BUSINESS AND LABOR COMMITTEE

NEBRASKA RETIREMENT SYSTEMS COMMITTEE

Joint Interim Study Committee Report
Legislative Resolutions 215 & 216

Examination of Political Subdivision Defined Benefit Retirement Plans

December 2011

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Interim Study Resolutions

LR 215

Introduced by Nebraska Retirement Systems Committee

PURPOSE: The purpose of this interim study is to examine issues related to defined benefit plans of political subdivisions.

NOW THEREFORE, BE IT RESOLVED BY THE MEMBERS OF THE ONE HUNDRED SECOND LEGISLATURE OF NEBRASKA, FIRST SESSION:

1. That the Nebraska Retirement Systems Committee of the Legislature shall be designated to conduct an interim study to carry out the purposes of this resolution.

2. That the committee shall upon the conclusion of its study make a report of its findings, together with its recommendations to the Legislative Council or Legislature.

LR 216

Introduced by Smith, Ashford, Lathrop, Nordquist

PURPOSE: The purpose of this resolution is to study public employee contracts entered into pursuant to collective bargaining and benefits for public officials. For purposes of this resolution, public employee has the same meaning as in section 49-1442, and public official has the same meaning as in section 49-1443. The study shall include the following:

1. An examination of benefits, including wages, pension, retirement, and health insurance benefits;

2. An examination of employee and employer contributions to pension, retirement, and health insurance plans;

3. An examination of minimum and mandatory retirement age and purchase of service provisions; and

4. An examination of the total costs associated with benefit packages.

NOW THEREFORE, BE IT RESOLVED BY THE MEMBERS OF THE ONE HUNDRED SECOND LEGISLATURE OF NEBRASKA, FIRST SESSION:

1. That the Business and Labor Committee and the Nebraska Retirement Systems Committee of the Legislature shall be designated to conduct a joint interim study to carry out the purposes of this resolution.

2. That the committees shall upon the conclusion of their study make a report of their findings, together with their recommendations, to the Legislative Council or Legislature.

REPORT AND COMMITTEE FINDINGS

Introduction

The committees of Nebraska Retirement Systems and Business and Labor held a joint hearing on September 26, 2011, to consider LR 215 and LR 216. The purpose of the study was to collect data concerning those political subdivisions that have defined benefit plans, including the plans' structure and funding status, and determine what role, if any, the Legislature should have in the decision of converting political subdivisions' defined benefit plans to alternative plans.

To this end, surveys requesting specific plan information were sent to political subdivisions known to provide defined benefit plans. Specifically, surveys were sent to the cities of Omaha (police, fire, and civilian) and Lincoln (police and fire), OPPD, MUD, Omaha Airport Authority, Metro Transit Authority, and the Central Nebraska Public Power Districts.

[See: Appendix A -- Political Subdivision Defined Benefit Plans -- Funded Ratio, Percentage of Annual Required Contribution, & Normal Cost; Appendix B -- LR 215/216 Survey Responses -- Omaha Political Subdivisions; Appendix C -- LR 215/216 Survey Responses -- Omaha and Lincoln Police and Fire; Appendix D -- LR 215/216 Survey Responses Regarding Long-term Sustainability of Plans and Consideration of Alternative Benefits and/or Plans.]

Additionally, information was provided through testimony describing the differences between defined benefit and contribution plans, the legal consequences of changing plans, the costs associated with changing plans, research conducted by the University of Nebraska at Omaha, and plan information from the cities of Lincoln and Omaha. Public testimony outlined funding status concerns with Omaha's defined benefit plans. This report contains testimony summary, staff-created and invited testifier exhibits provided to the committee, and the committees' findings.

TESTIMONY SUMMARY

Invited Testifiers

1. **Kate Allen, Legal Counsel for the Retirement Systems Committee**, provided a legal analysis of the protections afforded public retirement plans based on research conducted by Amy Monahan[1]. Historically, retirement plans were viewed as a gratuity or gift which could be altered or removed at any time for any reason. Most states have abandoned this approach, finding that public pensions create a protected right under legal theories of contract, property, or promissory estoppel (enforceable promise).

The majority of states, including Nebraska, have determined that pensions are a contract between the governmental entity/employer and employee, protected by both the federal and the state's

[1] *Public Pension Plan Reform: The Legal Framework,* Amy B. Monahan, University of Minnesota Law School Legal Studies Research Paper Series; Research Paper No. 10-13; 2010.

constitutions. Some states' constitutional provisions specifically protect public pensions, while others like Nebraska, have inferred legislative intent to create a contract, which is protected by both the federal and the state constitutions' contract clauses prohibiting governmental interference with contracts.

Protections, in some states, are limited to benefits already accrued, while others extend protections to both past and future benefits. Nebraska courts have found that the state and federal constitution protects both past and future accrued pension benefits. *See Halpin v. Nebraska State Patrolmen's Retirement System*, 211 Neb. 892, 320 N.W.2nd 910 (1982)*;* and *Calabro v. City of Omaha*, 247 Neb. 955, 531 N.W.2d 541 (1995).

In 1995, the Nebraska Supreme Court adopted the "California Rule" when assessing whether a proposed change to a pension is constitutionally violative. Specifically, the court held that a public employee's constitutionally protected right in his or her pension vests upon the acceptance and commencement of employment, subject to reasonable and equitable unilateral changes by the governmental entity. *Calabro* at 967.

To determine whether a legislative act or an administrative action unconstitutionally impairs a contractual right, a court must employ a three-part test: (1) whether there has been impairment of a contract; (2) whether the provisions of the act or the administrative action, in fact, operated as a substantial impairment of the contractual relations; and, if so, (3) whether the impairment is nonetheless a permissible, legitimate exercise of the state's sovereign powers. *Calabro* at 968.

Whether the impairment is a legitimate exercise of the state's power depends on whether the action was both reasonable and necessary to serve an important public interest. Citing *Halpin*, the *Calabro* Court stated that "[t]he application of the tests of necessity and reasonableness requires a much greater degree of judicial scrutiny in cases involving state action which purports to abrogate the state's own financial obligation than in cases involving an impairment by the state of purely private contracts." *Calabro* at 969, citing *Halpin* at 901. That the maintenance of a retirement plan is heavily burdening a governmental unit has not itself been permitted to serve as justification for a scaling down of benefits figuring in the contract. *Halpin* at *902.*

The state may make reasonable changes or modifications to public retirement systems in which the employees hold vested contract rights, but changes that result in disadvantages to employees must be accomplished by offsetting or counterbalancing advantages. *Calabro* at 970; *Halpin* at 901. In other words, to be reasonable, modifications of the retirement system that results in disadvantages must also confer comparable new advantages. *Id.*

2. **Carol Ebdon, University of Nebraska at Omaha, School of Public Administration**, provided a comparison of defined benefit and contribution plans as well as an update of recent research initiatives concerning public pensions. Defined benefit plans guarantee a benefit based on a formula including retirement age, average salary, and years of service. These plans are not portable.

The risk in these plans is borne by the pension system/government, rather than the employees/plan members. Nationally, there is an estimated $700 billion to one trillion dollar gap between the various public pension plans' assets and liabilities. On average, 58 percent of defined benefit plan revenues come from investment earnings. Accordingly, the financial crisis in 2008 created an average investment loss of 25 percent. To make up for the losses, employers cut benefits, increase contributions, or both. The average funding level for 2009 was 78 percent. Governments that have fiscal constraints are more likely to under fund their plans or alter their actuarial assumptions to artificially inflate their funding levels.

The questions raised by defined benefit plans include: 1) what is a reasonable rate of return; 2) what is the optimal asset allocation; 3) how much risk should public pension plans take; 4) what is an acceptable funded ratio; 5) what is the appropriate benefit level; and 6) whether defined benefit plans are sustainable.

States have considered converting defined benefit plans to defined contribution plans, but have not done so in the last few years. Converting is costly especially when the defined benefit plan is under funded. Because 27 percent of state and local employees are not covered by social security, defined benefit plans, for these employees, represent the only retirement guarantee.

Defined contribution plans do not guarantee benefits. The amount of the benefit is determined by how the plan participant chooses to invest the funds. Thus, the risk is borne by the employee, rather than the employer. Employees are offered a number of investment options through service providers hired by the employer. Because of their portability, younger employees tend to favor defined contribution plans. Defined contribution plans are more common in the private sector. *[See Appendix E -- A Comparison of Public-Sector Pension Plan Structures compiled by the Pew Center on the States, June 20, 2011]*

Defined contribution plans raise public policy concerns. Research indicates a lack of plan oversight, that little expertise is involved in making investment decisions and, that participants do not change their asset allocations, which can be detrimental over time as risk should be limited over time. When membership is optional for defined contribution plans, the participation rate averages 22 percent.

One study showed that 33 percent of plan participants in defined contribution plans, or government plans, did not know whether they had a defined contribution or defined benefit plan, and did not know their benefit levels, or what they would receive upon retirement. Research of private sector plans indicates that plan participation increases with automatic enrollment and employer contribution matches.

Ms. Ebdon has surveyed Nebraska's cities and counties to determine which entities have retirement plans, the types of plans offered, the benefits, contributions and investments associated with the plans, and how and what decisions are made regarding the plans. As of the date of the hearing, survey responses were low. Of the received responses, only six cities and four counties indicated they provide defined benefit plans, while 77 cities and eight counties provide defined contribution plans. However, these preliminary results should be read with caution as Ms. Ebdon reported confusion among the entities as to the kind of plans offered as well as the details associated with the plans. Anecdotally, the surveys highlighted one community that has been paying higher than average plan administrative costs, while others have hired outside vendors with little oversight or monitoring.

3. **Donn Jones, actuary with SilverStone Group** discussed the differences between defined benefit plans, defined contribution plans and hybrid plans, and the implications of transitioning new employees into a defined contribution or hybrid plan. Contributions for a defined benefit plan are deposited into a pooled investment fund managed by professional managers. Employer contributions depend upon the plan's experience (investment gains and losses).

Contributions for a defined contribution plan are defined by a percentage of pay. Unlike defined benefit plans, experience does not affect the employer contribution rates. Contributions are placed in individual retirement accounts that are managed by the plan participant. The benefit amount is the account's value at the time of retirement.

Hybrid plans are defined benefit plans with additional features resembling defined contribution plans. State employees, for example, have cash balance plans which have both defined contribution and defined benefit plan components. The defined contribution component is a notional participant account that includes employee and employer contribution credits. The defined benefit plan component is a guarantee that the accounts will grow at a certain rate. Like a defined benefit plan, contributions are pooled into an investment fund.

Defined benefit plans have been popular because they provide a secure method of retirement and are designed to attract and retain employees. Pooled assets are managed by professional investment managers and are generally expected to provide a greater return rate. Unfunded liabilities must be managed by plan design, funding practices, and effective investment management. It can take up to a generation to address an unfunded liability.

For governmental entities with defined benefit plans, creating a defined contribution plan for new employees will not decrease total contributions in the short term. In fact, employers should expect larger contributions for 15-20 years or perhaps over a generation. The impact on contributions will depend on: 1) how rapidly the shift from one plan to another occurs; 2) the defined benefit plan's funding status; 3) the defined benefit plan's funding policy, i.e., whether the political subdivision is responsive to the actuary's recommendations; and 4) the scheduled contribution rate. Diverting new employees into a defined contribution plan will have negative financial effects for the existing defined benefit plan, especially for a plan that is under funded.

Defined benefit plans rely on contributions from existing employees, including new employees, contributions from retired former employees (when they were working), investment income, and contributions from the employer. If a defined benefit plan is converted to a defined contribution plan for new employees, then the defined benefit plan will no longer have access to the contributions from new employees and the employer. This funding source loss will burden the employer who still has a contractual obligation to the existing defined benefit plan members. The employer must make up the deficiency and establish, before converting, how much is needed to take care of the obligation to the defined benefit plan participants. Generally, a long-term approach will be needed to address any unfunded liability.

4. **Paul Lutomski, Pension Fund Officer for the City of Lincoln**, testified regarding the plans available to Lincoln city employees. Lincoln city employees are covered by a defined contribution plan that does not include death or disability benefits. Employees participating in the defined contribution plan also pay 6.2 percent into social security, which is matched by the city.

Police and fire employees have a defined benefit plan and do not pay into social security. Social security benefits earned through other employment will be reduced due to the pension benefits. Additionally, social security benefits owed to a widow or widower will be offset by the pension benefits. Thus, for most police and fire employees, their pension benefits will be their only retirement.

Factoring in social security contributions, the city's total contribution rate for the defined contribution plan is 15.2 percent compared to 12 percent under the defined benefit plan.

The recent normal cost to provide benefits under the defined benefit plan is 18.83 percent of salary. The city's share is 12.14 percent and the average employee's share is 6.69 percent. New employees share percentage is more, while older employees is lower. *[See Appendix F -- City of Lincoln Nebraska Police & Fire Pension Plan DB to DC Comments]*

If the city converts the police and fire defined benefit plan to a defined contribution plan, police and fire employees may be eligible for social security if a section 218 referendum agreement is obtained pursuant to the federal Social Security Act. If the referendum is successfully passed, both the employees and the city would contribute to social security. There is some concern that this may be subject to legal challenges if there is no union agreement.

Taking into account social security and death and disability benefits, converting to a defined contribution for the city would likely increase the city's contribution from 12.14 percent to 16.2 percent. Thus, converting to a defined contribution plan would likely be more costly to the city.

In addition, including existing employees in the conversion would require agreement by the employees to accept a reduced percentage of their defined benefit value in the new defined contribution plan account. Absent employee agreement, the city would have to contribute funding to equal 100 percent of the defined benefit value and transfer that amount into the new defined contribution accounts.

Defined benefit plans have both advantages and disadvantages. They provide guaranteed income, and are less expensive per dollar of benefit pay because professional managers make the investment decisions including how to invest the interest earned off of the plan's assets. Defined benefit plans provide irreplaceable financial security for those employees not covered by social security and encourage employees to continue in service. These plans are less portable and are not as valuable for the non-career employees. The employer's cost of the plan will fluctuate if the plan's experience is different than actuarial projections. These plans are more difficult for participants to understand how much their employer is contributing on their behalf.

5. **Pam Spaccarotella, Finance Director for the City of Omaha**, provided information relating to the funding status of the city's defined benefit plans. Both the civilian and police and fire plans are severely under funded.

As of January 1, 2011, the civilian plan had total assets of $240.3 million dollars and an actuarial accrued liability of $409.4 million dollars, creating an unfunded liability of $169.1 million dollars. The current contributions are more than enough to cover the year's normal cost, but with the unfunded liability the city is contributing 20.35 percent of the recommended contribution rate of 33.91 percent -- a contribution shortfall of 13.56 percent.

The police and fire plan has total assets of $456.2 million dollars and an actuarial accrued liability of $1.029 billion dollars, creating an unfunded liability of $572.7 million dollars. As with the civilian plan, the current contribution are enough to cover the current year's normal cost, but with the unfunded liability, the city is contributing 44.76 percent of the recommended contribution rate of 63.47 percent -- a contribution shortfall of 18.71 percent.

Since 2001, the funding ratio for the plans has steadily declined. The market value[2] funding ratio for the police and fire plan was 85 percent in 2001 and after the stock market crash in 2008, fell to 45.8 percent. (the current actuarial funding ratio is 44.34 percent) *[See Appendix G -- Omaha Police and Fire Retirement System 2001 to 2011 Funding Status and Actuarial Information]*

The civilian plan similarly plummeted from a market value[3] funding ratio of 96.1 percent in 2001 to 62.9 percent (the current actuarial funding ratio is 58.69 percent).

In 2009, a task force made several recommendations to improve the funding status of the police and fire pension. The task force's recommendations included: 1) increasing contributions and decreasing benefits, 2) eliminating spiking and, 3) funding the contributions through property tax increases, increased sales taxes, and/or garbage fees.

In 2010, the police and city negotiated a contract that increased contributions and decreased benefits by an equal percentage and eliminated spiking. The city passed a restaurant tax to help fund its obligation. These changes positively affected the unfunded liability by decreasing it by $52 million dollars. The city and fire union reached a similar agreement, but it was rejected by the city council. The city council has now taken over negotiations and will hire a law firm to assist with the negotiation. *[See Appendix H -- Testimony of Pam Spaccarotella, Omaha City Finance Director]*

[2] Funded ratio on an Actuarial Basis was not available until the 01/01/2009 Valuation Report.
[3] Funded ratio on an Actuarial Basis was not available for 01/01/2002 and 01/01/2004.

Public Testimony

1. **Jim Krieger, Vice-Chairman and CFO for Gallup and chairman for the Greater Omaha Chamber of Commerce**. Mr. Krieger represented the Omaha, Lincoln, and State Chambers of Commerce. Mr. Krieger raised concern about the sustainability of defined benefit plans and believed alternative plans should be considered. Mr. Krieger questioned whether taxpayers should bare the risk as is the case in defined benefit plans, or whether the employee should own the risk, and have greater flexibility in choosing investments as in defined contribution plans. Mr. Krieger acknowledged that the employer must cover its existing obligations before converting to a new plan. Michigan, for example, realized savings when it transitioned its state employees from a defined benefit plan to defined contribution plan.

2. **Roger Rea, President of the Nebraska State Education Association-Retired**, clarified that there is a distinction between retirement systems controlled by state law and those controlled by collective bargaining. Defined benefit plans provide a predictable benefit that keeps retirees out of poverty and away from public assistance. Defined benefit plans are more affordable than defined contribution plans due to pooling of longevity risk, a more balanced professionally managed portfolio, and lower administrative costs.

3. **Jerry Hoffman, representing the Nebraska State Education Association**, testified that the state school retirement system has an 88 percent funding ratio. Both employers and employees, not taxpayers, pay any unfunded liability. These plans encourage teachers to remain in the field and the community, and to spend their retirement dollars locally, supporting small businesses.

4. **John Corrigan of Dowd, Howard and Corrigan and representing Nebraska AFL-CIO**, testified that professional managers secure the financial futures of defined benefit plan participants, while the employee, who likely is not a financial expert and does not spend the time studying investment options, bears 100 percent of the investment burden in defined contribution plans. One reason returns are less in defined contribution plans is the administrative investment fees.

5. **David Nabity with the Omaha Alliance for the Private Sector**, expressed concern over the funding status of the city of Omaha's defined benefit plans. Mr. Nabity acknowledged that Lincoln's defined benefit plan's funding status and benefit level is comparable to others in the Midwest.

COMMITTEE FINDINGS

1. The known political subdivisions that provide a defined benefit plan include, Omaha (police, fire, and civilian) and Lincoln (police and fire), OPPD, MUD, Omaha Airport Authority, Metro Transit Authority, and the Central Nebraska Public Power Districts.

2. There are legal barriers preventing conversion from a defined benefit plan to an alternative plan for existing employees. In Nebraska, public pensions are considered a contract and are protected by both the federal and state's constitutional contract clauses. Unless agreed to or replaced with a plan with comparable advantages, conversion to a new plan would be challenged and would be struck down as unconstitutional.

   The court would undergo a three-part test to determine if the conversion is unconstitutional: (1) whether there has been impairment of a contract; (2) whether the provisions of the act or the administrative action, in fact, operated as a substantial impairment of the contractual relations; and, if so, (3) whether the impairment is nonetheless a permissible, legitimate exercise of the state's sovereign powers.

   The first two prongs are easily met because taking away a guaranteed benefit is not only an impairment, but a substantial impairment of the contract. The employer promised the retirement benefit and the employee necessarily relied on the promise, basing his/her life's decisions on the promise.

   Whether the impairment is a legitimate exercise of the state's power depends on whether the action was both reasonable and necessary to serve an important public interest. As stated earlier, the position that the maintenance of a retirement plan is heavily burdening a governmental unit has not itself been permitted to serve as justification for a scaling down of benefits figuring in the contract. Accordingly, an unfunded liability caused by an economic downturn, would not justify conversion to a new plan for current plan members.

3. There are important differences between defined benefit and defined contribution plans. Defined benefit plans guarantee a benefit based on a formula including retirement age, average salary, and years of service. The employers bear the risk if the plan's experience suffers due to decreased investment earnings. Employer contributions may vary depending on the plan's experience. Defined benefit plans are not portable, which encourages career employment. These plans are managed by professional financial consultants. Administrative and investment fees are lower, since funds are pooled.

   Defined contribution plans do not guarantee a benefit amount upon retirement. Individual accounts are created for plan participants. Set employer and employee contributions are deposited into the accounts. The employee bears the burden and risk of investing the money. There is little plan oversight. Research indicates that participants are not educated in investment decisions and do not change initial asset allocations even when nearing retirement. These plans are more portable and favored by younger employees likely to change employment. Administrative and investment fees are higher due to the multiple employee accounts.

Hybrid plans were also discussed. Hybrid plans are defined benefit plans with additional components resembling defined contribution plans. Though the employer and employees share the risk, a guaranteed minimum investment return limits the employee risk.

4. The current funding ratios for the Omaha and Lincoln plans are: 1) Omaha Police and Fire: 44.34%; 2) Omaha Civilian: 58.69%; 3) Lincoln Police and Fire: 88%.

5. The city of Omaha defined benefit plans were the only Nebraska plans that raised concern at the September 26, 2011 hearing.

6. The city of Omaha currently has unfunded liabilities of $109.1 million and $572.7 million. The city must address these liabilities with a fiscal strategy to fully fund its obligation in order to convert to a new plan or plans.

7. There are costs associated with converting from a defined benefit plan to a new plan, like a defined contribution plan. This cost represents the single biggest hurdle to converting from defined benefit to defined contribution. Creating a defined contribution plan for new employees will not decrease total contributions in the short term. In fact, employers should expect larger contributions for 15-20 years or perhaps, over a generation. Creating a new plan for new hires will have negative financial effects on the existing defined benefit plan because contributions from existing employees, including new hires, are one of the defined benefit plan's funding sources.

   Removing this funding source does not remove the employer's liability to the defined benefit plan's participants. Before converting, the employer must fund its unfunded liability. In Omaha's case for example, a long-term approach is needed to address its unfunded liability. Removing the new employee funding source would further exacerbate the funding status of its defined benefit plans.

8. There are policy reasons that favor keeping existing defined benefit plans. Defined benefit plans provide a guaranteed and secure benefit. It encourages career employment. The plans are less expensive to operate because investment and administrative fees are lower. The funds are managed by professional investors and generally provide a greater return rate than a defined contribution plan.

9. The decision to establish a new plan for new employees should be made by the political subdivision. As discussed, there are costs associated with establishing a new plan, while maintaining the existing defined benefit plan. Any unfunded liability will need to be addressed, and the political subdivision will necessarily be the entity to decide how to address it. Local retirement boards maintain the plans. Accordingly, the decision to create a new plan rests with the local governmental entity, not the Legislature.

LIST OF APPENDICES

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APPENDIX A
LR 215/216 Survey Results
Political Subdivision Defined Benefit Plans

FUNDED RATIO	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
Lincoln Police & Fire		88%	95%	100%	101%	98%	96%	95%	96%	98%	104%
Omaha Civilian	57.75%	59.80%	62.90%	75.50%	76%	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
OPPD		72.0%	72.5%	80.1%	80.1%	79.3%	82.3%	82.9%	84.6%	99.3%	105.8%
MUD		83.00%	82.80%	84.50%	93.60%	97.30%	105.80%	106.50%	107.09%	109.04%	113.42%
Omaha Air Authority		98.33%	98.03%	98.00%	97.40%	96.83%	96.88%	95.99%	95.00%	101.21%	100.93%

Funded Ratio is the ratio of a plan's current assets to the present value of earned pensions.
(The Funded Ratio is based on actuarial value rather than market value).

% ARC CONTRIBUTED	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
		56.58%	57.93%	69.08%	73.82%	36.94%	81.93%	N.A.	82.47%	N.A.	107.25%
Lincoln Police & Fire		72%	76%	87%	99%	71%	63%	49%	43%	41%	44%
Omaha Civilian	60.01%	56.18%	56.74%	72.38%	73.61%	N.A.	N.A.	75.34%	N.A.	82.00%	N.A.
OPPD		100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
MUD	est 100%	100.58%	80.64%	53.64%	58.16%	124.42%	131.03%	230.36%	100%	100%	N.A.
Omaha Air Authority		100%	140.59%	100%	100%	100%	100%	100%	100%	100%	100%

ARC (annual required contribution) is the actuarially-determined level of employer contribution that would be required on a sustained, ongoing basis to systematically fund the normal cost and to amortize the Unfunded Actuarial Accrued Liability (UAAL) attributed to past service over a specified number of years.

APPENDIX A
LR 215/216 Survey Responses
Political Subdivision Defined Benefit Plans

NORMAL COST	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
Omaha Police & Fire	25.84%	28.91%	28.99%	28.34%	28.70%	28.98%	29.10%	N.A.	26.98%	N.A.	N.A.
Lincoln Police & Fire	N.A.	12.14%	11.82%	10.61%	10.73%	10.72%	10.76%	10.75%	10.73%	11.70%	11.75%
Omaha Civilian	13.83%	14.13%	13.78%	13.66%	13.46%	N.A.	N.A.	10.16%	N.A.	9.49%	N.A.
OPPD	N.A.	11.13%	9.79%	9.07%	9.01%	9.26%	8.71%	8.42%	9.76%	2.17%	0.48%
MUD	N.A.	16.13%	15.46%	15.74%	14.76%	13.59%	13.32%	13.39%	N.A.	N.A.	N.A.

Normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.
The employer normal cost equals the total normal cost of the plan reduced by employee contributions.

APPENDIX B

Omaha Political Subdivisions -- LR 215/216 Survey Responses

	Omaha Civilian	MUD	OPPD	Omaha Air Auth	Metro Transit
a. Employee rate	9.33%	3.76%	6.20%	0%	6%
b. Employer rate	11.03%	17.46%	ARC (Annual Required Contribution)	ARC	6.5% hourly; 14.02% salaried employees
c. Pay into Social Security	Yes	Yes	No	Yes	Yes
d. Normal Retirement Age	60	62 - 65	65	65 (ARFF age 55)	65
e. Final Average Salary	High 26 consec pay periods (1 yr) of final 130 pay periods (5 yrs)	2 years	DB Highest consecutive 18 month average	5 Consecutive years	High 5 of last 10 years
f. Include in Compensation	Most earnings. See Omaha Munic Code, Ch 22; $200,000 salary cap adj for inflation	Regular pay $250,000 salary cap	Base pay, shift differentials & pay as acting crew leader, bonuses, overtime & special pay excluded	Regular payroll -- no overtime; includes vacation and sick pay	Any wages except deferred comp employer match & severance pay
g. Multiplier	2.25%		2.25% or CB option	1% + 1/2% monthly comp x yrs employment	1.40% hourly; 1.45% salaried employees
h. Retirement Age Eligibility			Only applies to FAS Rule of 90;	1 yr service and age 21	65
i. Early Retirement		Age 55 with 3%/yr reduction until age 60	Rule 70= min age 50 & min 10 yrs service	60 (50 for ARFF); special at Rule 85	58 with 20 yrs or 30 yrs continuous service
j. Purchase Service	No, except former staff may pay back any refund taken with interest		No	No	No
k. Vesting	5 year cliff	5 year	5 year	7 year cliff	10 year cliff
l. COLA	No, except those hired before 1/28/98	Cap of 3%/year	Discretionary	No	No
m. DROP	No	No	N/A	No	No
n. Retiree Health Care	Provided by City, not pension system	Yes	Cost share Medical: Retiree pays 20%; Vision: Retiree pays 100%	Employer pays 100% premium for employees with 15 years service, 50% for retirees < age 60	No
o. Additional Plans	457 Plan -- no employer contribution	457 -- MUD contributes max of $1,000 if employee contributes $2,000	401(k) and/or 457; OPPD match 100% of first $150 plus 50% of contrib not to exceed 6% base pay; match on only 1 plan	401(k) -- employer match 1/2 to 6% of employee wage; 457 Plan --no employer match	457 with employer match up to 1% of gross salary

APPENDIX C
LR 215/216 SURVEY RESPONSES
OMAHA AND LINCOLN -- POLICE AND FIRE

	OMAHA -- Police & Fire	LINCOLN -- Police & Fire
a. Employee Contribution rate	Police 16.35% Fire 15.4%	Plan A: 8% career Plan B: 7.6% first 21 yrs Plan C: 7.0% first 21 yrs
b. Employer Contribution rate	Police 33.17% Fire 21.015%	Recommended by actuary annually
c. Participate in Social Security	No	No
d. Normal Retirement Age	Varies: 45, 50 or 55	Plan A: 50 Plan B: 53 Plan C: 53
e. Final Average Salary	Varies [highest 26 consecutive pay periods (1 yr) out of final 130 pay periods (5 yrs) or 78 (3 yrs) out of final 130 (5 yrs)]	Last 26 bi-weekly pay periods, or in the case of demotion the highest 26 bi-weekly pay periods.
f. Included in Compensation	Most earnings. See Omaha Municipal Code, Ch 22 for list. $200,000 salary cap adjusted for inflation.	Base pay benefits consists of hourly rate of pay, shift differential and longevity pay.
g. Multiplier	Schedule by bargaining unit	Plan A: 2.56% Plan B: age 53 and 21 years of service = 58% Plan C: age 53 and 21 years of service = 54%
h. Retirement Age Eligibility	Plan A: 50 + 25 yrs Plan B: 53 + 21 yrs Plan C: 53 + 21 yrs	Plan A: 50 + 25 years of service Plan B: 53 + 21 years of service Plan C: 53 + 21 years of service
i. Early Retirement Eligibility	No	Plans A, B & C: 50 + 21 yrs
j. Purchase Service	No, except former employees who took refund and are re-employed may pay back refund with interest before re-employment.	Allowed by Sec 415 IRC
k. Vesting	10 year cliff	Cliff vesting at 10 years service
l. COLA	Yes	Police -- No Fire may purchase 0-3% in .5% increments
m. DROP (Deferred Option Ret Plan)	Police only	Yes
n. Retiree Health Care	Provided by City, not pension system, except pension system may cover some costs for approved service connected disabilities.	Retiree may continue coverage until age 65 contingent upon paying full cost.
o. Additional Retirement Plans	457 Plan -- no employer contribution	457 Plan -- no employer match

APPENDIX D
LR 215/216 Survey Responses
Regarding Long-term Sustainability of Plans
And Consideration of Alternative Benefits and/or Plans

City of Omaha Police and Fire Retirement System (COPFRS)

- Update Fire contracts to become similar to Police with increases in contributions and reductions in benefits.
- Carve out disability provisions to a third party.
- Provide military service credit only if contributions are paid by employee.
- Add a DROP to Fire.

City of Omaha Employees Retirement System (COERS)

- Change age, percentage, factor, or contributions.
- Carve out disability provisions to a third party.
- Provide military service credit only if contributions are paid by employee.

Omaha Public Power District

In an effort to maintain a competitive, comprehensive and viable retirement plan, we continually conduct market studies, communicate with other plan sponsors and monitor financial developments to stay abreast of the industry.

Among current topics of discussion within the marketplace for retirement plans are:

- Increasing employee contributions
- Changing the benefit formula
- New plans for new hires

In 2008, the plan was amended to include a cash balance accrual option, which will lower our long term obligations associated with the plan. In addition, employee contributions have been increased to cover more of the expenses of the plan.

All retirement plan benefits are negotiated items; any specific plan design changes would be identified and discussed during our negotiations process.

Metropolitan Utility District

None.

Metropolitan Transit Authority

Both pension plan documents state that if the Funded Ratio goes below 85%, the Pension Committee member and Metro's Board of Directors need to take actions to improve the Funded Ratio. Committee members and the current money managers discussed and put in place new asset allocations for both of the plans. As the Funded Ratio continued to decline, the committee members selected a consultant to evaluate both the plans. The consultant created new Investment Policy Statements and negotiated fees with the Custodian and both funds were moved from the Equity Mangers to a passive bond account.

Omaha Airport Authority

Our plan has consistently been nearly fully funded and all indications are that it is sustainable. Our employee base/size has remained very stable for many years with a low turnover rate. We have not contemplated plan changes for new employees.

City of Lincoln Police and Fire

- The City of Lincoln Police and Fire Pension contracts with Milliman Inc. for actuarial services. Annually valuation report is created and reviewed by Pension Administration and the City Council and five year projections on anticipated budget requests are prepared. Principal and Consulting Actuary, Gregg Rueschhoff, prepared the August 31, 2011 Actuarial Valuation and presented the report, in person, to Pension Administration and the City of Lincoln Council on February 14, 2011. The transcript of his presentation is attached (F:paul\depts\citycouncil\ 2-14-2011 Actuary Presentation to City Council.doc). In his presentation Mr. Rueschhoff explained and discussed the pension's current funding status, long-term sustainability and the expected future funding scenarios. He later provided projections that were used to create the five year budget request projection that were forwarded to the City Budget Office, Mayor and City Council. Those projections and the resultant anticipated five year budget requests are contained in the table below.

	1	2	3	4	5	6	7	8
Fiscal Year	Valuation Payroll	Employer Normal Cost Percent	Employer Normal Cost Contribution (1) * (2)	Admin. Expenses	**Mandated City Contribution (3) + (4)**	Recommended UAL Contribution Percent	Recommended UAL Contribution (1) * (6)	***Budget Request (5) + (7)***
2011-12	34,233,197	12.14%	4,155,910	227,678	**4,383,588**	3.48%	1,191,315	***5,574,904***
2012-13	35,688,108	12.03%	4,293,279	234,509	4,527,787	5.86%	2,091,323	6,619,110
2013-14	37,204,852	11.93%	4,438,539	241,544	4,680,083	7.40%	2,753,159	7,433,242
2014-15	38,786,059	11.83%	4,588,391	248,790	4,573,194	8.84%	3,428,688	8,265,869
2015-16	40,434,466	11.73%	4,742,963	256,254	4,999,217	9.14%	3,695,927	8,694,927

- Pension Administration also received advice from actuary Rueschoff to develop a simulation program for longer term financial planning and funding status projections that incorporates variable asset return rates and employer contributions.

- The City of Lincoln Police and Fire Pension Investment Board oversees investments of the fund's assets and directs the City in the making of such investments. The pension contracts with Smith Hayes Advisors for recommendations regarding investment of pension fund assets. Smith Hayes Advisors meet with pension administration and the Investment Board every six months and annually reviews both pension fund's asset allocation strategy, individual manager selection and manager performance. In anticipation of, and in response to, changing market conditions, pension assets have been diversified to optimize the tradeoff between risk and return. The following is a hyperlink to the Investment Policy. Appendix "A" contains the asset allocation table.

http://lincoln.ne.gov/city/person/PFpen/documents/Investment%20Policy%2020110816.pdf

- The following study was prepared internally by Pension Administration as regarding changing the City of Lincoln Police and Fire employee's pension from the current defined benefit plan to a defined contribution plan.

<u>If the proposed change involves only new hires:</u>

We understand changing from the current defined benefit retirement plan to a defined contribution savings plan requires approval from existing employees. Therefore a new defined contribution plan could only be imposed upon new hires, not upon existing employees or retired members currently in the DB plan.

Placing new hires in a DC plan does not eliminate the funding obligations to existing employees and retired members currently in the DB plan. Also, employees in a Defined Contribution plan would need to be enrolled in Social Security at a cost of 6.2% of their pay.

Below is an example using the City of Lincoln Police and Fire Pension DB plan (PFPF) and the City's new 9/7 DC plan:

The latest (08/31/2011) calculation of the PFPF "Normal" cost to provide future benefits was 18.83% of member pay with 6.69% paid by members and 12.14% paid by the employer.

> *The member financed portion of that percent is 6.69% because the pension system has three sub-plans. Members in Plan A contribute 8% for their career. Members in Plans B and C contribute 7.6% and 7% for their first 21 years and then do not contribute.*

The PFPF has a $60 million Unfunded Accrued Liability (UAL). The UAL represents the difference between the market value of assets and the cost to provide benefits for services previously rendered. The actuary expects additional contributions will be needed to pay off the UAL. The dollar amount of the additional UAL contributions will not vary regardless of the retirement plan for new hires, as the UAL pertains to previous service. If new hires are members of a DC plan their pension contributions will not go into the DB plan and the opportunity to capture any excess returns, from earnings above 7.5% on those contributions, will not be available to use against the UAL.

PFPF members are not covered by Social Security, therefore the 12.14% "Normal" cost is the total employer retirement cost, not withstanding any future UAL events, for new hires if the current retirement plan is retained.

If Police and Fire new hires enter the new 9/7 DC the cost is 9% for the employer retirement match and 6.2% for Social Security, for a total of 15.2% compared to 12.14% under the PFPF. However, this system eliminates the possibility of costs from a future UAL event.

One would expect the Police and Fire labor unions to resist a change to a DC, as it divides their respective members.

<u>If the proposed change also involves existing employees:</u>

We understand changing from the current defined benefit retirement plan to a defined contribution savings plan requires approval from existing employees in the DB plan. Therefore a new DC plan would need to be agreed upon by existing employees and would most likely involve a transfer of all or part of each existing member's DB plan present value.

Using values, in millions, from the latest (08/31/2011) actuarial valuation report:

$135.8	market value of assets
+69.2	present value of future normal costs
-1.7	liability to inactive vested members
<u>-94.8</u>	liability to in pay members
+108.5	interim value of assets + future normal costs
<u>-167.9</u>	liability to active employees for services previously provided
-59.3	unfunded accrued liability

There are several ways to transfer the full value of each member's DB plan present value into a separate DC plan account for each member. The first would be to sell all assets for $135.8 million. The liability is $167.9M, so the City would have to provide an immediate infusion of $32.1M. Employee acceptance of an 80% ($135.8 / $167.9) partial payout would not require an additional infusion of City cash.

If this happens there would be no assets in the plan and no future employee contributions to cashflow future benefit payments to inactive vested members and in pay members (DROP members, retirees and beneficiaries). The present value of these payments is estimated at $96.5M ($1.7 + $94.8M). Currently the monthly benefit cash out payment is $825k (retired $640k + DROP $175k). The annual amount is $9.9M.

The active employees transferred from the DB to the DC would be covered under Social Security.

A table of estimated costs is below.

			Current DB system		Potential DC system				
	From Plan Actuary								
Fiscal Year	Valuation Payroll	Mandated City Contribution	Recommended UAL Contribution	Budget Request	Cash infusion	DC match 9% * (1)	Social Security contribution 6.2% * (1)	DROP and retirement payments*	DC Total
2011-12	34,233,197	**4,383,588**	1,191,315	5,574,904	32,100,000	3,080,988	2,122,458	9,900,000	47,203,446
2012-13	35,688,108	4,527,787	2,091,323	6,619,110	-	3,211,930	2,212,663	9,652,500	15,077,092
2013-14	37,204,852	4,680,083	2,753,159	7,433,242	-	3,348,437	2,306,701	9,405,000	15,060,138
2014-15	38,786,059	4,573,194	3,428,688	8,265,869	-	3,490,745	2,404,736	9,157,500	15,052,981
2015-16	40,434,466	4,999,217	3,695,710	8,694,927	-	3,639,102	2,506,937	8,910,000	15,056,039

Note: *Current amount decreased equally over 40 years

Other considerations:

In fulfilling their duty to protect the public, Police Officers and Fire Fighters risk physical injury, psychological injury and even death. When disability or death occurs a defined benefit plan provides a partial income replacement to the disabled former employee, or their family. In addition to the musculoskeletal injuries that you might reasonably predict could occur, such as back, shoulder and foot injuries, injuries from altercations and vehicle collisions, injuries from fires and rescues, the State of Nebraska has legislated specific protections in two statutes.

The first statute is chapter 18-1723 established in 1969. In summary it states that for Police Officers and Fire Fighters, a rebuttable presumption exists in cases of death or disability as a result of a heart or lung defect or disease that such defect or disease was caused in the line of duty. The second statute is chapter 35-1001 established in 1996. In summary it states Fire Fighter death or disability as a result of certain cancers or diseases is prima facie evidence that such death or disability was caused in the line of duty.

A defined benefit pension has traditionally been the means to protect the men and women, and the families of the men and women, that protect us. In the absence of a DB plan with disability coverage, a different means of providing this type of protection is needed.

Finally, providing a DC plan when the prevalent practice for Police Officer and Fire Fighter pension's is a DB plan, may adversely affect recruiting numbers, quality of applicants, and employee retention.

Central Public Power District

We plan to start researching the possibility of implementing a defined contribution plan for all new hires. Current employees may have the option of switching from the defined benefit plan to the defined contribution plan. Union negotiations will begin in the summer of 2012 to consider the change.

A Comparison of Public-Sector Pension Plan Structures

	Defined Benefit (DB)	Defined Contribution (DC)	Hybrid
Description[1]	Benefit is calculated using a predetermined formula based on a percentage multiplier of earnings and service.	Account includes employee and optional employer contributions, invested by employee until retirement.	Combines features of traditional DB and DC plans. The plan has a modest multiplier for each year of service, and an employee-directed supplemental DC plan.
Benefit Accrual	Benefit accrual accelerates near retirement.[2]	Benefit accrual is steady, based on pay.[3]	DB component has accelerated accrual near retirement. DC component has steady accrual.[4]
Ability to Predict Liabilities	Plan liabilities change based on actuarial experience (e.g. future salary increases, investment earnings, employee turnover).[5]	Plan liabilities are fully funded annually as contributions are made to employee accounts based on a percentage of payroll.[6]	Liabilities for the DB component may vary. DC component is stable.[7]
Investment Risk	Regardless of investment performance, employer pays specified lifetime benefit. Employer bears the risk.[8]	Employer is responsible for scheduled contributions. Employee bears the investment risk.[9]	Investment risk is shared by employer and employee.[10]
Contributions	Annual employer contribution may vary year to year, based on actuarial experience (see above). Rates may be set by statute to increase predictability.[11]	Annual employer contributions are more predictable because they are based on a set percentage of employee salaries.[12]	DC contribution rates are fixed, but DB component contributions can vary.[13]
Expenses[14]	The plan pays administrative and investment fees.	Typically, employee pays administrative and investment fees.	Typically, employee pays the portion of administrative and investment fees attributable to the DC portion.
Portability[15]	Benefits have limited portability. Employee contributions may be refunded at termination.	Benefits can be transferred at termination.	Hybrids are more portable than a pure DB plan. Employee contributions can be transferred or rolled over to another pension account.
Retirement Benefit Form	Lifetime annuity.[16]	Lump sum unless lifetime annuity is purchased.[17]	Lump sum, partial lump sum, annuity.[18]
Employees Who Benefit Most	Career employees and employees hired in mid-career.[19]	Employees who terminate employment at a young age.[20]	Dual outcomes. DB element: longer-service, late-career employees. DC element: shorter-service, early-career, younger employees.[21]

Compiled by the Pew Center on the States from multiple sources **June 20, 2011**

[1] Minnesota Statewide Retirement Systems, *Retirement Plan Design Study*, (June 1, 2011): 50-88, http://www.msrs.state.mn.us/pdf/Study6-1-2011web.pdf. Defined Benefit: 50. Defined Contribution: 59. Hybrid: 72.

[2] Janet S. Hansen, "An Introduction to Teacher Retirement Benefits," *Education Finance and* Policy *Vol. 5, Issue 4* (Fall 2010): 427, http://www.mitpressjournals.org/doi/pdfplus/10.1162/EDFP_a_00012.

[3] National Conference of State Legislatures, *Defined Benefit and Defined Contribution Retirement Plans*, 2005, Table 3, http://204.131.235.67/programs/fiscal/defineretire.htm.

[4] Pew Center on the States analysis.

[5] National Conference on Public Employee Retirement Systems, *The Evolution of Public Pension Plans: Past, Present and Future*, *(*March 2008): 11-12, http://www.ncpers.org/Files/evolution_of_public_pensions_2d.pdf.

[6] Ibid.

[7] Pew Center on the States analysis.

[8] National Conference of State Legislatures, Table 3.

[9] National Conference of State Legislatures, Table 4.

[10] National Conference on Public Employee Retirement Systems, 12.

[11] National Conference on Public Employee Retirement Systems, 11.

[12] Ibid.

[13] Pew Center on the States analysis.

[14] National Conference on Public Employee Retirement Systems, 12.

[15] Minnesota Statewide Retirement Systems, Defined Benefit: 54. Defined Contribution: 62. Hybrid: 75.

[16] Janet S. Hansen, 427.

[17] Ibid. Also see: National Conference on Public Employee Retirement Systems, Table 3.

[18] Minnesota Statewide Retirement Systems, 52.

[19] National Conference of State Legislatures, Table 4.

[20] Minnesota Statewide Retirement Systems, 59.

[21] Minnesota Statewide Retirement Systems, 74.

City of Lincoln Nebraska
Police & Fire Pension Plan
DB to DC comments

Two types of pensions

Defined Contribution

Defined Benefit

“Old” Defined Contribution

For Civilian employees:

- **12% employer**
- **6% employee**

"New" Defined Contribution

For Civilian employees:

- **9% employer**
- **7% employee**

All civilian new hires except for one labor union are under the new plan.

Defined Contribution

“Old” and “New” DC plans

- **Both require Social Security contribution**
- **Neither provides death or disability benefits**

Defined Benefit Pension

For Police and Fire public safety employees:

Normal Cost*	Percent of salary	
Service pensions (> 10 YOS)	15.97%	
Pre-retirement death benefits	0.39%	
Disability benefits	0.59%	~ 1%
Termination benefits (< 10 YOS)	1.87%	
Total Normal Cost	18.83%	
Employee contributions (avg.)	6.69%	
Net Employer Normal Cost	12.14%	

* per August 31, 2010 Actuarial Valuation

Defined Benefit Pension

For Police and Fire public safety employees:

- **Employer Normal Cost of 12.14%***

  *** per August 31, 2010 Actuarial Valuation**

- **Neither employer nor employee contribute to Social Security**

DB>DC New Hires only

- **Would be required to be enrolled in Social Security**

- **May be subject to legal challenge w/o union agreement.**

DB>DC Cost Comparison

Employer Contributions	Hypothetical DC	Existing DB
Pension	9.0%	12.14%
Social Security	6.2%	0.00%
Pre-retirement death and disability benefits	1.0%	included in 12.14%
Total	**16.2%**	**12.14%**

DB>DC Existing Employees

- **Would require approval from existing employees**

- **Would involve a transfer of all or part of each existing member's DB plan Actuarially Accrued Liability (AAL) to their DC plan account**

AAL is the value of benefits for services rendered

DB>DC Existing Employees

Example #1

Employees agree to transfer 40% of each existing member's DB plan Actuarially Accrued Liability (AAL) to their DC plan account.

$135.8	**Market value of assets**
-94.8	**AAL for Retirees**
-1.7	**AAL for Vested Separated Members**
39.3	**remaining Market value of assets**
-39.3	**40% of AAL for Active members service rendered**
0.0	**Immediate Employer addition**

DB>DC Existing Employees

Example #2

Transfer 100% of each existing member's AAL to their DC plan account .

\$135.8 Market value of assets
-94.8 AAL for Retirees
-1.7 AAL for Vested Separated Members
39.3 remaining Market value of assets
-98.6 AAL for Active members service rendered
-59.3 Immediate Employer addition

DB Advantages

1. Provides guaranteed lifetime income to retirees.

2. Per dollar of benefit paid, it is less expensive to provide benefits through a DB plan than through a DC plan.

3. Some governmental employee are not covered by Social Security. In these cases, a DB plan offers irreplaceable financial security.

DB Advantages

4. Provides more income for career employees. Motivates employees to continue in service.

5. Automatically provides inflation protection during the working career.

6. Cost-of-living protection after retirement may be provided.

DB Disadvantages

1. **Provides less income for non-career employees.**

2. **Most DB plans were not designed with portability in mind.**

3. **Cost of the plan will fluctuate from year to year as a result of plan experience being different from actuarial projections**

DB Disadvantages

4. Difficult for employees to understand how much the employer is contributing on their behalf.

5. Usually more complicated to administer.

City of Omaha Police and Fire Retirement System
$ Millions

	1/1/2001 [3]	1/1/2003 [3]	1/1/2005	1/1/2006	1/1/2007	1/1/2008	1/1/2009	1/1/2010	1/1/2011
Actuarial Value of Assets	$ 357.5	374.2	422.9	453.2	494.7	530.5	439.1	440.5	456.2
Actuarial Accrued Liability (AAL)	$ 340.6	581.2	657.6	746.5	829.1	898.2	971.9	1,021.8	1028.9
Unfunded Actuarial Liabilities (UAL)	$ 16.9	206.9	220.5	279.3	320.6	354.2	519.6	581.3	572.7
Annual Normal Cost as a Percentage of Pay [1]		26.98%	29.1%	28.98%	28.7%	28.34%	28.99%	28.91%	25.84%
Funded Ratio (Actuarial Value) [2]	-	-	-	-	-	-	45.8%	43.1%	44.34%
Funded Ratio (Market Value)	85.0%	65.2%	77.3%	64.4%	63.4%	60.1%	38.2%	39.7%	43.99%
Annual Required Contribution (ARC)	27.18%	40.55%	45.22%	48.86%	49.93%	53.20%	63.61%	64.86%	63.47%
Employee Contribution Rate	10.89%	13.14%	14.93%	14.94%	14.95%	14.88%	14.96%	14.94%	15.91%
City Contribution Rate	18.26%	20.30%	22.12%	22.00%	21.91%	21.87%	21.89%	21.76%	28.85%
Total Contribution Rate	29.15%	33.44%	37.05%	36.94%	36.86%	36.75%	36.85%	36.70%	44.76%
Percentage of ARC Contributed	107.25%	82.47%	81.93%	36.94%	73.82%	69.08%	57.93%	56.58%	70.52%

(1) Normal Cost was not reported in the 01/01/2001 Valuation Report

(2) Funded Ratio on an Acturial Basis was not available until the 01/01/2009 Valuation Report.

(3) Valuations were reported on an annual basis beginning with the 01/01/2005 Valuation Report

September 26, 2011 LR 215 Testimony

Members of the Committee:

My name is Pam Spaccarotella, Finance Director for the City of Omaha, and I want to thank you for the opportunity to offer testimony on LR215.

The City of Omaha currently maintains two separate defined benefit pension plans. The first is the City of Omaha Employees' Retirement System (referred to as the Civilian Plan) and the second is the City of Omaha Police & Fire Retirement System (referred to as Police & Fire).

Plan Provisions

With respect to the Civilian Plan, we currently have 1,130 active member (members contributing to the plan), and 1,281 retirees (members withdrawing from the plan). The active members contribute 9.33% of pay with matching city contributions of 11.03% of pay. The City's Charter requires that the City and the Members make "substantially equal" contributions to the pension system. The normal retirement age for the Civilian plan is age 60, and is based on the highest 26 consecutive pay periods out of the employee's final 130 pay periods. An individual may retire at age 50 if the rule of 80 is met, or at age 55 subject to reduction if the rule of 80 is not met. There is no cost of living adjustment in the Civilian Plan.

With respect to the Police & Fire, we currently have 1,422 active member (members contributing to the plan), and 1,454 retirees (members withdrawing from the plan). Police active members currently contribute 16.35% of pay with matching city contributions of 33.17%, whereas Fire active members currently contribute 15.4% with matching city contributions of 21.015%. Again, the City's Charter requires that the City and the Members make "substantially equal" contributions to the pension system.

With respect to the Police Union, new provisions were adopted on September 18, 2010, that increased the age of retirement for individuals with less than 20 years of service, and new hires. Active members with greater than 20 years of service can retire at age 45 with 25 years of service; those with 0-20 years of service retire at age 45 with 30 years of service, and new hires (after September 18, 2010) retire at age 50 with 30 years of service. For all years of service, the bases upon which retirement benefits are calculated were changed to eliminate spiking by adding a career average overtime formula in which "each hour an employee earns for overtime is computed back to their date of hire or 1991 (whichever is later) and divided by the number of years the employee worked after December 31, 1990." With respect to the Fire Union, there has been no change to existing provisions. Active fire members are allowed to retire at age 45 with 25 years of service at maximum benefits. In addition, retirement benefits remain calculated at the highest average monthly compensation during any consecutive 26 pay periods out of the last five years of service, and includes spiking.

Both Police and Fire members receive a cost of living adjustment each year and all retirees receive health care through the city from the age of retirement until 65.

Plan Assumptions

There are various assumptions that go into the calculation of the actuarial liability. The Pension Systems periodically review these assumptions in an experience study. The City's last experience study was conducted for the Police & Fire in March 2007 for the period ended 12/31/05, and for Civilians in September 2007 for the period ended 12/31/06. The most significant of these assumptions are as follows:

1. Rate of Return. Both plans assume a rate of return of 8.00%. While recent returns have fluctuated significantly, it is important to note that over the long term the rate of return for both plans have exceeded 8.00%.

	City of Omaha Employees	City of Omaha Police & Fire
1991	27.29	23.13
1992	11.58	9.44
1993	11.66	11.19
1994	-1.18	-0.66
1995	24.02	24.79
1996	11.42	10.48
1997	15.18	18.26
1998	8.35	9.42
1999	7.14	0.27
2000	8.17	2.77
2001	-4.22	-2.20
2002	-4.49	-9.82
2003	18.91	22.71
2004	11.68	11.46
2005	6.78	9.40
2006	11.28	12.97
2007	5.94	5.70
2008	-25.67	-27.94
2009	12.98	16.16
2010	17.50	16.64

20 Year Avg	8.72	8.21
10 Year Avg	5.07	5.51
5 Year Avg	4.41	4.71
1 Year Avg	17.50	16.64

2. Rate of Inflation. An assumed annual rate of inflation of 3.5% is included.
3. Increase in Wages. Annual wage increase of 4% is assumed.

Board Membership

Both the Civilian and the Police & Fire Pension Plans have a seven member board with consistent membership. Each board has three active union members, in addition to one city council member, the Finance Director/Comptroller, and the Human Resources Director. And each board is supplemented with a seventh member from the community. For Police & Fire, the seventh member is an attorney with a background in Worker's Compensation. For the Civilian plan, the seventh member is a professor of Economics from the University of Nebraska at Omaha.

Within the Board Membership there exist various committees, which includes the Investment Committee. The Investment Committee, in conjunction with the Investment Consulting Firm of Demarche & Associates, and under the Investment Guidelines as enacted by the Board, guides the selection and monitoring of an active investment portfolio.

Plan Funding Status

Both the Civilian Plan and the Police & Fire Plan are severely underfunded. Both systems use an asset smoothing method in the valuation process. As a result, the plan's funded status and the actuarial contribution rate are based on the actuarial (smoothed) value of assets – not the pure market value.

As of January 1, 2011, the Civilian Plan had total net assets of $240.3 million and an actuarial liability of $409.4 million. The unfunded actuarial liability was $169.1 and its funded ratio was 59%. The actuarial recommended contribution rate is 33.91%. With a member contribution rate of 9.325% and matching city contributions of 11.025%, the current contribution shortfall is 13.563%. It is important to note that the recommended contribution rate includes both a normal cost and an unfunded liability cost. The normal cost (which represents the liability for current year service) is 13.8%, which is substantially less than the actual contribution rates. But for the unfunded liability, the current contribution rates would be sufficient.

As of January 1, 2011, the Police & Fire Plan had total net assets of $456.2 million and an actuarial liability of $1028.9 million. The unfunded actuarial liability was $572.7 and its funded ratio was 44%. The actuarial recommended contribution rate is 63.47%. With combined contributions from members and the City at 44.759% the current contribution shortfall is 18.710%. Again, it is important to note that the recommended contribution rate includes both a normal cost and an unfunded liability cost. The normal cost (which represents the liability for current year service) is 25.836%, which is substantially less than the actual contribution rates. But for the unfunded liability, the current contribution rates would be sufficient.

On 1/1/2001 the funded ratio of the Police & Fire plan was 85% and the Civilian Plan was 96.1%. Since that time, the funded ratio has declined and in 2009 the funded ratio dropped significantly primarily as a result of the investment losses sustained in the fourth quarter of 2008. By January 1, 2009, the funded ratio of the Police & Fire plan was 45.8 % and the Civilian Plan was 62.9%. Preliminary calculations projected the plan would run out of money in the year 2030, and the city would then be forced to pay retirement checks approximating $173 million out of the general fund each year thereafter. Due to the sharp decline in funded ratios and the projected fund balance, then Mayor Mike Fahey commissioned a tax force to review the Police & Fire Pension System. Specifically, their objective was "to provide recommendations that will lead to the equitable restoration of the Police & Fire Pension System's integrity and achieve actuarial balance for all stakeholders in a reasonable amount of time."

In May of 2009, the task force issued a draft report in which those recommendations were made. Specifically, the task force recommended:

1. Any solution must be a 50/50 solution, i.e., 50% of the necessary funding would come from increased contributions by the City and approximately 50% of the necessary funding would come from decreasing the value of police and fire employees' pension benefit accruals.
2. Spiking must be eliminated.
3. Three possible solutions for decreasing the value of police & fire benefits were proposed to include a final average pay plan, career average plan, and a fixed dollar plan.
4. Three possible funding sources were identified to provide for the increased contributions by the city to include a property tax increase, 0.5% sales tax increase, and a garbage fee.

In May of 2009, Mayor Jim Suttle was elected to replace Mayor Fahey. Mayor Suttle was tasked with the implementation of the task force recommendations. In late 2010, the City was successful in negotiating a contract with the Police Union that increased the city's contributions 13.5% and decreased the Police Union's benefits 13.5%, recognizing the task force recommendation that any solution must be a 50/50 solution. Spiking for police officers was eliminated, the Police Union opted for the career average plan recommended, and a restaurant tax of 2 ½ % was enacted in order to fund the City's obligation.

Immediately following the Police Contract, the City began negotiating with the Fire Union. A tentative agreement was reached with the Union in July of 2011 that would provide for a 13.5% reduction in benefits for Omaha firefighters, would eliminate spiking, and would also be funded by the restaurant tax. The agreement was voted on and agreed to by the Union on August 1st and 2nd, and was rejected by the City Council on August 9, 2011 following the introduction of various amendments. Mayor Jim Suttle reintroduced the contract following communications from the Union that it would not entertain any amendments, and that introduction was placed on file. A resolution was subsequently adopted revoking previously granted authority to the Administration to negotiate union agreements.

Currently, the City Council has requested City legal to recommend several law firms to engage their services to act as negotiator on their behalf. As of today, no negotiations have yet been conducted pending the engagement of outside counsel.

The City Finance Department has encumbered funds for both 2010 and 2011 for the anticipated pension contribution.

Finally, it is important to note that the changes in the Police Contract as enacted on September 18, 2010, did have a positive effect on the unfunded pension liability as intended. On page 5 of the report, the changes in plan provisions decreased the unfunded actuarial liability by $52 million from January 1, 2010, to January 1, 2011. We are encouraged by those results and look forward to a successful resolution with the Fire Contract.

Thank you again for the opportunity to testify. I would be happy to try to answer any questions you may have.

Testimony provided by:

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