

July 11, 2011

Supervisor Paul M. Cesarz
Chairman
Pension Study Commission
901 N. 9th St.
Milwaukee, WI 53233

RE: Actuary's Review of Proposed Ordinance Amendment to the Employees' Retirement System for State-Mandated Employee Pension Contributions

Dear Supervisor Cesarz:

As requested, we have analyzed the actuarial impact on the Milwaukee County Employees' Retirement System of the attached ordinance amendment. The attached amendment incorporates the most recent law and one of our recommendations (see below). We understand that the attached will be proposed for adoption in the place of an earlier draft. This ordinance amendment is a result of Section 166 of 2011 Wisconsin Act 10, as amended by Section 1684p of 2011 Wisconsin Act 32. This letter replaces our letter dated June 10, 2011 on the same subject. County staff and the actuary have worked together to collect more information in an attempt to be as consistent as possible with the implementation of Wisconsin Act 10 utilized by the Wisconsin Retirement System (WRS).

Section 166 of 2011 Wisconsin Act 10, as modified by Section 1684p of 2011 Wisconsin Act 32, adds section 59.875 of the State statutes, which reads:

59.875 Payment of contributions in an employee retirement system of populous counties

(1) In this Section, "county" means any county having a population of 500,000 or more.

(2) (a) Beginning the effective date of this subsection, in any employee retirement system of a county, except as provided in a collective bargaining agreement entered into under subch. IV of ch. 111 and except as provided in par. (b), employees shall pay half of all actuarially required contributions for funding benefits under the retirement system. The employer may not pay on behalf of an employee any of the employee's share of the actuarially required contributions.

(b) 1. An employer shall pay, on behalf of a nonrepresented law enforcement or fire fighting managerial employee, who was initially employed by the employer before the effective date of this subdivision, the same contributions required by par. (a) that are paid by the employer for represented law enforcement or fire fighting personnel who were initially employed by the employer before the effective date of this subdivision.

2. An employer shall pay, on behalf of a represented law enforcement or fire fighting employee, who was initially employed by the employer before the effective date of this subdivision, and who on or after the effective date of this subdivision, became employed in a nonrepresented law enforcement or fire fighting managerial position with the employer, or a

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successor employer in the event of a combined department that is created on or after the effective date of this subdivision, the same contributions required by par. (a) that are paid by the employer for represented law enforcement or fire fighting personnel who were initially employed by the employer before the effective date of this subdivision.

The state-mandated employee pension contributions will not change the overall liability and costs of the Employees' Retirement System. Thus, the law does not have an actuarial impact on the retirement system. It will, however, shift some of the cost of the Employees' Retirement System from the County to some, but not all, of the active employees covered under the Employees' Retirement System. The shift will come in the form of employee contributions. These employee contributions will be based on the results of the annual actuarial valuation.

Actuarial Analysis

Our actuarial analysis is based on our interpretation of the language in Section 166 of Wisconsin Public Act 10 and how the Wisconsin Retirement System has implemented the Act. The reader is encouraged to refer to our section entitled "*Commentary on Section 166 of Wisconsin Public Act 10*" later in this letter.

Our actuarial interpretations include:

- Sheriffs and firefighters, both non-represented and represented, are not required to contribute nor are members receiving benefits (retirees) or deferred members of the retirement system. We refer to these members as "non-contributors" in this analysis. All other members will be required by the State to contribute and are referred to as "contributors" in this analysis.
- The employee contribution rate is to be consistent for all contributors despite differences in benefits between individual members. Using one contribution rate minimizes administration and variability in contributions from year to year, employee group to employee group, and employee to employee. This is similar to WRS treatment of Act 10, which has limited the contribution rates to four groups: two for protective members and two for all others.
- Contributors that are already making contributions, such as most nonrepresented employees and elected officials, will migrate to the new rate upon the effective date of the law. Other represented groups will begin a contribution upon expiration of their respective bargaining agreements. A recalculation will not be needed in between valuation reports because their numbers are already included in our calculation of the contributors' contribution rate.
- Contributors will pay for half of *their portion* of the actuarially required contributions. This entails allocating unfunded liabilities between contributors on one hand and retirees and other non-contributors on the other hand. In addition, contributors contribute one-half of the contributors' normal cost. This treatment is consistent with the WRS. Under WRS, different rates are calculated for each of the four groups. In addition, retirees liabilities are not assigned to the rates assigned to actives.

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- In our previous letter, we interpreted the term “employees shall pay half of all actuarially required contributions for funding *benefits* under the retirement system” to mean that contributors do not pay for the amortization of administrative *expenses* contained in the actuarially required contributions from the County. Under the WRS, administrative expenses are assigned to each rate group. As such, we have now allocated administrative expenses to the contributor rates in proportion to the contributor liability.
- The draft ordinance amendments we reviewed base the employee contribution on the budget, or estimated contribution. We believe that a more accurate method for calculation of the employee contribution would be to base the calculation on the “current year” or “actual” contribution. The current year contribution is based on verified asset and liability experience rather than being an estimate. Thus, the contribution to be made by employees in 2012 should be based on the 2011 “current year” or “actual” contribution. The county makes the 2011 actual contribution in 2012 and employees would be making their share of the 2011 contribution at the same time as the county. As noted earlier, we understand that the attached substitute resolution will be offered in order to incorporate our recommendation on this point. Therefore, for purposes of determining employee contributions for calendar year 2012, we use the 2011 Actual Contribution of \$26,808,037 as the basis for the employee contribution rate. The derivation of this 2011 actual contribution is contained in the January 1, 2011 Actuarial Valuation report issued May 13, 2011.

The determination of the employee contribution is on the next page. It is based on the interpretations above.

**Milwaukee County Employees' Retirement System
Development of State-Mandated Employee Pension Contributions
Based on January 1, 2011 Valuation Results**

Item	Results Based on Proposed Change		
	Non-Contributors	Contributors	All Members
	Amounts	Amounts	Amounts
Valuation Results as of January 1, 2011			
1. Present Value of Future Benefits			
a) Active Participants *	\$ 123,674,010	\$ 647,041,952	\$ 770,715,962
b) Participants with Deferred Benefits	69,435,621	-	69,435,621
c) Participants Receiving Benefits	1,379,441,317	-	1,379,441,317
d) Total	\$ 1,572,550,948	\$ 647,041,952	\$ 2,219,592,900
2. Present Value of Future Normal Cost	\$ 27,844,427	\$ 99,821,822	\$ 127,666,249
3. Actuarial Accrued Liability: (1 - 2)	\$ 1,544,706,521	\$ 547,220,130	\$ 2,091,926,651
4. Actuarial Value of Assets	\$ 1,424,715,251	\$ 504,712,613	\$ 1,929,427,864
5. Funded Status: (4 / 3)	92.2%	92.2%	92.2%
6. Unfunded Actuarial Accrued Liability: (3 - 4)	\$ 119,991,270	\$ 42,507,517	\$ 162,498,787
7. Normal Cost Rate	11.567%	8.006%	8.457%
8. Total Normal Cost for the Plan Year	\$ 3,248,496	\$ 15,496,676	\$ 18,745,172
Projected Employee Contribution for 2012			
1. Actual Contribution for 2011			
a) Normal Cost with Interest	\$ 3,375,936	\$ 16,104,153	\$ 19,480,089
b) Net Annual Amortization Payments **	5,411,054	1,916,894	7,327,948
c) Total Contribution: ((a + b), not less than zero)	\$ 8,786,990	\$ 18,021,047	\$ 26,808,037
2. Employee Contribution (50% of 1c for Contributors)	N/A	\$ 9,010,523	N/A
3. Expected Salaries in 2011	28,084,168	193,563,275	221,647,443
4. Employee Contribution Rate (2÷3)	N/A	4.7%	N/A
Projected Employee Contribution for Future Years***			
2013		4.9%	
2014		5.1%	
2015		4.9%	
2016		5.4%	

* The actives in the Non-Contributor group include 448 members comprised of Represented Firefighters and Sheriffs and Non-Represented Firefighters and Sheriffs.

** The Net Annual Amortization Payments for the Contributors was prorated based on the contributors' actuarial accrued liability compared to total actuarial accrued liability of the Retirement System. These payments include amortization payments for administrative expenses.

***Based on 8% investment return on a market value basis for years beginning in 2011 and all other actuarial assumptions being realized.

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Based on the above analysis, \$9,010,523 of the \$26,808,037 actual contribution for 2011, to be made in 2012, will be shifted from the County to active employees.

Basis for the Analysis

Unless otherwise noted below, we have based this analysis on the data, assumptions and methods used for the most recently completed valuation, which was as of January 1, 2011.

The undersigned is a Member of the American Academy of Actuaries and meets the Academy's Qualification Standards to issue this Statement of Actuarial Opinion.

Commentary on Section 166 of Wisconsin Public Act 10

At first glance, the language in Section 166 of Wisconsin Public Act 10 seems quite straightforward. Unfortunately, from an actuarial standpoint, it is quite vague and potentially subject to what appears to be unanticipated consequences. These ambiguities lead to the necessity to make the actuarial interpretations that are noted above. We will address some of these ambiguities here.

- The language superficially appears to require an allocation to active, non-exempt employees of one half of the entire actuarially required contribution that would otherwise be paid by the County. For example, of the \$26,808,037 2012 actual contribution from page 16 of the Actuarial Valuation Report, employees would be required to pay one-half, or \$13,404,019. If we were to utilize that interpretation to derive the employee contribution rate, we would divide the employee contribution portion of \$13,404,019 over expected payroll of \$221,647,000 to arrive at an employee contribution rate of 6.0% for 2012. But Section 166 exempts sheriffs and firefighters from contributing. Following the superficial interpretation would effectively require the contributing County employees to pay for one-half of the cost of the exempt employee's benefits. This interpretation would reduce the payroll over which the employee contribution rate is based to \$193,563,000, resulting in an employee contribution rate of 6.9% of pay. This comes close to almost the entire normal cost of the contributor group, meaning that contributors would pay for almost all of their entire annual accruals. We do not believe such an interpretation to be appropriate and furthermore, it is inconsistent with the WRS implementation.
- Most of the volatility inherent in the contribution is due to asset changes rather than liability or benefit changes. Over 65% of the assets are held for the benefit of retirees. Subjecting affected employees to contribution volatility of assets held for the benefit of retirees would result in excessive employee contribution volatility.
- Contribution rates are currently lower than anticipated due to the reflection of contribution variances over the past couple of years. In the future, total contributions are expected to almost double, resulting in a doubling of the employee contribution rate. Employee communications will be important.
- Computed total employer contribution rates for WRS over the 25-year period ending December 31, 2010 have ranged from a low of 10.3% to a high of 12.9%. When compared to the contribution range for Milwaukee County over the past 25 years, the WRS exhibits an extremely

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low level of contribution volatility. There are two primary drivers of the contribution's lack of volatility. First, unlike ERS, under WRS benefits for members receiving payments can be increased or reduced based upon the actual experience of WRS. Second, according to page I23 of its latest actuarial valuation report, a "fundamental WRS objective is stable contribution rates." As a result, WRS contribution rates are based on reserves and other smoothing techniques which are not currently in use by the Milwaukee County Employees Retirement System. Because of that, large market volatility such as that seen during 2008 can result in significant changes in both employer and member contributions for ERS. The projection of employee contributions shown on page four is based on all assumptions being met. If all assumptions are met, contributions will increase from 4.7% to 5.4% over the next five years. Large market volatility as seen in 2008 can result in increases or decreases of 1.0% of employee pay per year. In the event of sustained market losses or gains, these increases or decreases may persist for several years. Stakeholders may wish to consider similar contribution volatility techniques to provide for stable contributions in the County of Milwaukee Employees Retirement System.

The above bullet points are in no means an exhaustive list of the challenges of this legislation. All stakeholders are encouraged to add input to the process.

We look forward to discussing this analysis with you.

Sincerely,



Larry Langer, ASA, EA, MAAA
Principal, Consulting Actuary

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cc: Mark Grady
Paul Wilkinson