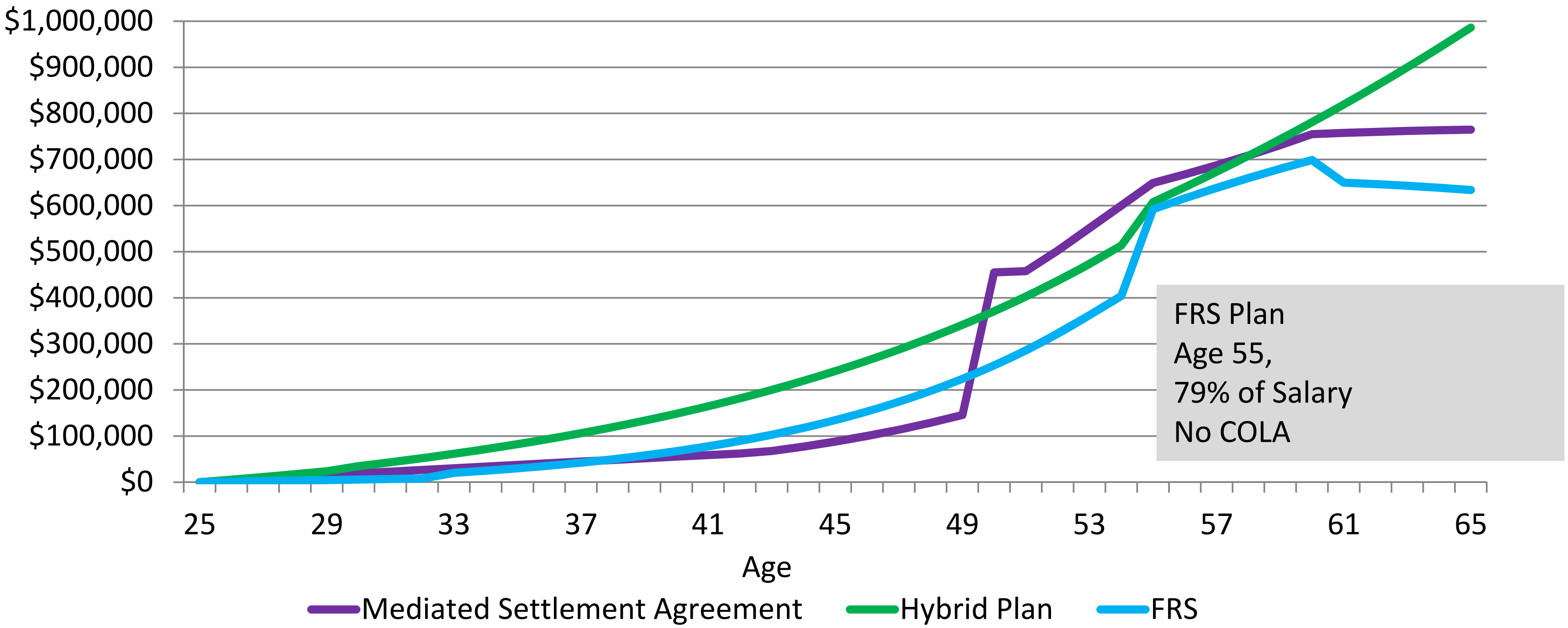


Source: The Terry Group, 2014
Analysis based on new employee entering at age 25 and is based on plan assumptions.
Investment returns are assumed to be 7 percent, except for the hybrid plan projection at 5.4 percent.
Hybrid benefits include both the defined benefit and defined contribution components

Adjusted for Inflation

Comparing potential plan designs to FRS Benefits for Public Safety Workers

The value of earned retirement benefits



Source: The Terry Group, 2014
Analysis based on new employee entering at age 25 and is based on plan assumptions.
Investment returns are assumed to be 7 percent..
Hybrid benefits include both the defined benefit and defined contribution components

Adjusted for Inflation

Potential Changes to Current Employees Presented to the Task Force by Policymakers and Stakeholders in Jacksonville

- **Increasing employee contributions**—Proposed to immediately increase from 7 to 8 percent and then subsequently increase to 10 percent following pay raises to make up for recent pay cuts.

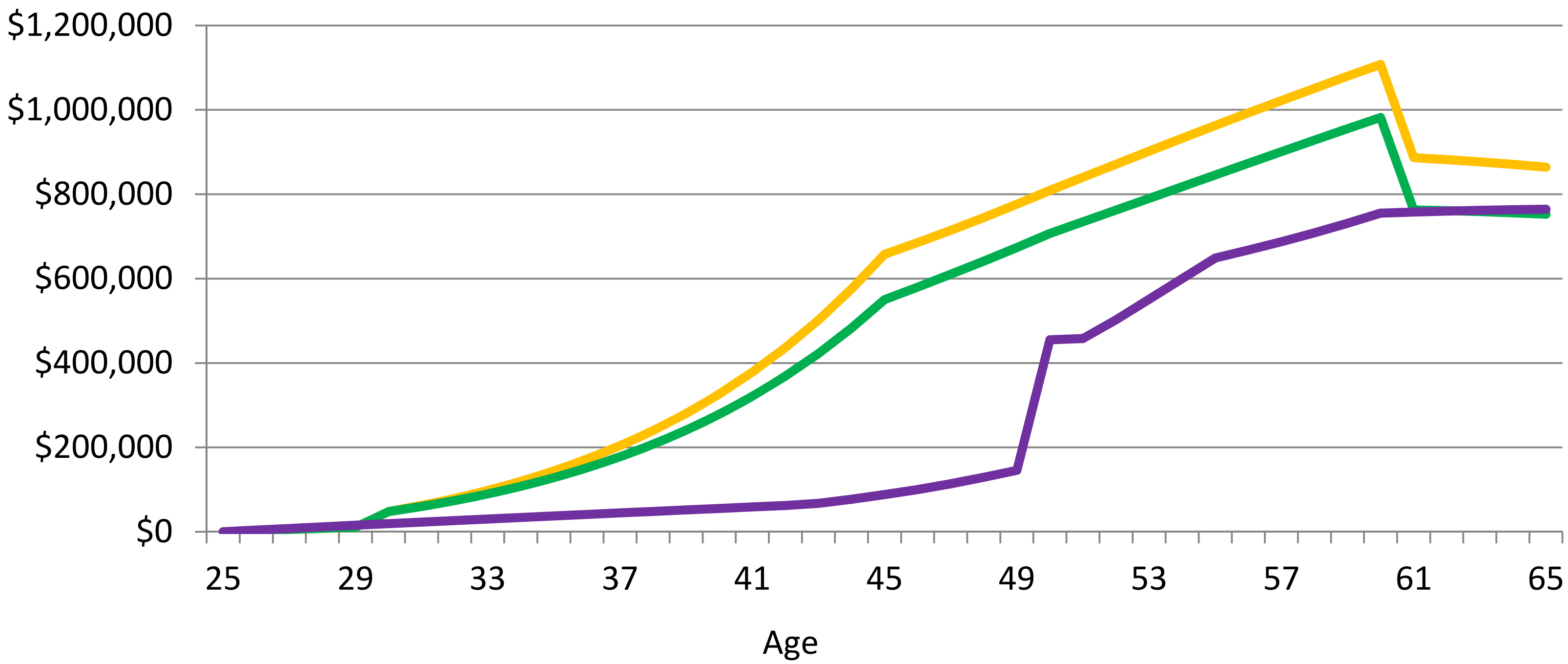
- **Changing or eliminating the DROP program**—Current proposal is to change the interest earned from DROP accounts from a guaranteed 8.4 percent to actual plan returns with a minimum return of zero and a maximum return of 10 percent.

- **Reducing COLAs prospectively**—The Mayor has proposed to reduce the Cost of Living Adjustments applied to benefits for current employees that have not yet been earned. Benefits based on current service and present salary will be increased by 3 percent annually in retirement but benefits based on increased service or pay will only get a COLA of 1.5 percent.

- **Allocating Chapter Funds to pay down the unfunded liability**—The Mayor's Office has proposed using the Chapter Funds not currently going towards paying the ARC to help pay down the city's pension debt at an accelerated rate until the plan is 80 percent funded.

Impact of COLA Changes to Retirement Benefits

The effect of the proposed COLA change on an example employee who currently has 5 years of service.



Source: The Terry Group, 2014
Analysis based on new employee entering at age 25
and is based on plan assumptions.

Adjusted for Inflation

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