City of Lincoln Nebraska
Police & Fire Pension
Summary for 2/3/00 Advisory Committee Meeting

Members present: Al Berndt, Aaron Drake, Dennis Duckworth, Jim George

Members absent: Ross Hecht, Al McCray

City Staff: Georgia Glass, John Cripe, Paul Lutomski

Others: Jeff Gottbreht (Fire Union President), Dave Engler (Fire Union Vice President) Loren Kampschneider

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Dennis Duckworth: The meeting is called to order. What are the recent events?

Georgia Glass: We presented and discussed the DROP in a City Council executive session. We recommended a 100% DROP with a $2.4 million cost to overfunding and a .61% future normal cost. We explained there was no real cost because the DROP did not increase basic pension benefits the City had already obligated itself to pay, but rather just changed the amount of time the City has to fund the benefits. Instead of 27 years the City might now have only 25 years to fund a benefit. Also, if 22 people entered the DROP the net budget cost would be zero because the increase in normal cost is offset by the decrease in valuation payroll. Don Herz (Finance Director) and Steve Hubka (Budget Officer) were at the meeting. They talked about the fact that they had $200,000 (two hundred thousand dollars) built into the five-year budget plan allocated as annual increases to the Pension's budget.

Aaron Drake: Did they give any indication of how many of them would be in favor of the DROP plan?

Georgia Glass: No, I didn't get any reading from them on that. I did get a reading the majority of think the concept of a DROP plan is a good idea.

Jim George: Do they understand other cities that have DROP plans are 100% DROP percentages, and that the actuaries for those cities have said that there is no cost?

Georgia Glass: We didn't discuss that. We have to compare apples to apples, we have to compare how those pension plans are designed to how our plan is designed, and then see if they're still 100% DROP's with no actuarial cost.

Aaron Drake: Is the Council's concerned about the cost of the plan or because they don't understand it?

Georgia Glass: Both. Paul, what do you think their concerns were?

Paul Lutomski: Both. I think they were more concerned with the funding aspects.

Aaron Drake: What do you suggest our next step be to get the Council to the level where they're comfortable in taking a vote on the DROP?

Georgia Glass: I think the concept of a DROP plan is very good. I know the Mayor supports it. I believe the Council also supports it.

Dennis Duckworth: Then I think we should bring in the actuary.

Jim George: The actuary is our biggest problem. The problem is the retirement assumptions they're using. I have a copy of an actuary report from the Colorado DROP plan. That actuary assumes people don't get into the DROP any sooner than they would normally retire and therefore the cost of the DROP is zero.

Georgia Glass: Jim, do you know if the other plans consulted an actuary before they implemented the DROP? Because when we've been talking to our actuary, they say that oftentimes that does not happen.

Paul Lutomski: Gabriel Roeder said they have run into instances where the DROP was established, and the actuary wasn't informed of it in advance. A few years later when they do their experience re-evaluation the actuary finds out the entity started a DROP four years ago and by that time, it's pretty much impossible to cost the DROP's impact on retirement patterns, so it's not costed. I'm not saying that's what went on in Colorado, but our actuary says that has happened before.

Jim George: In plan A, when a person attains age 50 and has 25 years of service, if they continue working and don't enter the DROP, they're going to have to continue paying 8% of their salary into the pension plan and their pension benefit is not going to go up very much. That person would probably retire right then. If there is a DROP, instead of retiring, they would get into the DROP when they would have otherwise retired, so there really wouldn't be any difference between the years of service with or without a DROP and that's what Colorado's saying. In other places where the maximum benefit is not 64%, where it's higher than that, people at those places seem to work to that higher benefit percentage and then they're in the same situation as our 64% people, but they don't get into the DROP any sooner than they would have otherwise retired.

John Cripe: I think your analysis is correct, but from a real perspective, we actually do have people that are age 50 and 25 years of service that are in the 8% plan and they haven't retired yet. They're still paying 8%.

Aaron Drake: There's a variable that can be eliminated to decrease the cost of the DROP and that is removing the one-year window from Plan A DROP eligibility. Let the Plan A people get into the DROP whenever they want to after they reach age 50 and have 25 years of service.

Jim George: I see what you're saying. I agree. Let's go back to the Lowman ideas on cost reduction. Lowman says the cost of the DROP plan is mostly driven by the DROP's effect on the retirement patterns. If we can get Gabriel Roeder to change their assumptions on retirement patterns, the cost of the DROP will decrease.

Aaron Drake: Our role is not to challenge the plan. We are trying to work with the plan administration to figure out what needs to be done and then present it to the Council in order to get the DROP plan implemented. The Council said they wanted to see some options. Either the DROP plan design can be changed to make it less expensive, or there is some option as to how the cost can be paid, without changing the design, or maybe we can change the design of the DROP and change how the DROP is funded.

Jim George: One of Tom Lowman's recommendations was to increase the DROP from a three-year DROP to a four- or five-year DROP to decrease costs. I have a couple recommendations if we do decide to bring someone in. There's an attorney from Florida that has implemented over a hundred DROP plans. His name is Bob Plausner. When I told him about our DROP plan, he said that 88% is crazy, that either the Plan Administrator or the actuary doesn't understand how DROP plans work.

Georgia Glass: We can't say that our actuary doesn't understand DROP plans, because they have costed many of them, and have been working with DROPs for several years. All of us are working towards the same goal to implement a DROP plan. Everyone thinks it's a good idea, if the City Council is okay with the costs, then we're done. That's the actuary cost, the real cost or the net cost is zero.

John Cripe: My perception is that the Council won't vote for a DROP design that has a $2.4 million actuary cost.

Al Berndt: I think you're going to see that the day a Plan A member turns 50 and has 25 years of service, they may not have another job waiting for them, or may have some concerns, like maybe a health insurance concern, that they want to stay on this job to provide health insurance for other members of their family so they wouldn't be retiring right away. However, that Plan A member would take advantage of the

DROP plan to stop paying 8%.

Paul Lutomski: The third recommendation would be for Gabriel Roeder to change their retirement pattern assumptions to make the DROP cheaper. I can say we have discussed this with the committee and believe that more people will enter the DROP sooner than GRS is assuming.

John Cripe: We could implement the DROP plan, and then after one or two years ask the actuary to re-cost it to include the DROP's real effect on retirement experience. If it turns out to be no cost, we'll refund what we originally took from the employees. In other words, get that DROP percentage from 88 up to a 100 or 95 percent.

Aaron Drake: How will the actuary be able to determine the cost, if you implement the DROP plan? Because they don't know what the retirement pattern would be if you hadn't implemented the DROP plan.

Paul Lutomski: The actuary won't be able to determine the cost. They'll have to use assumptions, just as they're doing right now. The only way to know what the DROP's cost is if we have one group of people without DROP plan, and another group exactly like them with the DROP plan. Then we can compare the retirement patterns of the two groups. Anything other than that is just basing the cost on assumptions.

Jim George: We're seeing 100% DROP plans everywhere we look, and some of those plans are better than the ones we're designing. Were not asking for the best DROP plan here.

Georgia Glass: Yes, Jim, but there may be other plans out there that don't have the 100% DROP, or there may be plans that don't even offer a DROP.

Jim George: Yes, I'm sure there are plans that don't offer a DROP. DROP is relatively new except in the South, where it's been around for quite a few years.

John Cripe: The longer we wait to take this to the Council, the less chance there is that the Council will approve anything that has a cost, actuary or otherwise. Right now budget preparations are beginning, as are negotiations.

Jeff Gottbreht: I hope they don't have to go to Court. I'd hate to see a rerun.

John Cripe: It appears the Council understands the economics of negotiations, and they also understand how negotiations will impact pension funding. All of this happens in the context of the big picture. It can't be looked at as just an individual item.

Aaron Drake: If the City wants police and fire protection, they're going to have to pay for it. Shall we wrap up what we want to do with this?

Jim George: Does the City even care to look at what they're saving in retirement costs in the Police and Fire Pension? Do they even care to look at what they're providing for a Police and Fire Officer's pension versus what they provide for a civilian employee's pension? Do they even care how much they're putting into the Police and Fire Pension versus what the actuarial recommendation is that they put in?

Georgia Glass: I think they care about all those things.

Jim George: Has this been pointed out to them?

Paul Lutomski: Last time we showed them a chart of the actuarial normal costs versus what the City actually contributed to the pension. Tom Lowman did want us to look at some of the assumptions, and I think that's what we need to do. Look at how we can change the assumptions and the design of the DROP to make it cheaper. Also, how we can change the funding aspects.

Jim George: If the Council wants to hang on to this actuarial cost, maybe we should point out to them that the actuary is recommending that they put in X dollars every year, and they haven't done that.

Aaron Drake: How long do you think it would take if we asked them to change some design elements and then get back to us with the real number?

Paul Lutomski: I wouldn't think it would be too long. At this point, they already have everything set up.

Jim George: Okay, so far we have, number one, changed the eligibility window.

Paul Lutomski: But that's only for Plan A people. Plan A would be eligible to get into the DROP any time after age 50 and 25 years without any restrictions. Plan B and C would still have the one year window.

Jim George: The second thing would be to change the retirement pattern assumptions as much as the actuary can, and the third thing would be to extend the DROP period from three years to five years.

Paul Lutomski: Well, then, we'd kind of be going backwards on the whole reason Plan A was established, which was to get people out of here at a younger age.

Jim George: But right now firemen in Plan B stay — they can stay until they're 58. If you offer another opportunity to switch to A, which means age 50, and then add the change from three to five years, that means they have to leave at age 55, rather than age 58.

Paul Lutomski: True, for those people that switch. If they don't, they can stay until 58, and then we're not losing anything. But if the DROP were three years, that would mean age 53 that they would have to leave, instead of age 55. And we also want to change the grandfather clause from allowing people get into the DROP anytime if they're already eligible for retirement to a one year eligibility window for those people.

Georgia Glass: Okay, we'll take these ideas to the actuary, have them cost it out, and then at a Pre-Council Session, explain all this in half an hour to the Council and ask them to be ready to vote next Monday's regular session on an ordinance change.

Aaron Drake: I make the motion that we do that.

Dennis Duckworth: I need a second to that motion.

Jim George: I second the motion.

Dennis Duckworth: All in favor?

Everyone:Aye. (Aaron Drake, Jim George, Al Berndt, Dennis Duckworth)

Jim George: There's one more thing that we might want to add to the motion that Tom Lowman mentioned would reduce the DROP cost, and that would be to make Plan B and C member eligibility begin at age 54 instead of age 53. If that is used, I would hope that we could use that as a last resort. Say something like, "If the other options didn't get us down to neutral, or get us down to be low enough, then we would be willing to add that change for the 53 to 54."

Aaron Drake: I make the motion that we include what Jim just said about changing from age 53 to 54 as part of the motion.

Jim George: I second.

Dennis Duckworth: Vote.

All members: Aye.

Dennis Duckworth: Motion carries.

Jeff Gottbreht: Can we add health insurance into our pension for retirees?

Paul Lutomski: We have had three meetings since the last time we met, so if you could read those notes over, we can vote on those in May when we meet again. There's a list of transactions in your package. Essentially the transactions are just what it took to implement the equity purchase plan. We did sell all of our holdings in Washington Mutual, and transferred all of that money into the Investment Company of America. Washington Mutual was not performing very well, and ICA has roughly the same type of companies and the same investment objective, so by moving the Washington Mutual assets into ICA, we didn't change our asset allocation.

Dennis Duckworth: What did that cost?

Paul Lutomski: Nothing. Also you may have heard the National Bank of Commerce was acquired by Wells Fargo. We obtain all our monthly market values for debt securities from NBC, so I called First Tennessee Bank, to see if they could provide us with those market value figures, just in case NBC no longer could, and First Tennesee said they would do that, if we needed them to. Last time I mentioned we had to violate the investment policy asset allocation guidelines in order to sell what was the most prudent debt security. We sold treasury bonds, notes, and trips, rather than any agency securities, because the spread to agencies was quite large. In your packet, there's a position paper describing the situation, and asking the committee to approve violating the investment policy while we are acquiring equity assets. Please read that over and sign it on your way out if you agree. Lastly, we wanted to report that other statements made in the pension analysis estimates that were originally sent out to the employees, used a negative 4.192% return as the year 2000 return, instead of using the 7% in the positive as the year 2000 return. We corrected that and sent those back out with a letter of explanation. A copy of those letters is in your packet. Are there any questions on that?

Dennis Duckworth: A lot of people in our department said that the second estimates had the same numbers as the first one.

Paul Lutomski: That would be the case, if the person was age 53 on December 31st of 1999. The program would use 12/31/99 as their estimated retirement date, therefore the forecasting of interest rates wouldn't even come into play. We're on item 8, the letter of agreement to change the pension calculations a little bit and everybody's here to sign.

Jeff Gottbreht: I'm under advisement by our attorney Fahey not to sign this agreement, because of item number 6, which is the hold to harmless clause.

Paul Lutomski: Does he have any recommendations as to how we can change that clause, so that it would be agreeable?

Jeff Gottbreht: Yes, he recommended that I not sign it and that the changes could still be implemented by the City.

Paul Lutomski: I guess we'll go to Don Taute with that and see what he has to say, and get back to you, Jeff. The next item is to raise the minimum monthly payment for people who are already retired and for deferred annuitants who left the City service but haven't reached their payment begin age. Aaron and I were working on this together. I'm going to put this up on the computer/TV screen to the numbers. John and I also have put together a scenario. We can show you both scenarios and then the committee can decide which one they would prefer.

Paul Lutomski puts the scenarios on the screen for viewing by the committee.

Paul Lutomski: What Aaron's method does is move members toward a target monthly benefit. If the target is $700 and the person's making $500, they're possibly going to be moved up to the full $700, but not necessarily. Duty disability members go straight to the target. Other members receive up to 21 points for completed years of service. So if you're here for 16 years and you leave, you get 16/21 or 16 points, but not 21 points. We use these points later.

Survivor beneficiaries will receive 21 points if the original member's years of service cannot be determined. For example, we have a lady that's 92 years old and her husband worked here forty years ago. We may not be able to determine her husband's year of service. If we can't determine years of service, we'll just give them full credit. The number of points a person receives is reduced by a variable percentage (50%). So if you were her for 21 years and got a refund, instead of 21 points, you're now going to get 10 ½ points. The member would receive an increase equal to the ratio of their number of points divided by 21 points and multiplied by the difference between the target and their current monthly benefit.

Aaron Drake: All of this is just to make it equitable so that no one gets more than they should. The question is what is the good target benefit amount and what is a good refund percentage reduction? Costs are listed.

Paul Lutomski: There is a separate cost for retirees and survivor beneficiaries versus the cost for deferred annuitants. There's also a count next to the cost, showing how many people are helped by this method.

The administration method of the monthly increase is two pieces. The first piece is for retirees and survivor beneficiaries. We would give them half a percent for each year they have been retired. For example, if they were retired ten years, they would get a five percent increase to their monthly benefit. The second piece is for deferred annuitants. Since they are not receiving monthly benefits yet, we base this off of years of service instead of years retired. For example, if a person were scheduled to receive less than the target, they'd be considered. If they had 12 years of service, we would multiply 12/21 times the target. If that came out to be more than what they were scheduled to receive when their benefits started, then they would get an increase to that amount, otherwise they would stay where they're at. And frankly, I like Aaron's method better. Aaron's method recognizes that a member took a refund and then reduces the increase because of it – similar to the actuarial reduction at retirement. It also gives a larger monthly increase to people that are receiving a lower monthly benefit. Usually these people older, so the pension won't have to paying out the higher amount for as long a period as with the other method, where everyone gets an increase, no matter if you're eighty or fifty-five. If you're fifty-five, we'll be paying that money out a lot longer than if you're eighty.

After some discussion, the committee decided to go with Aaron's method with a $600 target benefit amount, 7.5% discount rate and 50% refund reduction percentage

Paul Lutomski: We have 79 retired employees and survivor beneficiaries getting an average increase of $173 per month at a total present value cost of $1.1 million. We have 34 deferred annuitants getting an average increase of $142 per month at a present value cost of $667,000. The grand is about $1.8 million. This will increase our annual pension payments by $222,000 total in the first year. It should decrease after that.

Aaron Drake: I move to go forward with this method and have the actuaries cost these numbers out, so we can take this to the Council for a vote.

Dennis Duckworth: Is there a second?

Jim George: I will second the motion.

Dennis Duckworth: All in favor say "aye".

All members say "Aye."

Dennis Duckworth: The motion passes.

The meeting is adjourned.