APPENDIX 1

# Memoranda from former Chief Financial Officers

CITY OF ATLANTA

SHIRLEY FRANKLIN
MAYOR

DEPARTMENT OF FINANCE
68 MITCHELL STREET, S.W., SUITE 11100
ATLANTA, GEORGIA 30335-0312
TEL (404) 330-6430 · FAX (404) 658-6667

JANICE D. DAVIS
CHIEF FINANCIAL OFFICER
jdavis@atlantaga.gov

OCT 0 2004

MEMORANDUM

October 5, 2004

TO: Chairperson Debi Starnes and
Members, Finance/Executive Committee

FROM: Rick Anderson RA

SUBJECT: Pension Issues Discussion Paper

Enclosed is a discussion paper I prepared on pension issues.

I think it is important to recognize the origins of the current issues of disparity among the city's four retirement plans, and for the city to take a thoughtful and comprehensive approach to determining the objectives it wants to accomplish through the provision of retirement plans to its employees. I have laid out a suggested process to accomplish that in this paper.

If I can provide additional information or clarification, please let me know.

encl.

cc: Mayor Shirley Franklin
Council President Lisa Borders
Janice Davis

# CITY OF ATLANTA RETIREMENT BENEFITS

The city of Atlanta first offered retirement benefits to its employees nearly eight decades ago, based upon the principle of providing income for employees when they are too old to work or become disabled from being able to work.

In recent years, there has been increasing hue and cry from employees for more equitable and consistent benefits under the four retirement plans offered by the city. The concerns of employees have been heightened and exacerbated by recent changes in retirement plan benefits which have dramatically changed long-standing correlation among benefits offered to city employees.

## Historical Relationships Between City Pension Funds

The city's three defined benefit pension plans were established in the 1920s. In the ensuing decades, changes to the plans were generally coordinated, resulting in little change in the relationship and comparability between the plans. The Police and Fire plans did gain a lower retirement age in 1955, but for the most part revisions through the years that affected employee contribution rates, benefit calculation, disability benefits, survivor benefits, early retirement, etc. were consistently applied to each of the three plans.

In recent year's, the city's responses to employee demands for greater benefits and the city's proffering of "early retirement" options as a budget reduction tool have led to a number of actions being taken which have impacted categories of city employees differently. This has given rise to a clamor for parity in the treatment of employees with respect to the provision of retirement plans.

The issue of "parity" has become highly emotional, tied to the perception of unequal and unjust treatment of categories of city employees. Parity has become the rallying cry for employees dissatisfied with their retirement benefits. The reality is that there are a number of fundamental issues around retirement plans at the city that need to be addressed, and it would be a mistake to deal with "parity" in a vacuum. The fact is that "parity" issues will best be addressed in a comprehensive approach to pension reform.

There clearly is now a significant level of disparity between the four retirement plans offered by the city. The city did not get to this current state of disparity through a cohesive, rational, and deliberate decision making process. The traditional maintenance of comparability between the different funds began to be eroded in the 1990s, but the current state of affairs is largely the result of precipitous actions taken in 2001

**Pension Changes of 2001**

In 2001, a series of actions were taken that marked a dramatic change in the relationship between the defined benefit plans and in the parity of retirement benefits offered to various categories of employees. Three revolutionary revisions were enacted:

1) The service credit factor for the Police plan was raised from 2 percent (.02) per year of service, to three percent (.03). This had the effect of essentially increasing pension benefits for Police Officers by fifty percent (50%).

2) The service credit factor for the Firefighters plan was raised from 2 percent (.02) per year of service, to three percent (.03), but only prospectively, for service after the effective date of March, 2001. While not as dramatic a change as that for the Police officers plan, this was a significant increase in benefits compared to all other city employees.

3) Effective July 1, 2001, a new "Defined Contribution" plan was put into place for all employees not members of the Police Officers or Firefighters plans. This had the effect of closing the General Employees Pension Fund to new members, and created a fourth set of retirement benefits. This new plan does not provide a defined, "guaranteed" benefit, marking the first time that regular, permanent employees were not covered by a defined benefit pension plan.

The actions of 2001 had a profound effect on city employee retirement plans, and shattered the basic relationships that had existed for nearly eighty years. In cumulative effect, these actions have created the greatest disparity the city's history of offering retirement plans to city employees.

The changes of 2001 were not the result of a thorough and comprehensive analysis of city retirement plan objectives, and were not taken as a cohesive set of adjustments. They have created "haves" and "have nots" among city employees, have generated great dissatisfaction among those employees that view themselves as "have nots", and have created "parity" as the overriding city pension benefit issue.

Unfortunately, "parity" has come to be defined for most employees who are not members of the Police Officers Pension Plan as increasing their benefits to the level of police, specifically a retirement age of 55 and a service credit factor of three percent. Meanwhile, members of the Police Officers Pension Plan are asking for increased benefits in the form of an even earlier retirement age.

## Getting Retirement Benefits Back on Course

The Pension Technical Advisory Committee (PTAC) made an excellent recommendation that the city establish a policy that determines the city's targeted percentage of an employee's retirement income. Put another way, the city needs to have an underlying philosophy and a clear objective for its retirement programs that will guide policy decisions over time.

The establishment of this philosophy and objective should precede any discussion of parity and any changes to city retirement plans.

The cornerstone of the city's retirement plan objective will be the target retirement income. As discussed in the PTAC report, most experts estimate that the average retiree will need between 70% and 80% of pre-retirement income to maintain their lifestyle in retirement. It is important to note that this assumes a "normal" retirement age; by definition pension income is not intended to provide equivalent income for persons in the middle of their earning years, still rearing children, or otherwise at the height of a consumption lifestyle.

The traditional approach to the provision of retirement income has been that there are three roughly equal components: one-third to come from the employer; one-third to come from the federal government (through social security); and one-third to come from the employee. Given that the city does not participate in social security, it is reasonable to allow that the city should be responsible for both the employer and federal government shares, or two-thirds of the retirement income. If the city were to accept a retirement income target of 75% of pre-retirement income, that translates to the city being responsible to provide roughly one-half, or fifty percent (50%) of the pre-retirement salary as a retirement benefit.

The Police Officers Pension Plan already allows for members to draw up to eighty percent (80%) of their pre-retirement salary in benefit from the city's pension fund alone. Additionally, most officers participate in the state's Peace Officers Annuity Fund, which provides a monthly pension benefit, and with the prevalence of outside jobs, most are likely to have earned social security coverage as well. Thus, the retirement benefits for members of the Police Officers pension fund already significantly exceed any reasonable, rational retirement income target the city is likely to set. To allow that generosity to be the basis for giving others "parity" with the Police plan benefits would be compounding the mistakes of 2001.

The group of employees with the greatest disparity in retirement benefits is those employees outside of the uniformed police and fire services hired since July 1, 2001, who are covered by the defined contribution plan. Unlike most participants in defined contribution plans, they do not have social security coverage. They have no set retirement benefit at all, and poor investment decisions could leave them with nothing at the end of a city career. They have no disability benefit, and no access to health insurance at retirement age. The highest priority for city pension adjustment must be to address these employees.

Even though the recent hires covered by the Defined Contribution plan are the highest priority, there should not be any attempt to address the shortcomings of this plan in the short-term or in a vacuum. The city should undertake a methodical, rational, and thorough process to make pension changes, starting with establishing the policy objectives and the target retirement income to be provided.

There is a clear sequence of decisions that will lead ultimately to addressing all of the retirement plan issues facing the city:

- Determine the city's retirement plan objectives, and establish the percentage of pre-retirement salary for which the city takes responsibility to provide in retirement. This objective will guide the evaluation of existing plans and the structure of a new plan or plans going forward.

- Determine whether there is a rational basis for different benefits for different categories of empoloyees, and whether multiple plans are desirable or whether the city and employees are best served by a single plan covering all employees.

- Design a new plan or plans for application to all persons hired after a date certain. The design of this plan(s) will incorporate decisions about whether the provision of social security should be part of the mix, and whether the plan(s) will be defined benefit or defined contribution, or a hybrid of both.

- Establish the new plan or plans prospectively, for all persons hired after a date certain.

- Determine what to do with existing employees in existing plans. The benefits provided under the existing plans should be evaluated against the established retirement plan objective and percentage of pre-retirement salary that the city takes responsibility for providing in retirement. If current plan benefits are less than those of the new plan(s), it should be easy to transfer employees to the new plan(s). In cases where the existing plan has greater benefits than the city establishes as policy, it will be more problematic. Members of the existing plans have vested, legal property rights to the benefits promised under those plans. These rights cannot be abridged. It may be that benefits will have to be left in place that exceed that which the city determines to be it's policy going forward.

It should be noted that literally thousands of employees have retired under the current benefit provisions, or in the case of police, significantly lesser benefit provisions. If the city makes significant changes in benefits for current employees in plans under which those employees retired, it will have to deal with a new disparity that will be created between members of the same plan whose benefits will differ greatly depending solely upon the date of retirement.

**Summary**

The city reached the current point of disparity and dissatisfaction with retirement benefits through a series of retirement plan adjustments that were not comprehensive or cohesive, and were highly reactionary to pressure from city employees and city budget shortfalls. It is critical that the city not fall into the trap of again reacting to pressure by applying more grease to squeaky wheels.

Only through a comprehensive and methodical process can the city put into place a rational, well reasoned retirement plan going forward, and make any adjustments to the benefits of existing plans in accordance with adopted policy objectives.

SHIRLEY FRANKLIN
MAYOR

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JANICE D. DAVIS
CHIEF FINANCIAL OFFICER

**TO:** Honorable Howard Shook, Chair, Finance Executive Committee

**FROM:** Janice D. Davis, Chief Financial Officer

**SUBJECT:** Pension Recommendations

**DATE:** July 3, 2008

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I promised that I would leave Council with a few ideas for dealing with pensions in the future. Attached is a document that provides the promised information and a primer on pensions. While the primer is directed toward the private sector the concepts also apply to government plans. Additionally, I am providing articles and reports that could provide a background and context for your discussions on the topic.

cc: Honorable Members of the Finance Executive Committee
Honorable Members of the City Council
Ray Zies, Controller

## Pension Recommendations

As you know a pension is an organization's promise to its employees to provide for their retirement either currently (defined contribution) or in the future (defined benefit). This promise is made in exchange for the services provided by the employee and especially, in the case of government employees, represents a contractual relationship for the government. The pension contract can not be unilaterally altered or terminated.

In the past, governments have used benefits, especially pensions, as a way of compensating employees for the relatively low wages paid by those organizations.

Prior to the introduction of Governmental Accounting Standards Board (GASB) Statements 25 and 27, there was no need to reflect the future cost of the pension obligation. There was no recognition of the fact that benefits earned today would impact the future costs of the organization. Pension funds, simply recorded the costs of the pension as payments were made to retirees. Under the GASB pronouncements, pension plans had to recognize the impact of today's decisions on the present and future. Additionally, past failure to fund the liability was also measured and reflected.

With the introduction of GASB Statements 25 & 27 in November 1994, governments were forced to measure the liability and amortize it as a charge against current operations over a period no greater than 30 years. Under GASB 25/27, the pension obligation is divided into 2 components – normal cost (the cost of benefits currently being earned) and actuarial liability (the value of benefits already earned). There is also a requirement to calculate an Annual Required Contribution (ARC). There was initially no requirement to fund the pension, only to reflect its impact on current results. However, to the extent that funds were not provided, the liability continued to grow. That is what happened with many state and local governments.

Pension funding is a complicated and imprecise science. The actuary, based on assumptions as to earnings on investments, growth in the workplace, payroll growth (future pay raises) and mortality of the participants agreed to by the pension boards, attempt to develop a contribution that will, over the prescribed time, completely eliminate the unfunded liability.

The amortization period, as well as type of amortization, is also a significant factor in the determining the ARC. Altering any of the assumptions, including the amortization period, can significantly alter the annual contribution.

A lower interest earnings assumption will increase the size of the required contribution. If you decrease the assumption related to payroll growth and you decrease the size of the contribution. If you adjust your amortization period you adjust your contribution.

However, whatever contribution, the liability must be scheduled to be completely funded.

In 2004, the City of Atlanta convened the Pension Technical Advisory Committee (PTAC). In August of that year the PTAC issued its report. The report identified nine (9) areas that needed to be addressed.

1. The PTAC recommended adoption of a two-year process for instituting changes with a financial impact to the City's pension plans
2. The PTAC recommended that the City set a policy that determines its targeted percent of an employee's retirement income.
3. Parity: (A) To ensure comparability of benefit, the PTAC recommended the City review contribution levels of all employee groups. (B) The PTAC recommended that high priority be given to addressing pension-related issues for General Employees hired after July 1, 2001. The PTAC's most overriding concern and recommendation, relates to the pension coverage of the DC plan participants.
4. Amortization of Unfunded Liabilities (A) The PTAC recommended that the City of Atlanta consider other methods of funding its unfunded liability. (B) They further recommended a funding approach be a stand-alone decision and not necessarily a means to fund new benefits.
5. The PTAC recommended that pension plan governance be reviewed with an eye toward possible consolidation of the boards.
6. The PTAC recommends that the City reduce the vesting schedule on its defined benefit plans.
7. The PTAC recommended that a total compensation approach be followed to set salaries and benefits. They suggested looking at a different type of plan to provide a more equitable plan for all employees while expressing concern over the City's ability to continue the existing police and fire plans.
8. PTAC does not recommend adoption of a DROP plan.
9. The PTAC recommended that the City increase employee education with respect to pension administration and short and long-term benefits.

In 2005, City Council made several changes to the pension funds as a result of the PTAC's recommendations. Specifically,

- The vesting schedule was reduced to 10 years.
- 65-75% was set as a target income replacement ratio for retirement income because the employees are not covered by social security.
- The amortization period was extended. However, it was done in conjunction with an enhancement to the benefits.
- Lower paid employees were allowed to transfer from the defined contribution plan to the defined benefit plan.

In addition, the Council voted to improve the benefit for the Fire and General Employees plans and implemented a "30 and out" provision for all plans.

Presently, the City is faced with a benefits burden that can not be maintained without a significant negative impact on the City ability to provide services. I think it is worthwhile to revisit several of the PTAC's recommendations.

- The adoption of a two-year process for instituting changes with a financial impact to the City's pension plans
- The review of pension plan governance with an eye toward possible consolidation of the boards. Additionally, I would recommend a change in the composition of the Board. I have attached an article which examines the potential conflict of interest which can exist when employees or retirees serve as pension trustees. Business or professional representatives might be preferable to the current employee/retiree representation.
- The development of a hybrid plan covering all employees, including public safety personnel. The plan would combine aspects of the defined benefit plan but with a lower multiplier and higher employee contribution and the defined contribution plan. This would also afford the City the opportunity to reset the retirement age to reflect the fact that people are living longer.

While a cost neutral Deferred Retirement Option Program (DROP) can be developed and I have supported it in the past, the temptation to make changes to the DROP which influence the behavior of employees may be too hard to resist. So I would suggest that plans for the DROP program be scrapped.