Government Operations Subcommittee

Wednesday, February 13, 2013
2:00 PM
Webster Hall (212 Knott)

ACTION REPORT

Will Weatherford
Speaker

Jason T. Brodeur
Chair

COMMITTEE MEETING REPORT

Government Operations Subcommittee

2/13/2013 2:00:00PM

Location: Webster Hall (212 Knott)

Summary: No Bills Considered

COMMITTEE MEETING REPORT

Government Operations Subcommittee

2/13/2013 2:00:00PM

Location: Webster Hall (212 Knott)

Attendance:

	Present	*Absent*	*Excused*
Jason Brodeur (Chair)	X		
Larry Ahern	X		
Frank Artiles	X		
Daphne Campbell	X		
Neil Combee	X		
W. Travis Cummings	X		
Erik Fresen	X		
Reggie Fullwood	X		
H. Marlene O'Toole	X		
Ricardo Rangel	X		
Daniel Raulerson	X		
Irving Slosberg	X		
Ritch Workman			X
Totals:	**12**	**0**	**1**

COMMITTEE MEETING REPORT

Government Operations Subcommittee

2/13/2013 2:00:00PM

Location: Webster Hall (212 Knott)

Presentation/Workshop/Other Business Appearances:

Salvatori, Rocco (General Public) - Information Only
Suncoast Professional Firefighters
1010 9th Ave
Braderton FL 34205
Phone: (941) 708-6233

Testimony from stakeholders
Heinrichs, Brad (General Public) - Information Only
Foster & Foster
13420 Parker Commons Blvd, Suite 104
Fort Myers FL 33912
Phone: (239) 433-5500

Testimony from stakeholders
Bogdahn, Joseph (General Public) - Information Only
Bogdahn group
4901 Vineland Rd., Suite 600
Orlando FL 33880
Phone: (863) 660-1645

Testimony from stakeholders
George, Ernest (Lobbyist) - Information Only
Florida Police Benevolent Association, Inc
300 E Brevard St
Tallahassee FL 32301
Phone: (850)222-3329

Testimony from stakeholders
Conn, Kraig (Lobbyist) - Information Only
Florida League of Cities
301 S. Bronough
Tallahassee FL 32301
Phone: 850-222-9684

Testimony from stakeholders
Suarez, Robert (Lobbyist) - Information Only
Florida Firefighters
345 W Madison Street
Tallahassee Florida 32302
Phone: (305) 984-3299

Testimony from stakeholders
Henning, Lisa (Lobbyist) - Information Only
Florida Fraternal Order of Police
242 Office Plaza Dr
Tallahassee FL 32301
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Committee meeting was reported out: Wednesday, February 13, 2013 5:21:59PM

COMMITTEE MEETING REPORT

Government Operations Subcommittee

2/13/2013 2:00:00PM

Location: Webster Hall (212 Knott)

Presentation/Workshop/Other Business Appearances: (continued)

Testimony from stakeholders
Clellan, Steve (General Public) - Information Only
Orlando Firefighters
4005 N. Orange Blossom Trail
Orlando FL 32804
Phone: (407) 448-1024

Years in the Making: Florida's Underfunded Municipal Pension Plans
Weissert, Carol (State Employee) (At Request Of Chair) - Information Only
LeRoy Collins Institute
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Committee meeting was reported out: Wednesday, February 13, 2013 5:21:59PM

LOOKING AT FLORIDA'S MUNICIPAL PENSIONS

How Some Florida Cities are Dealing with Pension Funding Issues

A JOINT REPORT FROM

AND

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INTRODUCTION

Municipal budget shortfalls in Florida since the onset of the Great Recession have focused increased attention on a fast-growing component of municipal budgets: public employee pension plans. Cities across the state have recognized that employee pension benefit levels set in previous years may be greater than is fiscally prudent, that pension obligations outstrip their pension assets, and that the result may lead to cutbacks in other city expenditures. Many cities have recognized their problems and have made efforts to address them—even at great political risk. Others have not yet dealt with what may be a looming problem.

This joint Florida TaxWatch and LeRoy Collins Institute (LCI) research report examines media coverage to provide a snapshot of some Florida cities that have acknowledged problems with their pension systems and how they have responded to these problems. It provides a sense of the reasons why pension underfunding has occurred, actions being taken in an attempt to reduce pension burdens, and the possible ramifications of not solving the issue of increasing pension costs.

The LCI has published several reports on potential problems with funding levels[1] of local pensions throughout Florida. In 2011, the LCI published *Report Card: Florida Municipal Pension Plans* ("Report Card"), which focused on the costs and sustainability of municipal pension plans.[2] In a report published in Fall 2012, the Institute looked at trends of pension funding and concluded that the problem cannot be laid at the feet of tough economic times. Rather, even in "good" economic years, many municipal pensions' obligations exceeded their assets.[3]

Pension entitlements make up a significant portion of the budget in some Florida cities, leaving a smaller portion of the budget available to fund other public obligations. For example, Jacksonville's City Council President Bill Bishop has estimated that approximately $110 to $120 million of the city's $950 million budget (11 or 12 percent) is spent yearly on public pensions (Wexler 2012). Likewise, Palm Beach Gardens spent more than 13 percent of its budget on pension obligations – approximately $8.7 million from its annual $65 million operating budget for public safety and city employee pensions in 2011 (Dipaolo 2011).

Given that pension liabilities can be such a large portion of the municipal budget, and that most are still far from fully funded, a number of questions are raised. Specifically, what are the possible factors that led to underfunding and what can municipalities do to solve this problem? And, possibly even more importantly, what could happen if these Florida governments do not make any changes? Based on media accounts and other public records, this report outlines some of the answers to these questions.

1 The term "funding level" used throughout this paper refers to the Unfunded Accrued Actuarial Liability (UAAL). The UAAL is the difference between the present value of projected future benefits earned by employees to date (actuarial accrued liability) and the projected value of the assets that reflects average investment returns over a period of time (actuarial value of assets) accumulated to finance the obligation.

2 Report Card: Florida Municipal Pension Plans. November 2011. http://collinsinstitute.fsu.edu/sites/collinsinstitute.fsu.edu/files/Tough%20Choices%20Report%20Card%20Nov%202011.pdf

3 Years in the Making: Florida's Unfunded Municipal Pension Plans. September 2012. http://collinsinstitute.fsu.edu/sites/collinsinstitute.fsu.edu/files/SEP%202012%20Years%20In%20The%20Making%20report_0.pdf

1 Possible Paths to Underfunding

There are a number of reasons why Florida local pension plans are underfunded. While the fallen housing market, diminished stock market returns, and an economy that did not rebound as hoped did not help the situation, they were not the primary determinants. This section examines four main issues often cited as causes for local pension underfunding: Mismanagement of the pension fund, chapter 175 & 185, "gaming" of the benefit calculation such as spiking, and the inability for localities to change contracts with unions prior to their expiration. The list is not exhaustive of the causes of underfunding, nor are these issues mutually exclusive.

A. Mismanagement of Pension Funds

Mismanagement of local pension funds can occur through, among other things: a) "pension holidays;" b) financial firms investing assets in a way that brings a minimal return on investment; and c) incorrect analysis in actuarial assessments.

"Pension holidays" are occasions when a city did not contribute to the pension plan. This was especially evident during times when investments were gaining a large rate of return and thus municipalities thought they did not need to contribute to the pension fund. While not making a contribution when a plan is fully funded does not create an issue in the short term, this could be a problem later on, or if the plan is underfunded. Miami Beach has been recognized as one locality that engaged in this behavior. The city of Miami Beach did not contribute to its general employee pension fund from 2001 to 2003, a period of high returns on investment (Smiley & Chang 2012). Another city that has been documented as engaging in this behavior is Jacksonville (Littlepage 2011).

Poor investment decisions are another issue related to the mismanagement of pension funds. The City of Auburndale relied on a financial firm that invested the plan's funds solely in currency, which produced an undiversified plan incapable of achieving the return on investment needed to cover the plan's liabilities.[4] This unexpectedly low return on investment, in turn, had to be paid by the municipality (Attinger 2012). While it is a pension board's choice to decide the type of investment options to make with the pension funds, investing in only one venture results in more market risk.

4 In Florida, as directed by state law, police and firefighter pension funds are administered and managed by local pension boards that make decisions on investment strategies and on the assumptions used to calculate the value of pension obligations and assets. Pension fund trustees hire investment managers, actuaries and consultants to advise them on their decisions.

It has also been suggested that incorrect analysis in actuarial assessments have led to the mismanagement of pension funds. The previous actuary employed by Winter Springs used investment and return figures indicating stronger financial stability and a 79% funding level. The new actuary found that these figures were not being calculated properly, and that the fund was actually 59% funded (Saggio 2011). While it is difficult to know if the actuarial assessment of a pension fund is on target, miscalculation of expected returns and demographic trends of the system could lead to significant consequences relating to the level of funding. If a local government is not receiving accurate information regarding its pension fund, then the management decisions it is making can lead to an inappropriate strategy.

B. Chapter's 175 & 185

In 1999, Florida Statutes ch. 175 and 185 were amended to significantly restrict the ability of cities to bargain with police and firefighters' unions regarding pension benefits, by guaranteeing in statute that existing "minimum standards and benefits" could not be reduced, while simultaneously limiting the expenditure of all premium tax revenues (taxes on property and casualty insurance premiums) to fund "extra benefits" for these employees only.

When investment returns and revenues decline, cities cannot simply choose which groups of employees to keep their promises to, they owe pension benefits to all employees, and the restrictions in ch. 175 and 185 make meeting these obligations significantly more difficult.

As the cost of these benefits continue to rise, cities such as Greenacres have seen their pension costs nearly triple compared to the same pensions five years ago. These "extra benefits" have driven taxpayer costs up, threatening the stability of the pension program for future police officers and firefighters, as well as all other public employees (Palm Beach Post 2011).

C. Spiking

Spiking is another factor that contributes to pension underfunding. Spiking is when an employee is able to include overtime, sick time, and additional earnings into their final average compensation rate, which can significantly enhance pension benefits. It may not be readily apparent that incorporating extra hours of overtime and sick leave into the final average compensation of a public employee would contribute much to pension underfunding, but this allowance has been abused.

One of the best-known cases of spiking in local government pensions in Florida is that of a 911 call center operator in Miami Beach. This individual racked up so much overtime and additional benefits in her last few years of service that she was able to transform her $60,000 a year salary into a $150,000 a year pension payment (Smiley & Chang 2011). Her ability to include overtime and unused sick/vacation leave into the calculation of her pension allowed her to more than double her working salary in retirement benefits. By the time this individual reaches her mid-seventies, the city of Miami Beach will have paid her $4,074,000 in pension benefits (Smiley & Chang 2011). Miami Beach is not the only local government faced with spiking. Two fire lieutenants and a police sergeant in Coral Gables were able to retire before age fifty, with yearly pension benefits exceeding their yearly salary by $20,000 to $30,000 (Smiley & Chang 2012).

Spiking has become such a well-known problem that in 2011 the state enacted a law that limits overtime used in the final average salary calculation to no more than 300 hours (Department of Management Services 2011).

D. Inability to Change Union Contracts in Non-Emergency Circumstances

Finally, the inability of localities to change contracts with unions unless the contract has expired is another possible path to underfunding. The inability to renegotiate contracts created during good economic times makes it difficult to adapt the system to one that is more affordable during an economic downfall. However, there is a way for cities to renegotiate the contracts through the declaration of financial urgency, which will be discussed later in this paper.

In summary, there are many different paths to the underfunding of a pension plan. This is by no means a comprehensive list of reasons pensions are underfunded, but it is a glimpse at a few possibilities that are evident in Florida.

2 Reforms to Reduce Pension-Related Costs

Two main categories of reforms to minimize the budget gaps in pension funding directly affect pension recipients. The first category is direct pension reforms that affect the flow of funding and disbursement of benefits in the pension. The second category affects pension funding indirectly and includes changes to municipal employees' salaries and overall cutbacks in the police, fire, and general government departments in order to minimize expenses, and thereby meet their obligations.

A. Direct Pension Reforms

There are numerous options for municipalities interested in reforming their pension systems. Some actions Florida local governments are taking include: increasing employee contributions, cutting pension benefits, eliminating or reducing the cost-of-living adjustment, changing the calculation of final benefits, increasing the retirement age, switching from a defined benefit to a defined contribution plan, making changes to the Deferred Option Retirement Program (DROP), or declaring Financial Urgency as a means to renegotiate union contracts.

1. Increasing Contributions

Increasing employee contributions to the pension fund appears to be a frequent reform localities are making to pensions. Local governments have implemented increased contributions either by subjecting all employees (new and old) to changes in the level of contributions, only applying the change to new hires, and in some cases, giving pay raises to offset an increased contribution. These three paths all lead to increased contributions, but have varying implications for different segments of employees.

Bradenton, Cape Coral, Winter Springs, Vero Beach, and Coral Gables increased contributions for all or some employees. Bradenton signed a three-year agreement with firefighters and paramedics stipulating a 1% increase in employee contributions each year for the next three years, which will gradually raise the employee contribution rate from 7% to 10% (Valverde 2012). Cape Coral instituted a 3% increase in contributions for police officers and a 2% increase for firefighters (Stewart 2011a; Ruane 2011; Stewart 2011b; Stewart 2011c; Repecki 2011). Winter Springs implemented a 2% employee contribution increase, raising the contribution rate from 3% to 5% (Saggio 2011). In Vero Beach, a new contract with the police union increases the amount existing employees contribute to their pension fund from 3 to 5.5% of their salary. Employees hired after Oct. 1 would contribute 8% (Bierschenk 2012). Following an 18-month impasse in negotiations, the Coral Gables commission increased the pension contributions of all police officers from 5 to 10 percent of their wage (Cohen 2012).

Delray Beach and Lakeland have introduced a plan to increase employee contributions, but will offset this increase by implementing a pay increase. Delray

Beach increased the fire pension contributions from 6% to 9%, but proposed a 5% pay increase in order to make up for cutting benefits and man-hours (Bagg 2011). Lakeland increased the contributions for its Defined Benefit plan from 8.5% to 11%, which is offset by a 2.5% raise. However, Lakeland also established a Defined Contribution plan, which all employees have the option of joining, with a 5% match for the next three years (Chambliss 2011c).

A few other municipalities, including Palm Beach Gardens, proposed increasing contributions for new hires only. This plan would leave employees hired prior to the date of the increased contribution rate at their previous level of contribution, while employees hired after this date would have to contribute more (Dipaolo 2011).

2. Eliminating or Reducing Cost-of-Living Adjustments

Eliminating or reducing the cost-of-living adjustment is another reform option for Florida cities with high pension costs or liability. Hollywood, New Smyrna Beach, Lakeland, and Temple Terrace have all implemented this reform. The citizens of Hollywood voted in favor of dramatic pension reforms in a recent special election including eliminating automatic cost-of-living adjustments (Alanez 2011). Similarly, New Smyrna Beach held a special election and citywide voters approved the elimination of cost-of-living increases for the police, fire, and general employee pensions (Daytona Beach News-Journal 2011). Retired city of Lakeland employees have not received a cost-of-living adjustment since 2008, and the city plans on continuing this practice until plan investments have a return higher than 7.25% (Chambliss 2011a). Temple Terrace has also frozen cost-of-living increases, but only until the pension is 80% funded (Knight 2012). Not only have changes to the cost-of-living adjustment been implemented in these municipalities, but they are being proposed in others such as Palm Beach Gardens, which reduced cost-of-living adjustments for firefighters from 3% to 1.5% (Dipaolo 2012).

3. Reworking the Formula used in Calculating Benefits

Some Florida cities have changed the part of the formula for the calculation of pension benefits. This type of reform can be done in different ways, including eliminating or changing the availability of spiking, decreasing the multiplier, capping accrued benefits, increasing the age/service requirement, changing the calculation of Average Final Compensation (AFC), and/or increasing the retirement age.

Coral Gables, Winter Springs, and Miami have reformed their pension systems by changing the AFC calculation. Winter Springs implemented proactive reforms that limit the allowable overtime hours in the calculation of benefits to 150 hours, and

decreased the multiplier from 3 to 2.5 (Saggio 2011).[5] Miami has put a $100,000 cap on annual pension payouts for employees not yet eligible for retirement (Rabin & Mazzel 2011). Coral Gables reduced the pension benefits for police officers whose pensions are not yet vested from 75 to 67.5% of their working pay after 25 years of service (Cohen 2012); changed the calculation of police benefits based on their average pay during their last five years of service, rather than three; and overtime pay and unused vacation time will not be included in the calculation (Cohen 2012).

Some municipalities are attempting to increase the age service requirement, or minimum and/or normal retirement age. Hollywood, Lakeland, New Smyrna Beach, Miami, and Palm Beach Gardens have proposed to increase the age service requirement, or retirement age. In both Hollywood and New Smyrna Beach, special elections were held to drastically reform pensions. Both of these elections approved changes to the pensions, which included an increase in the retirement age (Alanez 2011; The Daytona Beach News-Journal 2011). Lakeland increased the retirement age from 60 to 62 for the new alternative plan, and has discussed raising the retirement age to 65 for all city employees (Chambliss 2011b). Miami increased the age-plus-service threshold from 68 to 70, with a new minimum age of 50 for retirement (Smiley & Chang 2012).[6] Additionally, Palm Beach Gardens proposed raising the retirement age from 52 to 59 (Dipaolo 2011). These examples are not the only municipalities that have proposed increasing the retirement age; however, this increase was typically made through the age/service requirement for retirement.

4. Switching to a Defined Contribution Plan

A few municipalities are proposing to switch from a defined benefit pension plan to a defined contribution plan. One city that has already initiated this transition is Lakeland. General city employees that have elected to remain in the defined benefit plan will be required to increase contributions from 8.5% to 11%; however, these members will receive a 2.5% raise to offset this additional contribution (Chambliss 2011c). Employees who opt into the new alternative plan will be required to contribute 6.25%, and will receive a match of their contributions from the city of up to 5% for the first three years, as well as having the option of investing additional money into a 401(k) plan. Moreover, an actuary estimated that the new plan will save more than $1.5 million this year, and increase thereafter (Chambliss 2011b).

5 This means that in Winter Springs the calculation of final average compensation from the pension will be – the number of years served x 2.5 (which is the multiplier) x final average salary. (Saggio 2011 – 73)

6 "age/service requirement" is the minimum retirement age (50 in this case) plus the minimum years of service for full retirement (18 years moved to 20 years in this case)

5. Making Changes to the Deferred Retirement Option Program (DROP)

Some local governments have elected to change DROP, which provides an employee the ability to continue working for a certain amount of time after they officially announce their intention to retire. Employees have their retirement benefit calculated at the time they enter into DROP, and accumulate monthly retirement benefits in a trust fund (which earns interest) while they continue to work. When the DROP term ends, the employee receives a lump sum payout of accumulated benefits and interest. Jacksonville found that DROP workers cost the "Police and Fire" plan millions, which is paid by other contributors and tax revenues (Gibbons 2012a). Due to the strain created by a large number of employees in DROP, Jacksonville increased the years of service employees need before entering the program (Gibbons 2012). Temple Terrace has also made changes to DROP by reducing the fixed interest rate from 6.5% to 3% for police retiring after July 1, 2012 (Knight 2012).

6. Declaration of Financial Urgency

Municipalities are prohibited from engaging in negotiation with unions over pensions until previously created contracts have expired. To renegotiate these contracts with benefits the cities feel they are able to afford, some municipalities are filing for Financial Urgency. The declaration of Financial Urgency allows city officials to reopen union contracts during troubled times, prior to their expiration.

In the past four years, Pembroke Pines, Miami, and Hollywood have filed for Financial Urgency. In 2009, negotiations in Pembroke Pines closed the general employee pension plan for new hires and froze it for existing staff. Those individuals who did not retire at that time lost their cost-of-living adjustments and took a 4% pay cut. Miami filed for Financial Urgency last year in order to close a $105 million budget gap created largely by generous contract terms and salary increases. Financial Urgency allowed Miami to change the age-plus threshold from 68 to 70 with a minimum of 50 years of age to begin receiving benefits, and cap pensions at $100,000 for employees not yet eligible for normal retirement. This renegotiation allowed through the declaration of Financial Urgency saved the city $80 million, but Miami declared once again this year. Hollywood also declared financial urgency, but the union leaders and city officials were unable to negotiate a contract. Therefore, the terms of the reform were left up to voters, who approved sweeping cuts and reforms to the pension system (Alanez 2011). While Financial Urgency seems to be a way for cities to negotiate themselves out of huge pension obligations, Hollywood has shown us what can happen if a settlement is not reached, and Miami has shown us that renegotiations do not always mean a financial solution.

7. Jacksonville's Proposed Reforms

One of the most far-reaching pension packages has been proposed by Jacksonville Mayor Alvin Brown. The mayor's long-awaited proposal will deal with the city's police, fire, and general employee pensions. The mayor's recommendations for the police and fire pensions would eliminate the COLA, extend the service considered for the final average pay to 60 months (from 24 months), double the employee contribution from 7 to 14%, exclude shift and differential pay in pension calculations, cap the annual benefits, increase the number of years served before retirement eligibility, provide that pensions could not be collected until age 60, lower the benefit accrual rate, and eliminate DROP. The mayor also proposed reforms in the general employee pensions including eliminating COLAs, increasing employee contributions from 8 to 12%, capping benefits, extending retirement start until age 62, changing the final average pay to the average of the final 60 months (instead of 36), and reducing the accrual rate from 2.5% to 2% a year (Office of the Mayor 2012a,b).

Changing the mechanics of the pension system itself is one way municipalities are working toward decreasing the budget gaps they are faced with in order to increase pension funding levels. However, beyond pension-related reforms being enacted to decrease budget shortfalls, some municipalities are also engaging in activities that indirectly affect pensions.

B. Indirect Activities Affecting Pensions

Indirect pension-related activities are actions taken by local governments such as cutting the budgets of police and/or fire departments through a reduction in payroll expenses and department cutbacks. These activities are not directly related to changes in the funding level of a pension, but they are indirectly related through the municipality's use of these activities to decrease overall spending.

Salary-related activities are changes made to restrict salary increases, cut pay, and limit the availability of overtime and sick time. These actions generally decrease payroll expenses. Cape Coral, Clearwater, Hollywood, and Palm Beach Gardens have restricted salary increases, or instituted pay cuts. Cape Coral began cutting back on payroll expenses by entering into a tentative agreement with its police officers to cut pay by 2%, and decrease the starting salary for new hires to $41,500 (Stewart 2011c). This change should have both an immediate effect on decreasing the budget through salary reduction, and a long-term reduction through the decrease in new hires' starting salary. Clearwater eliminated the yearly step raises given to employees and replaced them with a flat rate raise of 2.5%; however, this is a temporary change. The yearly step raises will return under constrained terms in three years (Harwell 2011). Palm Beach Gardens has also eliminated an increase in payroll expenses by

restricting local police officers from obtaining their yearly raise (Dipaolo 2011). Vero Beach reduced the number of paid holidays for unionized police, thus reducing the overtime the city pays out (Bierschenk 2012). Finally, Hollywood cut the pay by 12.5% for police and fire, and 7.5% for general employees (CBSMiami 2011a & b).

Local governments have also reduced sick leave and overtime pay to reduce payroll expenses. In a tentative agreement with police and fire unions, Cape Coral eliminated pay for two holidays (Stewart 2011c). Delray Beach eliminated two days of holiday pay, and has also cut officers two-week period by 4 hours, making their new schedule consist of 80 hours per two-week period as opposed to 84 (Burdi & Herrera 2011).

Beyond the reduction in payroll expenses, many municipalities are attempting to reduce operating expenses. East Naples has proposed closing fire stations and implemented temporary station closings (known as "brown out days") (Bhasin 2011). Cut-backs are a popular way of saving money, but if costs continue to rise without an increase in revenue, losing a few programs or closing a few stations for a day at a time will no longer be enough.

3 Possible Ramifications for Taxpayers

If pension costs are not controlled and local government budgets are unable to bear the costs, taxpayers at large will have to pay off these obligations. These actions vary in severity and ramifications, but all of these options will affect the citizens in the locality. Municipalities have the option of borrowing from reserve accounts, reducing other city services, raising taxes, contracting out services to different local government units, or in the worst case, declaring bankruptcy. The varying levels of worst-case scenarios outlined in this section are not just possibilities, some have actually taken place in Florida.

A. Borrowing from Reserve Accounts

Borrowing from the reserve account means that the municipality will not have that money in case of an emergency or to spend on other necessary public ventures. Additionally, bond rating agencies often consider the amount of budget reserves in rating government entities. Both Hollywood and Indian River Shores have taken funds from the reserve account to pay their pension debts. Hollywood took $7.3 million out of the emergency fund to pay off its pension obligations, leaving only $2 million in the fund (Burnett 2011). Indian River Shores borrowed $250,000 from its emergency fund to assist in closing its budget gap (Begley 2012a). Other municipalities, such as St. Petersburg, have also considered shortening the budget gap by dipping into reserve funds. Reducing their reserve accounts for pension payment might be particularly risky for Florida cities located near a coast that might need funding for hurricane or weather-related emergencies.

B. Reductions in Other City Services

Having to spend a larger portion of the budget on pensions means having less money for other services. Miami-Dade county is a case in point. Its budget gap became so large that layoffs and increased pension-related reforms were unable to eliminate the shortfall, so they had to take more drastic measures. There was a proposal to eliminate 1,300 county jobs, close 13 libraries, eliminate two fireboats, and cut the budgets to county commissioners by 10% (Brannigan & Haggman 2011). Hollywood has also considered reducing other city services by using $200,000 in grants used to fund local food banks and after school programs to minimize the budget gap (WIOD-AM Local News 2011).

Layoffs are another option for local governments to reduce other city services and make up for budget shortfalls, which may be caused in part by underfunded pension plans. For example, Hollywood laid off 17 police officers, 18 staffers, and 16 other employees in the commissioner's office (O'Matz 2011; Alanez 2011). North Miami has laid off 22 full-time employees, 17 part-time employees, as well as additional police officers (Green 2011). These layoffs may be just the beginning if budget shortfalls are not reduced or eliminated.

C. Increasing Taxes

Another option available for municipalities facing funding shortfalls for required expenses such as pension obligations is to raise taxes. This option has been chosen by a few of the previously mentioned municipalities, including Hollywood, which raised property taxes by 11% in 2010, and the city has considered raising them once again to assist in paying off the budget shortfall (Figueroa 2011). Other municipalities have proposed these changes as a solution to the shortfall if no other concessions are available.

D. Consolidating Departments or Contracting Out Services

A more extreme measure that municipalities can make is closing the public safety stations and pension plans, then contracting services out to a different local government. Contracting out or consolidating services is a fairly common approach to reducing municipal budgets. East Naples, Sarasota and Venice have considered consolidating the police and sheriff's departments, or contracting out fire services to other local governments. However, these actions, particularly for fire and police services, can have some bearing on jobs, response times, and the safety of the community. A recent example of a city contracting out fire services is Belleair Bluffs which is now contracting out fire services from Largo (Ayers 2012a). The city could no longer afford to have a fire department within their city and also had to close the pension system. The city was unable to negotiate the pension into the contract they signed with Largo, and the amount due to close the pension is $2.63 million, while they only have $1.25 million (Ayers 2011). The city's dispute with the fire pension board over payoffs was referred to a state judge.

E. Bankruptcy

The final, and most devastating, option a city has to eliminate debt is Chapter 9 Bankruptcy.[7] Chapter 9 Bankruptcy provides relief for municipal entities and assists them in restructuring their debt.[8] Florida is one of 24 states that authorize municipal bankruptcy upon state approval, and specific authorization by the Governor.[9]

7 Over 141 municipalities have filed for Chapter 9 since 1980, some notable examples are: Jefferson County, Alabama (2011); Boise County, Idaho (2011); Washington Park, Illinois (2009); Westfall Township, Pike County, Pennsylvania (2009); Vallejo, California (2008); Gould Arkansas (2008); Moffett, Oklahoma (2007); Los Osos, California (2006); Milport, Alabama (2005); Desert Hot Springs, California (2001); Prichard, Alabama (1999); Orange County, California (1994); Hamilton Creek Metropolitan District, Summit County, Colorado (1989).

8 Municipalities cannot be forced into chapter 9, nor be forced to liquidate assets, does it not provide protection for collective bargaining agreements or retiree benefit guarantees, though many state constitutions require municipalities to meet their pension obligations (Curriden 2011).

9 Chapter 9 bankruptcy, FL. Stat. 218.01 Authority to accept benefits of bankruptcy acts: "For the purpose of rendering effective the privilege and benefits of any amendments to the bankruptcy laws of the United States that may be enacted for the relief of municipalities, taxing districts and political subdivisions, the state represented by its legislative body gives its assent to, and accepts the provisions of any such bankruptcy laws that may be enacted by the Congress of the United States for the benefit and relief of municipalities, taxing districts and political subdivisions and its several municipalities, taxing districts and political subdivisions, at

While municipal bankruptcy has not been an issue in Florida to date, Reuters placed Miami on a list of U.S. cities set to enter the default danger zone. The listing includes "major cities and counties in danger of defaulting on their debt," and it is noted that one of the reasons for being on the danger list is "low reserves and high pension obligations" (Connor 2012).

Prichard, Alabama is an example of a city geographically close to Florida that has undergone Chapter 9 bankruptcy. Prichard filed for bankruptcy in 2009 because of its inability to pay pension obligations. Instead of engaging in massive pension and non-pension related changes in order to fulfill its pension obligations, the city was left resorting to bankruptcy. Due to the complete depletion of funds in the pension fund, the city stopped sending 144 retirees pension checks (equating to $140,000 per month). This problem was further exacerbated by an economy that was not producing jobs, so the retired were faced with having to rely on family or friends for support. Even more of a problem was that some of these individuals were too young to collect either Social Security or Medicare (Cooper & Walsh 2010).

Central Falls, Rhode Island also filed for bankruptcy, but was placed under receivership in 2010. This city of 19,000 is headed for bankruptcy because it promised retired police and fire employees millions of dollars in pension benefits that it is unable to afford. However, instead of eliminating payment of these individuals, like Prichard, retirees were asked to give back a large portion of their pensions, or risk losing them entirely (Walsh & Zezima 2011).

There is much that can be learned about bankruptcy filings by looking at Prichard and Central Falls. Most importantly, local governments need to take action to address unsustainable pension obligations before it is too late. Bankruptcy results in uncertainty for everyone, from retirees to bond holders, and is the last available option for local governments that have not taken steps to minimize budget shortfalls.

the discretion of the governing authorities thereof, may institute and conduct and carry out, by any appropriate bankruptcy procedure that may be enacted into the laws of the United States for the purpose of conferring upon municipalities, taxing districts and political subdivisions, relief by proceedings in bankruptcy in the federal courts."

4 Conclusion

The LeRoy Collins Institute and Florida TaxWatch have documented the perilous financial positions of around one-third of Florida's municipal pensions. Many of these cities have recognized their funding problems and are taking action to address their pension costs. A review of media accounts of the issues being dealt with by local governments shows that Florida cities are taking a number of different approaches, and some are dealing with the consequences of addressing the issue late in the game.

There are both direct and indirect actions that municipalities can take to adequately fund their pension systems. Direct actions include increasing contributions of employees, eliminating or reducing cost-of-living adjustments, reworking the formula for calculating the average final compensation, switching to a defined contribution plan, making changes in the DROP program and declaring financial urgency as a way to reopen union contract negotiations. Indirect actions include restricting salary increases, cutting pay and limiting the availability of overtime and sick pay. Cities can also raise taxes, contract services out to other governments, reduce other services, or borrow from their reserve funds. At its most extreme, a city could even declare bankruptcy. The consequences of these actions range in severity. However, the good news is that many Florida municipalities have realized that there is a problem and are attempting the first steps in eliminating the problem prior to it becoming irreversible or adversely affect the economic well-being of the municipality and its citizens.

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ABOUT FLORIDA TAXWATCH

As an independent, nonpartisan, nonprofit taxpayer research institute and government watchdog, it is the mission of Florida TaxWatch to provide the citizens of Florida and public officials with high quality, independent research and analysis of issues related to state and local government taxation, expenditures, policies, and programs. Florida TaxWatch works to improve the productivity and accountability of Florida government. Its research recommends productivity enhancements and explains the statewide impact of fiscal and economic policies and practices on citizens and businesses.

Florida TaxWatch is supported by voluntary, tax-deductible memberships and private grants, and does not accept government funding. Memberships provide a solid, lasting foundation that has enabled Florida TaxWatch to bring about a more effective, responsive government that is accountable to the citizens it serves for the last 33 years.

More information at: http://floridataxwatch.org

ABOUT 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 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.

The Collins Institute has published three reports on municipal pensions in the state. All publications from the Institute can be found on the Institute's website: http://CollinsInstitute.fsu.edu

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The findings in this Report are based on the data and sources referenced. Florida TaxWatch research is conducted with every reasonable attempt to verify the accuracy and reliability of the data, and the calculations and assumptions made herein. Please feel free to contact us if you feel that this paper is factually inaccurate.

The research findings and recommendations of Florida TaxWatch do not necessarily reflect the view of its members, staff, or Board of Trustees; and are not influenced by the individuals or organizations who may have sponsored the research.

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STATEMENT ON THE COLLINS INSTITUTE REPORT ON MUNICIPAL PENSIONS BY AFSCME FLORIDA COUNCIL 79 TO THE HOUSE GOVERNMENT OPERATIONS SUBCOMMITTEE

Public employees all across the state appreciate the investments that our elected representatives and leaders have made in assuring that our service to the public is productive and responsible. We especially appreciate their long-standing commitment that we will be able to enjoy our retirements and not be a financial or social burden to future taxpayers.

The Collins Institute report has raised important concerns that rightfully deserve a response. We appreciate the scholarship and we want everyone to know the important contexts in which people in public service labor.

- **We chose these careers for service, not for enrichment.**
- **We are the first to step into harm's way in many locations, and we do so willingly.**
- **We work 24/7/365 providing the safety and security a free society expects.**
- **We do not want to be a burden to others when we leave the workforce.**
- **We expect to be paid less than others.**
- **We accept the criticism that comes with service.**
- **We are the ones who receive and respond to 911 calls.**

We would ask all parties that have reviewed the "Trouble Ahead" research report to consider an additional perspective on the matters it measures and discusses:

1. Raising the minimum retirement age does real damage to those in first response professions who do not have office jobs. By law, these jobs place a premium on physical agility and stamina. These qualities naturally decline over time and continuation of a career in such circumstances serves no one well. In addition to public safety personnel, many of these employees work in industrial-type occupations where the risk of injury or death is heightened. Lengthening the time to retirement also suppresses the replenishment of the workforce. This itself only adds to the costs of promised benefits as longer serving workers do not leave the workforce.

2. Reducing the annual leave factor in the calculation of a retirement benefit is not as universal as the report suggests. In many cases these hours are earned because the employer is so short staffed that overtime is the natural result. Remember also that it is the employer that requires overtime, not the employee. It would be better if this report advocates for reduced overtime hours, thus putting staffing where it needs to be. That is the surest way to reduce overtime costs, both immediate and deferred, and to make certain the fatigue of repetitive back-to-back shifts is removed from the workplace as best as possible.

For more information contact AFSCME Legislative Director Doug Martin at (850) 212-7447 or dmartin@afscmefl.org

3. The "subsidization" of health care benefits is simply a recognition that retirees will be heavily exposed to out-of-pocket health care costs when they leave the coverage of their employer's workplace policy. For thousands of retirees these "subsidies" make the difference between making it through the end of the month, or food stamps, or Medicaid. To put it another way: the average monthly retirement benefit of an FRS employee is equal to family health insurance premiums before Medicare eligibility. When wages can outpace costs then every employer and employee will have done a good day's work. We are not even close to that day yet.

4. We already have statutes that permit the pooling of public employer health care risks and services. Few local governments utilize these laws and it is a fair question why more do not use the economies of scale that such an approach would provide. We would support any serious review that allows employers, employees, and taxpayers to get the best and most accessible services at a fair cost. We do not know if state oversight is needed, as the Institute recommends, but we think a commitment to fact-finding is the first step.

5. We have always supported the maintenance of a normal cost contribution by retirement plan sponsors. If this is not already the letter of the law, it is certainly its spirit. We also understand that in legislation being discussed this Session there are proposals to ensure that a local plan sponsor's funding of its promised retirement obligations should not allow a "creaming off" of any supplemental revenues for unrelated purposes. We have all experienced the Great Recession and there are public employees who have lost their homes, just like many others. We want our home communities to recover and prosper, we want jobs and careers to grow along with that, and we want everyone to be held to the promises that they have made.

6. We understand that there has been some creative ideas exchanged on how to address the effects of ch. 99-1 that serve the taxpayers, employers and employees equally well. We want to assure you of our support of such approaches so that the needs of all of these parties are fairly and equally addressed.

7. There are bills filed that would extend the application of *Transparency Florida* to many other jurisdictions and databases, in particular those dealing with promised benefits. Generally, these are welcome ideas but there should be no rush to implementation that could cause inadvertent sanctions along the way. We will work with all parties to assure that the taxpayers know exactly what their investment in government and public service entails. This they will always deserve.

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Government Operations Subcommittee comments

Joe Bogdahn

February 13, 2013

Our approach

Our Mission:

To transform our industry by redefining independence

Client Service Culture

- Institutional focus ($33 billion AUA)
- General consulting only
- Public Plan Experts
- Over 40 employees including dedicated Research and Performance teams
- 10 CFAs, 2 CPAs, 1 CAIA and 26 MBAs

- Accessible service model
- Fully customized solutions
- Service guarantee
- Fee transparency/cost effective
- 100% reinvested in the firm
- All inclusive fee structure

Focused Resources

Truly Independent

- Fiduciary, without exception
- No employee has license to sell product
- Hard dollar fee only
- Definitive recommendations
- Complete open architecture with vendors

Range of Stock, Bond and Blended Total Returns

Annual total returns, 1950 – 2012

	Annual Avg. Total Return	Growth of $100,000 over 20 years
Stocks	10.8%	$782,751
Bonds	6.2%	$335,627
50/50 Portfolio	8.9%	$554,754

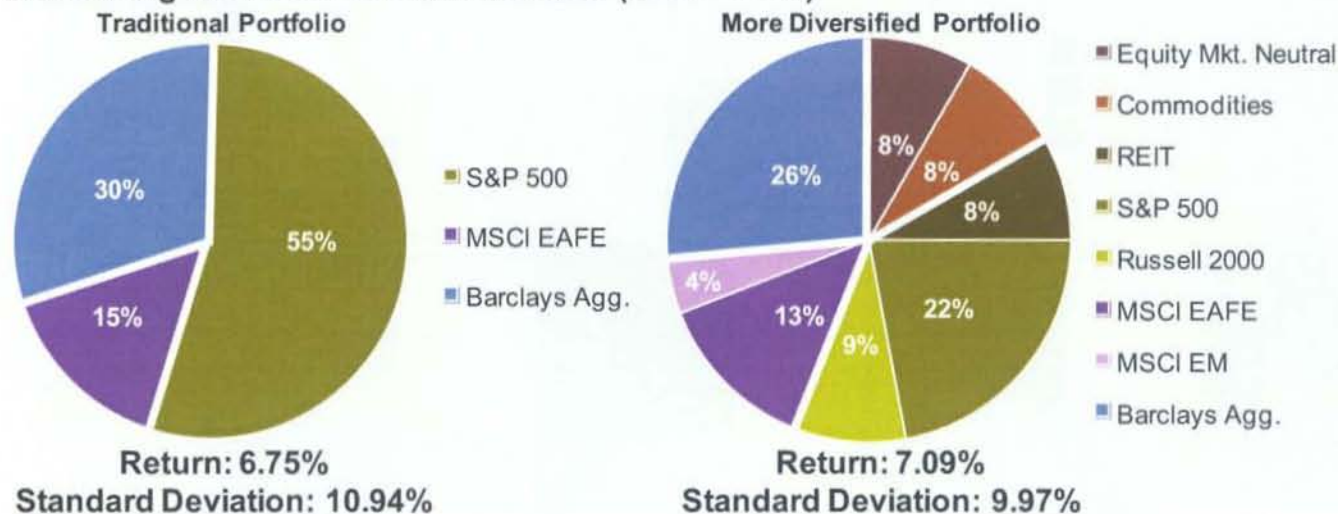
Asset Class

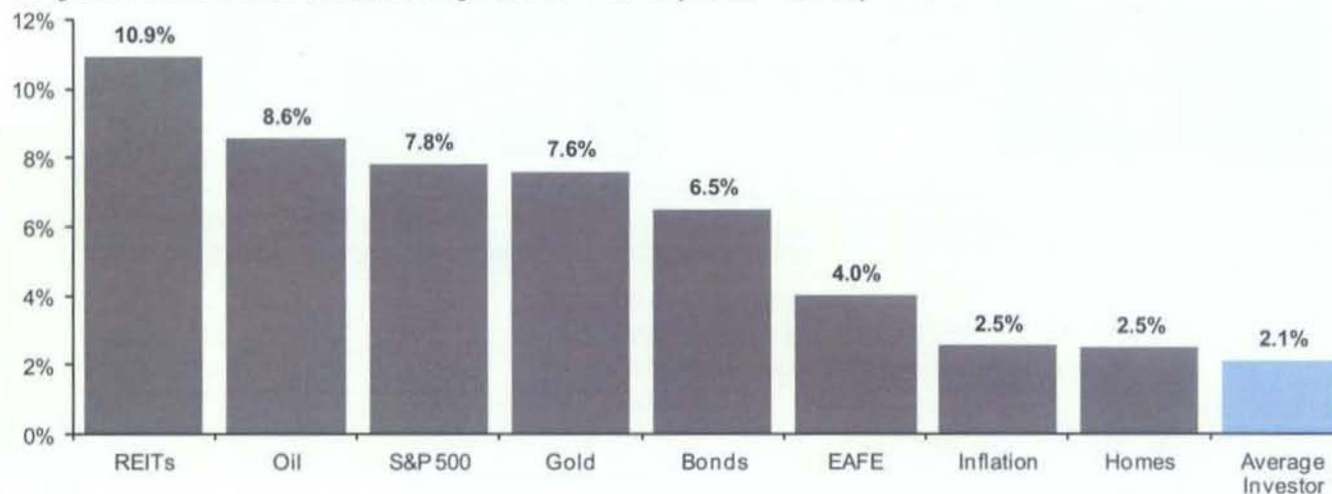
Sources: Barclays Capital, FactSet, Robert Shiller, Strategas/Ibbotson, Federal Reserve, J.P. Morgan Asset Management.

Returns shown are based on calendar year returns from 1950 to 2012. Growth of $100,000 is based on annual average total returns from 1950-2012.

Data are as of 12/31/12.

Diversification and the Average Investor





(Top) Indexes and weights of the traditional portfolio are as follows: U.S. stocks: 55% S&P 500, U.S. bonds: 30% Barclays Capital Aggregate. International stocks: 15% MSCI EAFE. Portfolio with 25% in alternatives is as follows: U.S. stocks: 22.2% S&P 500, 8.8% Russell 2000; International Stocks: 4.4% MSCI EM, 13.2% MSCI EAFE; U.S. Bonds: 26.5% Barclays Capital Aggregate; Alternatives: 8.3% CS/Tremont Equity Market Neutral, 8.3% DJ/UBS Commodities, 8.3% NAREIT Equity REIT Index. Return and standard deviation calculated using Morningstar Direct. Charts are shown for illustrative purposes only. Past returns are no guarantee of future results. Diversification does not guarantee investment returns and does not eliminate risk of loss. Data are as of 12/31/12.

(Bottom) Indexes used are as follows: REITS: NAREIT Equity REIT Index, EAFE: MSCI EAFE, Oil: WTI Index, Bonds: Barclays Capital U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Gold: USD/troy oz, Inflation: CPI. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/11 to match Dalbar's most recent analysis.

Asset Class

S&P 500 Intra-year Declines vs. Calendar Year Returns

Despite average intra-year drops of 14.7%, annual returns positive in 25 of 33 years

40%
30%
20%
10%
%
-10%
-20%
-30%
-40%
-50%
-60%

26 -10 15 17 1 26 15 2 12 27 -7 26 4 7 -2 34 20 31 27 20 -10 -13 -23 26 9 3 14 4 -38 23 13 0 13

-17 -18 -17 -7 -13 -8 -9 -34 -8 -8 -20 -6 -6 -5 -9 -3 -8 -11 -19 -12 -17 -30 -34 -14 -8 -7 -8 -10 -49 -28 -16 -19 -10

'80 '82 '84 '86 '88 '90 '92 '94 '96 '98 '00 '02 '04 '06 '08 '10 '12

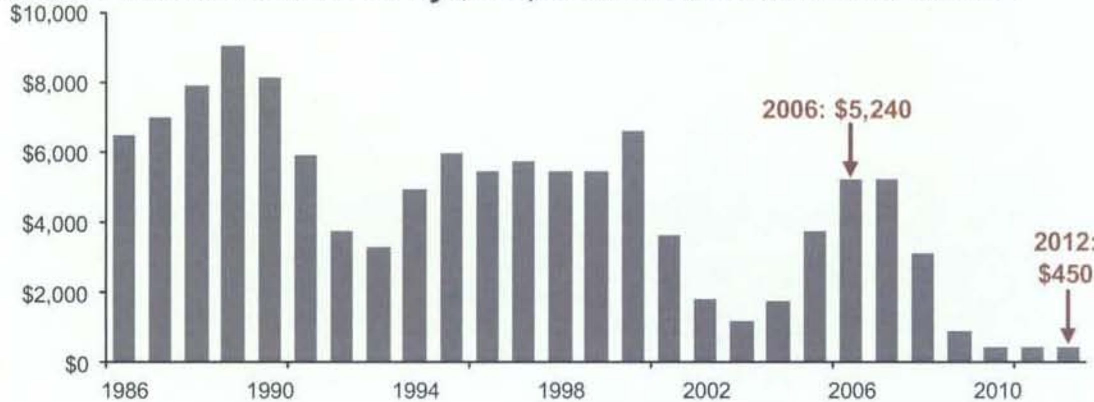
Source: Standard & Poor's, FactSet, J.P. Morgan Asset Management.

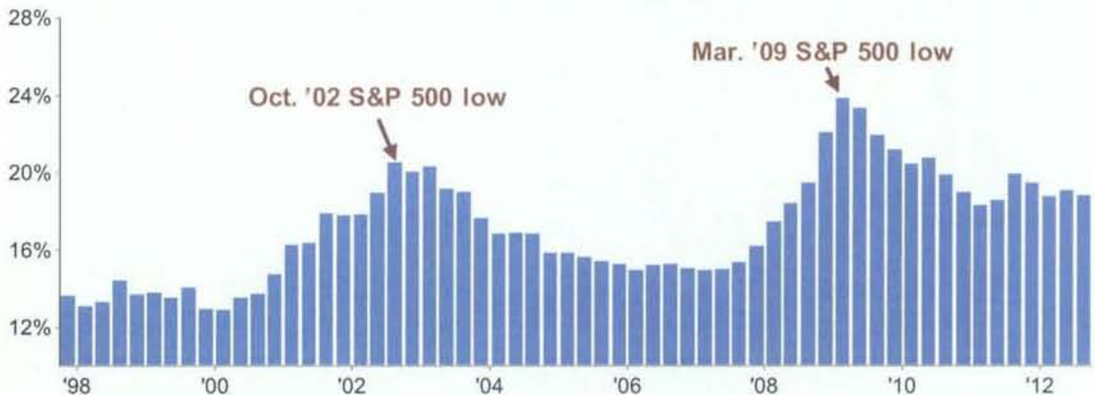
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2012.

Data are as of 12/31/12.

Asset Class

Cash Accounts





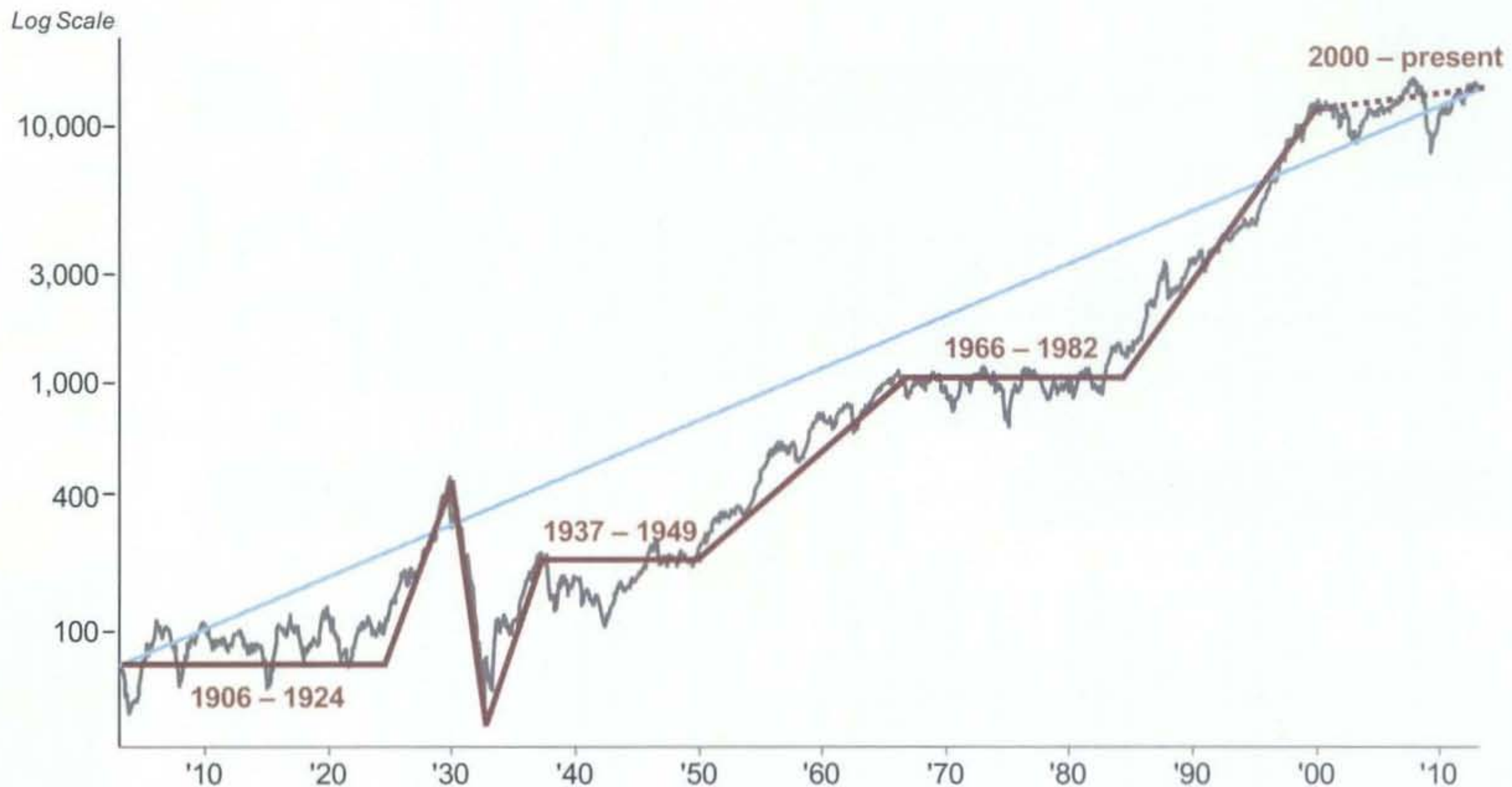
Money Supply Component	$ Billions	Weight in Money Supply
M2-M1	**7,873**	**76.9%**
Retail MMMFs	632	6.2%
Savings deposits	6,596	64.4%
Small time deposits	645	6.3%
Institutional MMMFs	**1,733**	**16.9%**
Cash in IRA & Keogh accounts	**638**	**6.2%**
Total	**10,245**	**100.0%**

Source: Federal Reserve, St. Louis Fed, Bankrate.com, J.P. Morgan Asset Management.
All cash measures obtained from the Federal Reserve are seasonally adjusted monthly numbers. All numbers are in billions of U.S. dollars.
Small-denomination time deposits are those issued in amounts of less than $100,000. All IRA and Keogh account balances at commercial banks and thrift institutions are subtracted from small time deposits. Annual income is for illustrative purposes and is calculated based on the 6-month CD yield on average during each year and $100,000 invested. 2012 average income is through November 2012. IRA and Keogh account balances at money market mutual funds are subtracted from retail money funds.

Past performance is not indicative of comparable future results.

Data are as of 12/31/12.

The Dow Jones Industrial Average Since 1900



Source: IDC, FactSet, J.P. Morgan Asset Management.

Data shown in log scale to best illustrate long-term index patterns.

Past performance is not indicative of future returns. Chart is for illustrative purposes only.

Data are as of 12/31/12.

Asset Class

Historical Return Comparison

Trailing Return Comparison
30 Years Ended September 2012

	1 year	3 years	5 years	10 years	15 years	20 years	25 years	30 years
Russell 3000 (DEQ)	30.20%	13.26%	1.30%	8.49%	4.95%	8.66%	8.69%	11.31
MSCI EAFE (IEQ)	14.33%	2.59%	-4.77%	8.69%	3.78%	5.94%	4.76%	10.26
Barclays U.S. Aggregate (FIX)	5.16%	6.19%	6.53%	5.32%	6.15%	6.34%	7.47%	8.39
50/10/40 DEQ/IEQ/FIX	17.88%	9.50%	3.63%	7.76%	5.93%	8.00%	8.25%	10.49

9/30/XX Fiscal Year Annual Return Comparison
15 Years Ended September 2012

	Sep 2012	Sep 2011	Sep 2010	Sep 2009	Sep 2008	Sep 2007	Sep 2006	Sep 2005	Sep 2004	Sep 2003	Sep 2002	Sep 2001	Sep 2000	Sep 1999	Sep 1998
Russell 3000 (DEQ)	30.20%	0.55%	10.96%	-6.42%	-21.52%	16.52%	10.22%	14.57%	14.26%	25.92%	-18.82%	-27.91%	18.19%	26.32%	4.64
MSCI EAFE (IEQ)	14.33%	-8.94%	3.71%	3.80%	-30.13%	25.38%	19.65%	26.32%	22.52%	26.54%	-15.26%	-28.27%	3.43%	31.32%	-8.08
Barclays U.S. Aggregate (FIX)	5.16%	5.26%	8.16%	10.56%	3.65%	5.14%	3.67%	2.80%	3.68%	5.41%	8.60%	12.96%	6.99%	-0.37%	11.50
50/10/40 DEQ/IEQ/FIX	17.88%	1.88%	9.32%	4.23%	-12.67%	12.86%	8.53%	10.92%	11.26%	16.91%	-7.31%	-12.31%	12.77%	15.55%	6.09

9/30/XX Fiscal Year Annual Return Comparison
15 Years Ended September 1997

	Sep 1997	Sep 1996	Sep 1995	Sep 1994	Sep 1993	Sep 1992	Sep 1991	Sep 1990	Sep 1989	Sep 1988	Sep 1987	Sep 1986	Sep 1985	Sep 1984	Sep 1983
Russell 3000 (DEQ)	38.67%	19.02%	29.31%	2.55%	16.54%	11.43%	34.36%	-12.51%	31.31%	-11.28%	37.77%	31.14%	14.61%	1.00%	47.93
MSCI EAFE (IEQ)	12.49%	8.94%	6.11%	10.11%	26.75%	-6.78%	22.31%	-27.39%	22.60%	-0.59%	45.22%	90.45%	41.27%	9.46%	36.93
Barclays U.S. Aggregate (FIX)	9.74%	4.88%	14.07%	-3.23%	9.98%	12.56%	15.99%	7.55%	11.26%	13.30%	0.26%	20.28%	22.02%	8.78%	15.59
50/10/40 DEQ/IEQ/FIX	24.37%	12.37%	20.90%	0.98%	15.13%	10.16%	25.41%	-6.15%	22.56%	-1.98%	23.45%	32.61%	20.29%	4.85%	32.85

FLORIDA

Key Findings

Benefits paid by state and local pension plans support a significant amount of economic activity in the state of Florida.

Pension benefits received by retirees are spent in the local community. This spending ripples through the economy, as one person's spending becomes another person's income, creating a multiplier effect.

In 2009, expenditures stemming from state and local pensions supported...

- 91,741 jobs that paid $3.9 billion in wages and salaries
- $11.8 billion in total economic output
- $1.6 billion in federal, state, and local tax revenues

... in the state of Florida.

Each dollar paid out in pension benefits supported $1.64 in total economic activity in Florida.

Each dollar "invested" by Florida taxpayers in these plans supported $4.47 in total economic activity in the state.

National Institute on Retirement Security

Pensionomics 2012:

Measuring the Economic Impact of DB Pension Expenditures

Overview

Expenditures made by retirees of state and local government provide a steady economic stimulus to Florida communities and the state economy. In 2009, 360,065 residents of Florida received a total of $7.2 billion in pension benefits from state and local pension plans.

The average pension benefit received was $1,668 per month or $20,011 per year. These modest benefits provide retired teachers, public safety personnel, and others who served the public during their working careers income to meet basic needs in retirement.

Between 1993 and 2009, 36.74% of Florida's pension fund receipts came from employer contributions, 2.15% from employee contributions, and 61.11% from investment earnings.* Earnings on investments and employee contributions—not taxpayer contributions—have historically made up the bulk of pension fund receipts.

Impact on Jobs and Incomes

Retiree expenditures stemming from state and local pension plan benefits supported 91,741 jobs in the state. The total income to state residents supported by pension expenditures was $3.9 billion.

To put these employment impacts in perspective, in 2009 Florida's unemployment rate was 10.2%. The fact that DB pension expenditures supported 91,741 jobs is significant, as it represents 1.0 percentage points in Florida's labor force.

Economic Impact

State and local pension funds in Florida and other states paid a total of $7.2 billion in benefits to Florida residents in 2009. Retirees' expenditures from these benefits supported a total of $11.8 billion in total economic output in the state, and $7.0 billion in value added in the state.

$5.4 billion in direct economic impacts were supported by retirees' initial expenditures. An additional $3.2 billion in indirect impact resulted when these businesses purchased additional goods and services. $3.3 billion in induced impacts occurred when employees hired by businesses as a result of the direct and indirect impacts made expenditures.

Total Economic Impact $11.8 billion

DIRECT IMPACT $5.4 billion	INDIRECT IMPACT $3.2 billion	INDUCED IMPACT $3.3 billion

Totals may not add up exactly due to rounding. For more information on the data and methodology used for these estimates, please refer to Boivie, I. 2012. *Pensionomics: Measuring the Economic Impact of DB Pension Expenditures.* Washington, DC: National Institute on Retirement Security. www.nirsonline.org

Economic Multipliers

*Caution should be used in interpreting these numbers. See the Technical Appendix of the full Pensionomics report for details.

Impact on Tax Revenues

State and local pension payments made to Florida residents supported a total of $1.6 billion in revenue to federal, state, and local governments. Taxes paid by retirees and beneficiaries directly out of pension payments totaled $120.9 million. Taxes attributable to direct, indirect and induced impacts accounted for $1.5 billion in tax revenue.

Federal Tax	961.2 million
State/Local Tax	635.3 million
Total	**$1.6 billion**

Economic Impacts by Industry Sector

The economic impact of state and local pension benefits was broadly felt across various industry sectors in Florida. The ten industry sectors with the largest employment impacts are presented in the table below.

Industry	Employment Impact (# Jobs)	Labor Income Impact	Value Added Impact	Output Impact
Food Services and Drinking Places	7,191	$184,570,067	$259,793,601	$480,562,278
Real Estate Establishments	6,058	$91,836,596	$687,208,565	$948,508,072
Physicians, Dentists, and other Health Practitioners	4,517	$333,819,040	$355,972,179	$602,385,762
Private Hospitals	4,472	$289,370,718	$308,885,619	$645,044,165
Nursing and Residential Care Facilities	3,902	$141,766,479	$153,019,152	$260,167,573
Private Household Operations	2,670	$20,431,103	$20,431,103	$21,185,968
Retail Stores - Food and Beverage	2,014	$62,526,449	$101,167,107	$115,605,000
Securities, Commodity Contracts, and Investments	1,980	$75,052,204	$83,889,880	$102,945,583
Wholesale Trade Businesses	1,961	$147,780,970	$255,529,495	$349,479,658
Retail Stores - General Merchandise	1,880	$56,274,358	$91,534,187	$104,027,056

Industry totals include impacts from in-state pension payment only, and do not account for the recaptured "leakage" impacts from other states.

DISCLOSURES

- Pages 3-7 sourced from JPMorgan's Market Insights 1Q 2013
- Page 8 uses index data provided by Russell, MSCI and Barclays

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Alaska Association of Chiefs of Police

Position Paper: Recruitment and Retention of Police Officers in Alaska

I. Recruitment Background: A Professional Perspective

Across the country, the law enforcement profession has experienced ever-increasing difficulties in attracting and retaining qualified personnel to serve as police officers in our communities. Unfortunately, this nationwide trend is being strongly felt in Alaska as well.

Twenty years ago, it was quite common to advertise for an entry-level police officer and have literally *hundreds* of applicants arrive to compete for a single position. Today, it is not uncommon to receive only a few dozen applicants, most of which are quickly eliminated through the initial testing and screening processes. One need only look at the most recent class of the Alaska State Trooper Academy, where fourteen (14) recruits began training, *but only five (5) Trooper Recruits graduated.*

The demands placed upon today's modern police officer make this one of the most difficult professional positions for an individual to attain. In almost any other career field, if one is willing to make a commitment of time and money for education and training, one can pursue the goal of their choosing. For instance, if one wants to be doctor or a lawyer badly enough, they can pursue student-loans, work to receive the appropriate education, and achieve their professional goals. This is not the case in law enforcement.

No matter how passionately one wants or desires to become a police officer, most will not possess the combination of skills, personality traits, and ethics/integrity necessary to successfully complete the comprehensive battery of academic, physical, and psychological testing employed through agency selection processes. These tests and evaluations, combined with comprehensive background investigations and truth-verification measures, preclude the vast majority of applicants from ever achieving employment as a sworn officer.

The flip-side, of course, is that there are those rare individuals who indeed possess the requisite combination of skills, personality traits, and demonstrated ethics/integrity necessary to pass a comprehensive selection-process. These applicants are considered "golden," and will quickly find themselves in a very enviable position as Federal, State, and local law enforcement agencies all vigorously compete to quickly attract and employ the prospective recruit before another agency can lure them away with a more attractive offer.

Working within the context of this incredibly competitive environment, all factors comprising an "offer of employment" must be carefully considered. In addition to basic wages, one of the most critical factors considered by the prospective recruit is that of retirement-system benefits offered pursuant to employment. In this respect, the State of Alaska has dealt a critical blow to law enforcement recruitment through the creation of "Tier IV" in the Public Employee Retirement System (PERS), in which defined retirement benefits for newly-hired police officers were eliminated.

II. PERS: A Recent History of Law Enforcement Retirement in Alaska

As is the case with nearly all states, Alaska offers a system of retirement and health benefits for its employees. This is known as the *Public Employee Retirement System,* commonly referred to by its acronym: PERS. As is also common, the PERS system is not restricted solely to State employees. Many of Alaska's municipalities participate in the PERS system, most often used for the inclusion of Peace Officers and Firefighters.

Consistent with the rest of the nation, PERS recognized early-on that employment as a Peace Officer or Firefighter is far different from most other jobs. Numerous factors supporting such an assertion include:

- Significantly elevated dangers and risk-factors associated with police work and firefighting;
- Necessity for shift-work designed to provide 24/7 coverage, resulting in significant disruption to personal and family life;
- Necessity for police employees to operate at levels of "hyper-vigilance" for extended periods of time, resulting in long-term health stressors;
- Necessity for Firefighters to rapidly transition from sleep to high-stress environments over extended time periods, resulting in these same long-term health stressors

In recognition of these factors, nearly all state retirement systems formulated and entered into a "social compact" with their prospective police officers and firefighters. In exchange for the employee risking their lives on a daily basis, turning their personal and family lives upside down, and absorbing the tremendous physical, emotional, and psychological toll that comes with such employment, the state systems agreed to extract (and match) a larger portion of the employee's monthly paycheck, thus allowing the Peace Officer/Firefighter to achieve a full retirement in twenty (20) years. Once this twenty-year goal was reached, the Peace Officer/Firefighter was secure in the knowledge that they could now enjoy a defined benefit in retirement, acknowledging their career of service and sacrifice to their communities.

While the above-referenced system was developed and implemented in the State of Alaska via PERS in 1961, the retirement benefits afforded to Peace Officers and Firefighters have steadily eroded over time:

- **Tier I:** Peace Officers hired between PERS inception and June 30th of 1986 fall under the "first tier" of PERS employees. Peace Officers in this group achieved a full

defined-benefit monthly retirement payment upon completion of twenty years continuous service, regardless of age. The retirement benefit was calculated based upon the employee's highest consecutive three-year period of earned wages. Tier I recipients also receive full medical coverage upon retirement, with health-insurance premiums paid by the retirement system. Additionally, Tier I recipients receive an additional 10% cost-of-living allowance (COLA) if they reside in Alaska.

- **Tier II:** Peace Officers hired between July 1, 1986 and June 30, 1996 fall under the "second tier" of PERS employees. A defined-benefit monthly retirement payment is still available upon completion of twenty years continuous service, and the benefit is still derived using the "high three years" salary calculation. However, medical coverage is *not* paid for by the retirement system prior to age 60, unless the Tier II employee works for an additional five years (for 25 years total service). Additionally, the 10% Alaska COLA is not paid for in-state residents until the retiree reaches 65 years of age.

- **Tier III:** Peace Officers hired between July 1, 1996 and June 30, 2006, fall under the "third tier" of PERS employees. A defined-benefit monthly retirement payment is still available upon completion of twenty years continuous service, but the benefit formulation was changed to average the highest five years of earned wages, rather than three. Retiree medical coverage under this tier is still not paid for unless the retiree worked for an extra five years (25 total), and the 10% resident COLA is not received until the retiree reaches 65 years of age.

- **Tier IV:** For Peace Officer hired after July 1st, 2006, there is no longer a defined monthly retirement benefit that can be counted on by the prospective retiree. Under this "fourth tier," the PERS system simply matches a portion of the employee's 8% salary contribution, which the employee then invests through self-directed action. Retiree medical coverage is based upon Medicare eligibility with retirees paying a differential percentage of the required premium. If ineligible for Medicare, and/or having exhausted any HRA allowances contributed by the State of Alaska, the retiree will then be responsible for all health-care premiums. Additionally, there is no longer any COLA benefit.

As previously referenced, the creation of this last "Tier IV" in PERS has created a significant impediment to effective police recruiting in Alaska. With many police departments throughout the nation offering defined-benefit retirement plans for officers completing twenty years of service, often with higher-percentage benefit calculations and significantly-increased health benefits, one would wonder why any young officer who was looking to provide for their family and future would look to Alaska as a first (or even second/third) choice for meaningful employment.

III. The Issue of Retention

Perhaps just as important as the issue of initial recruitment is that of long-term employee retention. Any police chief will tell you that a five-year police employee represents an *enormous* investment in initial screening, hiring, training, placement, personalized equipment, and derived local knowledge and experience. The cost of continuously replacing such employees can be staggering for the police agencies involved. Additionally, the experience and heightened performance that a community receives from seasoned police officers being perpetually replaced by far more ineffective and inefficient junior officers imposes a far greater "community cost" that is often unacknowledged, and rarely quantified.

By moving from a defined-benefit retirement system to a truly portable, "401K-type system," the new Tier IV of PERS literally begs its forward-thinking participants to seek greener pastures. By offering such portability, there is no longer an incentive for an Alaskan police officer to remain within our state. Under prior tiers in PERS, a police officer who had vested in the system would rarely consider moving outside of Alaska, as their PERS time would not transfer to other systems. As such, agencies could feel quite comfortable that their considerable investments in time and training were relatively secure once an employee had vested. This safety-net for police administrators has now been removed. All sworn peace officers who have been hired after July 1, 2006 must now be regarded as a transitory resource, capable (and highly likely) to pick up and leave at a moment's notice once a better employment opportunity is identified. Given the documented "generational-shift" that has occurred with today's young people, (who are likely to change jobs and residential locations at a far greater frequency than their predecessors) this poses an issue of significant concern.

IV. The Position of AACOP on Tier IV PERS Retirement

In light of the above history regarding the evolution of PERS, and in consideration of the factors affecting recruitment and retention as explored above:

It is the official position of the Alaska Association of Chiefs of Police, comprised of approximately 70 Executive Law Enforcement Officers representing police departments and agencies throughout Alaska, that:

- *AACOP feels the Alaska State Legislature seriously erred in creating a "fourth tier" in PERS, thereby depriving law enforcement officers hired after July 1st, 2006, of a defined-benefit retirement.*

- *AACOP has significant concerns that continuation of such detrimental public policy will continue to pose serious recruitment and retention problems for law enforcement in Alaska. This will likely result in protracted and severe staffing shortages, jeopardizing the safety of our communities.*

- *AACOP has significant concerns that, due to these predicted staffing shortages, police agencies will come under increasing pressure to lower entrance and retention standards, thus placing a lower-quality police presence on the street.*

- *AACOP has significant concerns that, due to the creation of portable retirement accounts under Tier IV, police officers will be far more difficult to retain in the State of Alaska.*

- *AACOP has significant concerns that a portable retirement account under Tier IV will make it virtually impossible to attract and recruit police recruits and veteran law enforcement officers from outside the State of Alaska.*

- *AACOP further recognizes that rapid escalation in health-care costs must be addressed, and that components of retiree health-care coverage may have to be separated from a defined-benefit retiree payment in some fashion in order to reach a workable solution.*

This position-paper by the Alaska Association of Chiefs of Police was authored and endorsed by the AACOP President and Executive Board in December of 2008.

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Tom Clemons, President
Alaska Association of Chiefs of Police

Alaska Public Pension Coalition

The Alaska Public Pension Coalition is leading the fight to return Alaska's public employees to a defined benefit retirement system.

January 24, 2013

Senator Egan Introduces Senate Bill 30, Retirement Choice for Public Employees

Today (January 22, 2013) Senator Dennis Egan, D-Juneau, introduced Senate Bill 30, which allows teachers, firefighters, troopers and other public servants to choose between two Alaska retirement systems: paying into the current 401(k)-style defined contribution accounts or earning a defined benefit pension. The legislation creates a new, more predictable pension tier for public employees.

"This bill is cost-neutral, and it gives people a choice," said Senator Egan. "Teachers and public employees will put more of their pay into the system than the old pension tiers. Also, most employees will have to be eligible for Medicare before the system helps pay for retiree health care and they'll always pay a share of those insurance premiums."

Senator Egan expects the law to save the state $40 million in the first five years and be cost-neutral over the long term because it splits the risk of rising health care costs between the employer and the employee so the new tier never costs more than the current defined contribution system. Additionally, since most Alaska teachers and public employees can't earn the defined benefit of Social Security, it gives them a chance to choose a safety net similar to the private sector.

"It gives employees the right to choose: some prefer flexibility, but for others, a secure retirement will help keep them in Alaska," said Senator Egan, noting that pensions are responsible for $1.4 billion in Alaska's economy each year. "Without the incentive to stay and build a life in Alaska, we'll lose our best and brightest to the Lower 48, where public servants earn pensions."

A defined benefit pension takes time to earn, but rewards a record of public service by paying a guaranteed monthly benefit and, for long-term employees, health insurance. An individual defined contribution account is portable from one employer to another, and flexible in how it can be used, but comes with no guarantees.

"The bill is a win-win," said Senator Egan. "The State saves money, while creating incentives for teachers, troopers, firefighters and other public servants to stay and keep their talents – and their retirement money – right here in Alaska."

For more information, please contact Jesse Kiehl in Senator Egan's office at (907) 465-4947.

Link to the latest full-text version of the bill.

Posted at 12:22 PM | Permalink

Alaska Public Pension Coalition

The Alaska Public Pension Coalition is leading the fight to return Alaska's public employees to a defined benefit retirement system.

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October 10, 2011

Seniors at Risk in Wall Street Financed Attacks on Retirement Security

As protests on Wall Street spread across the country, the dire need for progressive solutions to financial corruption and savage inequality is capturing national attention. One aspect of Wall Street's agenda that has not been sharply criticized enough is emerging as a defining issue in the presidential campaigns of challengers to President Obama: dismantling Social Security and public pension systems. Texas Governor Rick Perry has grabbed the most headlines by absurdly characterizing Social Security as a "Ponzi scheme," and calling it a "crumbling monument to the failure of the New Deal." Other presidential candidates are also trying to stake out positions to privatize retirement funds, and state policymakers who are leading ideological attacks on workers have targeted pension funds in an effort to pit union and non-union workers against each other.

News from last week reveals that attacks on retirement funds are not just deceptive, but are actually a major front in the overall push to privatize public assets and dismantle government. Think Progress and Huffington Post both reported on how the US Postal Service's financial woes were engineered intentionally by conservatives to cripple USPS financially and force privatization. At the same time, several sources reported that many conservative state lawmakers currently pointing the finger at workers are themselves among the worst abusers of state pensions.

In fact, the major charges laid against pension plans — and government workers in general — are either exaggerated or invalid. Public employees are actually paid less than their private sector counterparts when comparable experience and education levels are taken into account, including pensions and other benefits. Beyond the cost of personnel, pension funds actually cost state governments very little, since the costs of managing them are paid for out of the funds' earnings and, in any case, are far lower than the fees charged by private sector fund managers. The much-touted problem of pension fund shortfalls was a short-term result of the stock market collapse, and by February 2011 many had already recovered.
Major finance companies like AIG, American Express, and Morgan Stanley have invested millions in the Cato Institute and other think tanks to undermine public faith in Social Security and pensions. Cato, Heritage, and others do so by using unrealistically low estimates of pension fund growth rates in order to paint problems that don't exist. For instance, an Ohio think tank grossly exaggerated employment costs by using a 4% rate of return for pension fund growth, when in fact Ohio's funds have grown at a rate more than double that (8.99%) over the last thirty years. It is particularly important to remember that the state budget crises that have fueled the fire of pension-cutting are the result of plummeting revenues, not states' expenses.

There is a need to reform rules that encourage employees to pad their wages with overtime in their final years to inflate their pension benefits. However, these are problems with the rules governing how individuals' pension benefits are determined, or with the absence of limits or controls on overtime. Even so, the vast majority of

pensioners receive modest benefits, averaging around $24,000 per year. For some 30% of those retirees, that modest amount is the only source of retirement income because they were ineligible for Social Security.

Not only are claims of widespread fraud and abuse generally based on individual examples that are rare rather than the norm; the worst abuses are typically committed by management — or high-level officials — including conservative policymakers themselves. For instance, of the seventy Ohio House and Senate officials who voted for legislation this year to strip public servants of collective bargaining rights, nearly all awarded themselves part-time salaries almost double what most of the state's nurses, teachers, and firefighters take home for full-time work. Twelve of those legislators are also "double-dippers," collecting a state pension in addition to their legislative salary, including House Speaker Bill Batchelder who receives a $100,000 pension on top of his $94,500 salary.

Progressives need not search long for the motivations behind the pension privatization agenda. Private sector workers have increasingly been pushed into 401(k) accounts as their sole form of retirement benefits, and while the result has been disastrous for account-holders it has been highly profitable for fund managers. The United Kingdom's experience with pension privatization in the last decade has been nearly identical. Lack of transparency and more speculative investing lead to stark inequalities for retirees, and excessive management fees can amount to $70,000 or more in net deductions from each individual's account.

The prospect of similar profits to be reaped on hundreds of millions of new accounts if Social Security and state pensions are privatized is simply irresistible for Wall Street. With the very possibility of retirement security at stake — and conservatives' hypocrisy in demanding concessions from workers they are not willing to make themselves — progressive leaders don't simply have a responsibility to protect Social Security and state employees' pensions. They have strong ground to stand on in pushing back on Wall Street, and a lot of friends rising up to join them.

Source: Excerpted From: Progressive States Network 10/10/2011

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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.

<u>In Defense of DB Plans</u>:

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 retiree 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.

[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

Thoughts on LCI's September 2012 article entitled "Years in the Making: Florida's Underfunded Municipal Pension Plans"

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- The paper's underlying premise is that there IS a problem and that Florida cities are "underfunding" their plans. The only public entities that are underfunding their plans are those involved in the Florida Retirement System. Every local municipal plan makes contributions at least as large as the actuary suggests which will ultimate result in 100% funding.

- The LCI's 2011 and 2012 reports continuously reference the term "funded ratio," and even go so far as to attach letter grades to plans on this basis. Yes, we concede that nearly every local municipal plan has a funded ratio of less than 100%, and many under 80%, but is that necessarily cause for alarm?

    - Funded ratios are calculated using liabilities that have projections of salary baked into the formula. Funded ratios, therefore, do NOT indicate what percentage of the accrued benefits and resulting liabilities have been funded to date. This ratio is probably 5-15% higher than the funded ratio consistently being referenced by the LCI. Instead, the funded ratio referenced by the LCI indicates what percentage of the ultimate benefits earned from service to date (but with pay projected to retirement) can be paid for by current assets. In our opinion, and in the opinion of the Federal Government who makes the rules for determining funded status for private sector plans, using projections of salary to develop a statistic to measure a current funded ratio is invalid.
    - Additionally, many local plans haven't been around for more than 15-20 years. How many homeowners are 100% funded in their homes after 15-20 years? Would 70% funded be a horrible place to be at that point?
    - Many funds public safety plans have lower funded ratios because they have improved benefits using a mechanism of funding whereby future state premium tax revenues are earmarked to pay for current benefit improvements. So while the funded ratio may be low currently, there are future premium tax revenues earmarked to drive the funded ratio higher in the future.

- The LCI report concludes that the plan managers "tended to underestimate salary growth and overestimate the rate of return" from 2004 to 2010.
    - In our opinion, the most noteworthy comment made in their report, on page 6 states "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 fact is, most of these assumptions HAVE been accurate over the life of the fund, yet have fallen short during the short time horizon that the LCI report references.
    - Since 2010, salary increases for governmental workers in Florida have been extremely low, oftentimes near 0%, and investment returns have been extraordinary (nearly 20% in 2012). Again, over a long time horizon, the assumptions are sound.

- The LCI report states that the portion of pension contributions used to pay down the unfunded liability has risen.
    - Why is this so alarming? Isn't this a good thing? When the unfunded liability grows, I applaud any funding mechanism which requires additional monies to pay down this increased liability.
    - Additionally, in most places, contrary to what the report states, contributions by the members have also increased, although not as much as the plan's sponsor's contributions.

- The LCI report makes note of a "new troubling trend" which may be emerging where annual payouts exceed contributions.
    - This is what happens as plans mature.
        - As mentioned previously, a majority of these plans aren't anywhere near being mature, and many were initiated with a group of 100+ members and 0 retirees. Obviously these ratios will change over the next 30-50 years as plans evolve and a full life-cycle of members have passed through.
    - There is nothing "troubling" about this trend. In addition to the comment above, the plan contributions are being calculated to achieve 100% funding.
    - Actuarially funded plans do not rely on contributions from current employees to pay benefits for current retirees. This line of logic is only applicable to pay-as-you-go plans, like Social Security.

- The LCI report remarks about how asset growth has slowed by the financial crisis, and specifically mentions that "the annual growth rate between 2004 and 2010 is approximately 4.6%, far below the plans' assumed growth rates of 8 percent."
    - The 4.6% statistic being referenced is completely different than the 8.0% investment return assumption being used in actuarial valuations.
    - The 4.6% statistic is a function of investment return, but ALSO a function of contributions and benefit payments.
        - If benefit payments exceed contributions (as the LCI report points out is now the case), then investments could earn huge returns and yet the assets could see very little growth.
        - On the other hand, for plans in their infancy where contributions greatly exceed benefit outlays, the plan could earn 0% and yet the value of the assets could go up 25-50% or more.
    - The growth rate of the asset balances, again, is only applicable to pay-as-you go plans.

In closing, the LCI report is intended to cause alarm where it is not needed. It is perplexing to me that the LCI issues a report about so called "Underfunding Pension Plans" yet they seem alarmed that contributions are increasing to fund them. Local governments in Florida are making revisions to the plans as they deem necessary in order to meet budgetary constraints. Making any broad-sweeping legislative changes based upon findings in this report would be unfortunate, as once again, the LCI has missed the mark.

Senate Bill 534 Comments

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As actuaries for nearly half of all Chapter 175/185 pension funds in the State of Florida, we are offering the following comments (after meaningful discussions with other actuaries, attorneys, and professionals in the industry) regarding the proposed Senate Bill 534:

- **Premise is Inaccurate—Meaningful Disclosure Already Exists!**
    - Chapter 2011-216, Laws of Florida (SB 1128) required the Division of Retirement to develop a plan for creating a rating system. This exists on their website.
    - GASB is increasing disclosure requirements effective for fiscal years beginning after June 15, 2013, and will provide many of the same statistics requested by the Bill

- **Apples-to-Apples Comparisons of Defined Benefit Plans is Dangerous and Nearly Impossible**
    - The Bill suggests standardizing the interest rate and mortality assumptions, but doesn't mention standardizing other extremely meaningful assumptions (salary increases, termination rates, and mortality rates). This will incorrectly suggest fair comparability.
    - Because participant behavior and asset allocation vary from plan to plan, standardizing assumptions will result in incorrect conclusions
    - It is better to have no rating system at all than a materially faulty one.

- **Why Are We Marking Pension Funds to Market?**
    - Pension funds are long-term instruments used to provide retirement benefits
    - Pension funds earn a much larger long-term return than those exhibited by corporate bonds
    - GASB considered taking this approach and decided to allow a long-term expectation (often 7%-8%)

- **Implementation Will Be Administratively Costly and Confusing**
    - With the onset of GASB 67/68, two actuarial valuations will need to be performed
    - This Bill will add 25-50% to the plan's administrative costs, which will already be higher due to the onset of GASB 67/68
    - Adding SB 534 requirements to the new GASB 67/68 statistics will further confuse the public, lawmakers, and bond rating agencies

Florida Retirement Security Coalition

The Facts About Florida's Public Retirement Plans

February 2013

FLORIDA
Retirement Security
Coalition

Introduction

Retirement plans for state and local government workers affect millions of Floridians and boost the state economy. These plans directly impact about 1.2 million current or former public employees in Florida and millions of their dependents and other family members. In addition, tens of thousands of Florida businesses benefit each day when retirees spend their retirement checks on goods and services in every community in Florida.

These vital benefits are provided through the Florida Retirement System and almost 500 local government retirement plans.

The Facts About Florida's Public Retirement Plans is designed to help policymakers, business owners, and other Floridians understand how these public retirement plans work for the people and economy of our state.

Eight Key Facts About Florida's Public Retirement Plans

1. The Florida Retirement System is fiscally sound.

The Florida Retirement System (FRS) is in sound financial condition and stronger than retirement plans in almost all other states. "Compared to other states, the pension plan is better funded," concludes the Florida Legislature's office of policy analysis.[1] Florida is "a top performer when it comes

to managing its long-term pension liability," one independent study said.[2] Another ranked the FRS among the top 10 state pension systems in the U.S. in a 2011 national analysis.[3]

Some states have overburdened state retirement systems, but Florida is not one of them.

2. Public retirement plans allow Florida workers to take care of themselves after retirement and not rely on other government services.

Retired public workers don't get rich from their retirement plans. In fact, the average annual payment from the Florida Retirement System is only about $18,000.[4] But those dollars are crucial income for many Floridians after their work years are done. That money helps retired workers take care of themselves instead of relying on other government programs. Without traditional retirement plans, they run the risk of outliving their retirement savings, at a large cost to the public treasury.

3. State and local retirement plans provide important support to the state and local economies.

In 2011 the Florida Retirement System paid out about $6.7 billion in retirement payments.[5] Local government retirement systems paid out almost $2 billion more.[6] These dollars support retirees and circulate throughout the economy. That money is spent in Florida for food, clothing, housing and other necessities and supports thousands of jobs spread throughout every community in the state. Every dollar paid in public pension benefits creates $1.64 in total economic activity in Florida. And **every <u>tax dollar</u> invested in retirement plans supports $4.47 in <u>total</u> economic output** (because investment earnings and employee contributions finance the lion's share of state and local pension plans).[7]

4. Traditional retirement plans cost taxpayers less and provide greater benefits to retired workers. Closing the FRS pension plan to new workers would cost taxpayers more and deliver less to retirees.

Most members of the Florida Retirement System are enrolled in the FRS "defined benefit" (DB) plan. Retirees receive a set pension benefit based on years of service and compensation. The FRS also offers a less popular "defined contribution" (DC) plan, which provides no guaranteed payment. The contribution is defined, but not the eventual benefit, as in a 401(k).

A change recommended by some – forcing all new FRS employees into the defined contribution plan – would cost the state and local governments more money and reduce benefits to public workers. It would be an inefficient use of tax funds.

Defined contribution plans by their very nature cost more than defined benefit plans, many studies have concluded. In fact, a defined contribution plan can cost employers (and taxpayers) almost twice as much as a defined benefit plan.[8] That's because defined benefit plans take advantage of economies of scale, professional management, and long-term investment horizons unavailable to individual investors trying to manage their own accounts.

An actuarial study performed at the request of the Legislature in 2010 concluded that forcing all new employees into the FRS defined contribution plan would almost double pension debt and cost taxpayers billions of dollars more over the long run.[9]

5. Most local government retirement plans also are on sound footing.

Most of the 492 local government retirement plans, covering about 180,000 active employees and retirees,[10] are on sound footing.[11] Even a disputed report attempting to grade local retirement systems based on only two criteria provided passing grades to two-thirds of the plans.[12] Some local plans, however, face long-term funding problems. Steps have been taken or are being considered in those localities to put the plans on sounder footing. In general, shortfalls of local plans are the result of turmoil in the financial markets during the Great Recession,[13] combined in some places by underfunding of the retirement plan by the local governing body.

6. The Florida Retirement System, funded at a strong level already, would be even stronger if the Legislature had funded it at the recommended rate in past years.

For the last three years the amount necessary to fully fund the unfunded actuarial liability has not been appropriated by the Legislature. While the Legislature had difficult choices to make to balance the budget, the FRS would be even stronger and the unfunded liability lower if the Legislature had met its obligation to fully fund the UAL.[14]

Postponing payments increases pension debt and therefore requires more taxpayer contributions. It also makes the unfunded liability look larger than it otherwise would.

7. Significant changes have already been made to retirement plans to the detriment of public employees. Any new legislation would inflict further, needless damage to public workers' economic security.

By mandating that three percent of public employees' pay be taken each year for retirement and eliminating future cost-of-living increases, the 2011 Legislature made significant changes to the FRS that have cost public workers more than $1 billion to date. Billions more will be lost in future years by first responders, teachers, and other public workers – many of whom already are compensated at less than the national average.

The effect goes far beyond a three-percent annual loss in income available for spending. The 2011 changes will cost public workers up to $329,000 over their working years, one Florida Supreme Court justice noted in opposing the majority opinion upholding the 2011 law. The elimination of the cost-of-living increase "will result in a 4% to 24% reduction" in total retirement income for public employees, the justice said.[15]

This damage to the financial condition of state employees should be recognized and further damage avoided, especially since the FRS is in good condition.

8. Retirement security for public workers benefits everyone in Florida – and many public servants you know personally.

Retirement legislation considered in Tallahassee is important to all of us. **If you're not one of the more than one million Floridians who depend on public employees' retirement systems for economic security after your work years are done, you know many of them.** They're your children's teachers, school bus drivers, and cafeteria workers. They're the school resource officers, law enforcement officials, firefighters, emergency medical technicians, and correctional officers who work every day to keep us safe. They're the public servants who work with veterans and Floridians with developmental disabilities. They make our health care, court, and park systems work. They're vital to creating the quality of life we enjoy in Florida and their financial well-being is important to our economy. And many of them are on call 24 hours a day, every day, or work shifts taking care of the public welfare while the rest of us sleep.

The Basics: Facts About the Florida Retirement System

The Florida Retirement System (FRS) is the primary retirement plan for employees of state and county government agencies, district school boards, community colleges and universities. It also serves as the retirement plan for employees of cities and independent special districts that have chosen to join the system. School districts employ half of FRS members, counties 23 percent, state agencies 16 percent, cities and special districts five percent, state universities four percent, and community colleges three percent.[16]

The FRS is the retirement plan for 1,000 government employers: 67 district school boards, 28 community colleges, 11 state universities, 414 county agencies, 436 cities and special districts, and 44 State of Florida agencies.[17]

Almost 1.1 million Floridians directly participate in the FRS, making it the fourth-largest public retirement system in the nation. They include about 644,000 employees (2011 figures), about 335,000 retirees or their beneficiaries, 45,000 in the Deferred Retirement Option Program (DROP), and 90,000 terminated vested members.[18]

The average salary of a participant is $42,026. The average benefit for a regular annuitant is $18,066, and $16,045 for participants in the Regular Class. About 220,000 retirees receive less than $2,000 per month.[19]

Women comprise 63 percent of FRS participants.

Workers in the FRS system now pay three percent of their salaries toward their retirement, as the result of a 2011 law recently upheld by the Florida Supreme Court. In addition, FRS employer agencies contribute a set percentage of salary for each member. The percentage is set aside is based on the membership class of the employee. The five classes are Regular Class, the 87 percent of FRS members who don't qualify for any other class; Senior Management Service, for those in senior management positions; Special Risk Class (law enforcement officers, firefighters, correctional officers and correctional probation officers, paramedics, emergency medical technicians, youth custody officers, and specified health care employees); Special Risk Administrative Support (Special Risk Class members now in an administrative support position); and Elected Officers.[20]

Contribution rates for each class are set by statute and consist of a normal cost contribution and an unfunded liability contribution.[21] The funding level needed for the FRS unfunded actuarial liability is amortized over 30 years, similar to a home mortgage.[22]

FRS members choose among three types of retirement plans. The Pension Plan is the traditional defined benefit plan. Employers contribute a percentage of employees' salaries to the plan, and employees receive a defined monthly benefit if they have at least six years of service and meet other eligibility requirements.

Under the Investment Plan, which became available in 2002, employers contribute a set percentage of employees' salaries to the plan each year and members select investment options and are responsible for managing their own retirement accounts. There is no guaranteed result, as there is in the defined benefit Pension Plan. The third option, a Hybrid Plan, allows employees to keep current Pension Plan benefits but participate in the Investment Plan for future employer contributions.[23]

Sixteen percent of total FRS members have chosen the Investment Plan.[24]

From 1998 through 2008, when the stock market decline eroded assets, the FRS was actuarially funded at more than 100 percent. This means actuarial assets exceeded actuarial liabilities. In 2009 through 2012, the funded percentage fell below 100 percent.[25] As of July 1, 2012, FRS assets totaled $127.9 billion and liabilities totaled $147.2 billion, leaving an unfunded actuarial liability (UAL, or the excess of actuarial liabilities over actuarial assets) of $19.3 billion. This means the FRS is 86.9 percent funded,[26] compared to the 80 percent generally identified as the benchmark for a healthy pension system.[27]

The Division of Retirement of the Department of Management Services administers benefit payments for the FRS and the State Board of Administration manages investments of FRS assets.

Historical Overview

Key decisions made in the past by the Legislature created the pension system that workers rely on and provide the background for changes being debated today. These decisions explain how the FRS was created, why it was established as a noncontributory plan for employees, how local systems were established, and significant changes made in 2011 to both the state and local plans.

The Florida Retirement System was established in 1970 to provide an actuarially sound defined benefit retirement system, replacing several older systems. In 1975, the FRS became noncontributory, meaning participants were not required to contribute a portion of their salary to the retirement system.[28]

That 1975 decision was made to save the state money and to reduce an unfunded actuarial liability. At that time, regular FRS workers paid four percent of their pay into the system, while special risk workers paid eight percent. But workers could receive a refund when they left state employment, creating the unfunded liability. The state therefore assumed all contribution costs to avoid the liability.[29,30]

In 1980, annual cost-of-living adjustments (COLA) of up to three percent were provided, and in 1987, the annual COLA was set at three percent. In 2000, the Investment Plan was established, to be implemented in 2002.[31]

Contributions Mandated in 2011

The Legislature in 2011 made significant changes to the Florida Retirement System. Those changes reduced total compensation for public employees like police, firefighters, and teachers and other school employees by hundreds of millions of dollars each year. FRS employees were required to contribute three percent of their pay after July 1, 2011, to their pension. The legislation also eliminated cost-of-living adjustments on retirement payments, lengthened the vesting requirement from six to eight years, and weakened the formula used to determine average compensation on which retirement payments are based.[32,33]

The money saved from these changes did not go the FRS, however, to shore up the funding for the retirement system. Instead, those dollars were used to balance the state budget. The givebacks by public employees, therefore, did not help to strengthen the retirement system.

The Current Debate

As several other states grapple with large liabilities in their pension systems, some in Florida have maintained that the Florida Retirement System and many local retirement plans are "unsustainable". They advocate significant additional changes to the laws that provide retirement security to more than a million Floridians.

But the Florida Retirement System is in good condition – much better than most states. While states like Illinois, California and Kentucky work to get a handle on large future pension liabilities, the FRS is 86.9 percent funded on an actuarial basis system,[34] well above the 80-percent level considered adequate by pension experts. In fact, the FRS would be in even better shape had the Legislature appropriated the full recommended amount to pay off the UAL. It has underfunded that obligation for the last three years, however.[35] The result will be an increase in the UAL, and therefore the obligation of taxpayers.

Closing the Defined Benefit Pension Plan: Costs More, Delivers Less

Despite the good health of the FRS, some advocate closing the traditional defined benefit (DB) plan, which now is the preferred choice of most FRS participants. Advocates of change would require all new state employees to participate in a defined contribution (DC) plan,[36] similar to a 401(k). In that case, all

new employees would be responsible for managing their own retirement funds and assuming all risks of a stock market downturn.

In effect, the current FRS pension plan accomplishes what insurance does – shifting risk to a large group, with each individual of the group bearing only a small risk. Abandoning that system for new hires imposes a high risk on those public employees.

Many actuarial studies have identified two major problems with forcing new employees into defined contribution plans: (1) It costs the taxpayers more money, and (2) It delivers less in retirement income for workers.[37,38,39]

The costs to Florida from closing the DB plan were determined in a 2010 actuarial study. Closing the plan to new hires at that time would have almost doubled the UAL, and therefore taxpayer obligations, over 15 years, the study found. (See the actuaries' explanation of increased costs in the endnote.)[40]

(1) **Taxpayer costs go up** because when a defined benefit plan is closed, it still covers current employees and retirees and future benefits continue to accrue. But new employees are not paying into the system to help fund future benefits. This increases the employer's (taxpayers') contribution rate. And since more of the plan's assets are used to pay benefits, without being replenished by contributions from new employees, more assets will be held in lower-paying short-term securities, thereby reducing investment returns.

(2) **Employees earn less** in defined contribution plans for several reasons. Each employee in a DC plan makes her own investment decisions, and few will match the performance of investment professionals hired to oversee DB plans. Secondly, DB plans cost less to manage due to economies of scale, while employees managing their own DC plans have to pay the expenses for their individual accounts. And defined benefit plans have a long time horizon with a large, constantly replenishing set of employees, so they can invest in riskier assets that may increase investment income. Individual DC investors, by contrast, invest more conservatively as they age to preserve assets since they have a shorter time period to recover any losses.

Problems With Closing DB Plans Have Been Evident Throughout the U.S.

- The National Association of State Retirement Administrators notes serious consequences from closing pension plans to new hires:

  ... including increasing administrative costs associated with running two plans, forgoing or undermining economic efficiencies of traditional pension plans, accelerating pension costs for employees in the closed plan, worsening retirement insecurity, and potentially damaging employer recruitment and

retention efforts. Moreover...401(k)-type plans...are inherently not as effective or efficient as a primary source of retirement income. By pooling mortality and investment risks, traditional pensions reduce participants' risk of outliving retirement assets and can provide the same benefit at nearly half the cost of a defined contribution plan.[41]

- Cautions about 401(k) plans being relied upon as the primary retirement vehicle are underscored by a report in January indicating that more than one in four workers have dipped into retirement funds to pay everyday living costs like mortgages. These workers not only reduce their retirement savings but also must pay penalties for early withdrawals from 401(k) plans.[42]

- A New Mexico study found that shifting from a defined benefit to a defined contribution system would decrease retirement benefits, increase total costs, undermine the health of the retirement system, or some combination of the above.[43]

  Furthermore, the New Mexico study said, "Switching to a DC plan is likely to result in lower and less secure retirement benefits for many long-term governmental employees, including teachers, police officers, and firefighters...."

- The New Mexico study noted that several states have backtracked on DC plans "due to inadequacy of plan benefits or increased costs."[44]

- A study by the National Institute on Retirement Security found that "a DB pension plan can offer the same retirement benefit at close to half the cost of a DC retirement savings plan. **Specifically, our analysis indicates that the cost to deliver the same level of retirement income to a group of employees is 46% lower in a DB plan than it is in a DC plan."**[45]

  The study found that a DB plan can save 15 percent because it better manages longevity risk, or the risk that money will run out in retirement, by pooling large numbers of individuals. Another five percent is saved because a pooled DB plan can maintain a balanced, diversified portfolio over time, whereas individuals become more conservative after retirement to preserve income. Finally, a DB plan's superior investment returns, achieved through professional management, deliver a given level of benefit at a savings of 26 percent.[46]

The Facts About Local Retirement Plans

About 240 municipalities and special districts sponsor 492 defined benefit retirement plans for local government employees – police officers, firefighters, and general government workers. These plans

provide pension benefits to about 176,000 members – 107,000 active employees and 69,000 retirees or beneficiaries.[47]

These plans are created in three ways: local law plans, created by local ordinance; chapter plans, created pursuant to Chapters 175 (for firefighters' plans) and 185 (for police plans) of Florida Statutes; or special act plans, created by a legislative act mandating a local government to create a local pension system.[48]

Chapters 175 and 185 do not govern pensions from government entities whose firefighters and police officers are eligible to participate in the Florida Retirement System.[49]

Local plans are funded from several sources, including employee and employer contributions and investment earnings.[50] The 351 Chapter 175 and 185 police and firefighter plans[51] also are eligible to receive revenue from state insurance premium tax collections on property and casualty policies written within the boundaries of the local government. Access to the insurance premium tax was provided to encourage local governments to participate in the uniform retirement system.[52] The Firefighters Pension Trust Fund under Chapter 175 receives 1.85 percent of the gross receipts on property insurance premiums written within the boundaries and the Police Officers Retirement Trust Fund under Chapter 185 receives 0.85 percent of gross receipts of auto insurance.[53] The premium tax earned the municipalities' pension trust funds about $131 million in calendar year 2011.[54]

Local governments' legislative bodies, subject to collective bargaining with employees, set local plan provisions. The plans are administered on a local level by boards of trustees.[55]

Generally, investment earnings provide 74 to 76 percent of funds in municipal defined benefit plans, employers 14 to 16 percent, and employee contributions six to 10 percent. [56]

For firefighters and police officers, minimum standards provide retirement at age 55 with 10 years of service, or age 52 with 25 years of service. At least a two percent retirement benefit for each year of service is required, multiplied by average final compensation (based on the five best of the last 10 years' pay).[57]

The Division of Retirement of the Department of Management Services, through the Bureau of Local Retirement System, monitors local retirement systems and oversees local police and firefighter pensions.

Current Proposals Affecting Local Plans

As it did with the Florida Retirement System, the 2011 Legislature made significant changes to local plans. Changes included eliminating payment of used annual and sick leave from calculation of benefits

and establishing a limit of 300 hours of overtime to be used in the calculation of benefits.[58] Since the adoption of that legislation, however, the Department of Management Services has interpreted the overtime provision to allow local governments to reduce overtime included in the definition of contribution to less than 300 hours.[59] The interpretation has a significant impact on police plans, since 1999 legislation set a minimum benefit of 300 hours of overtime to be counted as compensation for retirement calculations.

New proposals affecting local plans are also being considered by the 2013 Legislature.

Dramatic changes should be carefully considered for several reasons. First, the changes made in 2011 have improved the condition of many local plans. Restructuring and employee givebacks have already occurred and abuses eliminated. Secondly, action should not be taken based on a one-time snapshot of a retirement plan or an analysis based only a few factors. Third, no one-size-fits-all solution exists. Each of the 492 local retirement plans is unique; the challenge is trying to improve a few without damaging others relied upon by Florida firefighters and police officers. Strong plans with governments and employees who have acted responsibly should not be punished with sweeping legislation aimed at a few other plans.

It is also important for policymakers to determine the causes of weaknesses in any individual plan. Lower investment returns following the near-collapse of the financial system hurt them all. But some plans have been underfunded by the governing bodies of municipalities and special districts for unique local reasons, through no fault of pension participants.

Finally, policymakers should respect local control and let any individual local pension problem be resolved at the local level.

Frequently Asked Questions

I've heard that the pension plans covering state and local workers are "unsustainable," and that without big changes they'll bankrupt the state or at least cause taxes to skyrocket.
This is a myth. The Florida Retirement System is in good financial condition, as are most local retirement plans. They are pre-funded, with money set aside each payroll period, pooled together and then invested, to provide a trust fund to pay future retirement benefits. Pension payments generally do not consume a large portion of tax dollars. Money set aside for retirement constitutes less than three percent of state and local tax revenue. That money is used as part of the total compensation of public workers like teachers, firefighters and law enforcement officers who perform some of the most important tasks in Florida.

Why should public employees have guaranteed pensions when most workers today participate in more risky 401(k) plans?
Public employee retirement plans and other benefits are designed in part to close the gap between private- and public-sector pay. Public employee salaries are lower than those in the private sector, both nationally and in Florida. State and local workers nationwide have a "wage penalty" of almost 10 percent, and total compensation, even with retirement and other benefits, does not match total compensation of private-sector workers.[60]

In Florida, the average salary in 2011 for a worker in the state personnel system was $37,898, 10 percent lower than the average for a private-sector worker. The average state employee salary is lower than in 2008, while the average private-sector salary is up four percent.[61] That's because state workers have received no general pay increase since fiscal year 2006-07 or even a one-time bonus since 2007-08.[62]

Florida's state employee salaries are lower than those in other states, ranking near the bottom in a national study.[63] And the state ranks lowest in the nation in state employee personnel costs and the number of state employees per 10,000 population. In fact, Florida spends half as much in payroll costs for state workers than the national average.[64]

Taking away the defined benefit plan from public employees hurts them <u>and</u> taxpayers. "...[C]losing a pension and shifting to a DC plan for new hires is less cost-efficient....Closing or freezing a plan is likely to lead to many unintended consequences....[M]any state level studies have found that closing a DB plan could cost substantially more than modifying it."[65]

Why shouldn't state and local workers participate in investment plans like 401(k) plans, rather than in guaranteed plans like they have today?
Actually, traditional retirement plans provide a bigger bang for the buck both for employers and workers than investment plans like 401(k)s. Requiring new workers to enroll in the defined contribution

investment plan delivers a double whammy: It would cost taxpayers more and provide less in retirement income for public workers.

Traditional defined benefit plans like the FRS pension plan play an important role in making retired public employees self-sufficient in retirement. A national study found that defined benefit pensions help reduce poverty. DBs were associated with 1.72 million fewer poor households and about three million fewer near-poor households. Hundreds of thousands of Americans avoided food, shelter, and health care hardships because of their DB pensions.[66]

Don't retirement benefits for public workers require a large portion of our tax dollars?
No. Despite claims that we can't afford them, benefits for public employees generally represent only about three percent of state and local budgets and even less in Florida.[67,68]

Don't taxpayers foot the bill for most of the funding for public employees' pensions?
Investment earnings do most of the work in funding retirement for public workers. Contributions made by workers and employers are invested and the earnings compounded over time. Investment earnings fund over two-thirds of retirement benefits.[69]

Is it true that traditional pensions like the FRS defined benefit pension plan help women and minorities?
Yes. Women and minority groups are at greater risk in retirement than white male co-workers. They generally make less money over their careers to invest on their own. And because the life expectancy of women is greater, women tend to outlive their savings more than men do. Traditional pensions, with a guaranteed retirement payment for life, shrink the gender and race differences in retirement.

Glossary

Annuitant: An annuitant is a person who receives a retirement benefit from the FRS or a local retirement plan.

Defined benefit (DB) plan: A defined benefit plan is a traditional pension that relies on pooled investments from many workers and offers a predictable, defined monthly benefit in retirement. It provides a steady income stream guaranteed to last for the remainder of a retiree's life.[70]

Defined contribution (DC) plan: A defined contribution plan, like a 401(k), provides benefits based on accumulation of contributions in individual accounts. The amount of contributions, instead of benefits, is defined. Participates determine their own investment choices and assume all risks. DC plans do not create an actuarial liability for the sponsoring government agency.

Pension: Money paid regularly to a worker after retirement. A pension is retirement income that cannot be outlived by the recipient, but is guaranteed throughout the life of the retiree.

Unfunded actuarial liability (UAL): An unfunded actuarial liability is the excess of actuarial liabilities over actuarial assets.

175 and 185 plans: These numbers refer to the sections of Florida Statutes that govern firefighters and police officers pension funds. Chapter 175 governs fire plans Chapter 185 governs police plans.

99-1: A piece of legislation passed in 1999 that amended Chapters 175 and 185 to provide for minimum benefits for all police and fire pension plans receiving funding from the state. The legislation also required that "additional premium tax revenues" after 1997 could be used solely to pay for "extra retirement" benefits for police and firefighters above those provided to general employees.

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"Over time, the DB plan cost per DB participant would increase as the less expensive shorter service and younger participants are eliminated from participation in the DB plan....

"Over time, the State Board of Administration may lose the ability to invest with a long-term perspective as annual cash flow becomes more and more negative. Under a closed plan, as the active population shrinks and the retired

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