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November 14, 2011

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

Re: Actuary's Review of Milwaukee Deputy Sheriffs' Association Voluntary Settlement Proposal Retirement Window

Dear Supervisor Cesarz:

As requested, we have analyzed the actuarial impact on the Milwaukee County Employees' Retirement System (ERS) of Retirement Window proposed in the Milwaukee Deputy Sheriffs' Association (DSA) Voluntary Settlement Proposal (VSP).

Actuarial Analysis

The VSP stipulates that any member of the DSA, who as of November 1, 2011, does not meet either the age, or the age and length of service requirement to retire, and who files an application for retirement benefits between November 1, 2011 and December 31, 2011, and completes their last day of active service as a county employee no later than December 31, 2011, shall be eligible for the addition to the employee's age of the amount of time that is necessary in order for the employee to meet the normal retirement age requirement or, if applicable to the employee, the Rule of 75 for retirement benefits, but in no event more than five (5) years. We will refer to this proposed provision as the Window throughout this analysis.

If enacted, the Window will increase projected benefits to be paid out of the ERS. There are two primary sources of the additional benefits paid out of the ERS System due to the window. First, the benefit enhancements used to incent the member to retire, relaxing the retirement eligibility by five years, add costs to the Retirement System. Members that elect the Window will receive benefits for up to five years longer than if the Window were not enacted. Second, we anticipate that members will retire earlier than assumed in the annual valuation. For purposes of the annual valuation, we do not anticipate that all members will retire at the earliest retirement date, but rather DSA members are anticipated to retire on average one and a half to two years after earliest retirement eligibility. When valuing the window we do assume that all members will retire by December 31, 2011 the earliest retirement date. These additional costs from benefits being paid earlier than anticipated are a significant portion of the increase in liability.

While there will be an increase in the liability of ERS, the cost of benefits accruing during the year, or normal cost, will be eliminated. The normal cost is eliminated because the DSA members who elect the window will no longer accrue benefits under the ERS.

With the assistance of county staff, we have identified 46 DSA members that would be eligible for the window. These 46 members have an average age and service of 50.2 and 20.6 years respectively. We have estimated the increase in actuarial accrued liability (AAL) if all 46 members elect the Window will increase from $14,635,893 to $19,923,680, or $5,287,787. The elimination in normal cost that results is

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$423,123. The impact on the County contribution is the sum of the amortization of the increase in actuarial accrued liability of $5,287,787 and the elimination of the normal cost of $423,123. The following chart summarizes the impact in contribution under various amortization periods.

Estimated First Year VSP Costs under Alternative Amortization Policies				
	Amortization Period for Increase in Actuarial accrued liability due to VSP			
	3 years	5 years	15 Years	30 Years
Increase in AAL Contribution	1,985,170	1,241,390	504,282	329,997
Normal Cost Savings	(423,123)	(423,123)	(423,123)	(423,123)
Net Change in Contribution	1,562,047	818,267	81,159	(93,126)

As noted, the costs above are first year costs. The increase in AAL contribution amount is the first year amount; future AAL contribution payments will increase from the first year amount by 3.5% each year throughout the course of the amortization period. The amortization period is the period of years over which the additional $5,287,787 in AAL is paid off. Under the three year amortization period, the $5,287,787 is paid off in 3 years; under the 5 year period, 5, and so on. As such, the increase in AAL contribution can be thought of as a mortgage.

Unlike the AAL contribution, the normal cost savings may not be realized over the amortization period listed. The normal cost savings will decrease over time to the extent that new DSA members are hired to replace members who elect the window. In the extreme case, if all members that elect the window are immediately replaced, there is effectively no normal cost savings. At the other extreme, if he DSA members that elect the window are never replaced, the normal cost savings are permanent.

The net change in contribution is the sum of the increase in AAL contribution offset by the normal cost savings. The current funding policy for the ERS includes a provision for amortizing unfunded liabilities over a thirty year period. Assuming no change in policy, unfunded liabilities generated by the window will be amortized over the current policy of 30 years. This will result in a net *decrease* in contributions of $93,126 in the first year of the window despite a marked increase in the liabilities of the ERS. Intuitively contributions to the ERS should increase as a result of the window. As such we recommend that a period no greater than 15 years be adopted in conjunction with the window. Furthermore, the costs associated with the window should be amortized over a period over which salary savings generated by the window are realized. This means that consideration should be given to amortizing the costs associated with the window over the same number of years in which salary savings are expected – which is generally considered to be 3 to 5 years. However, if the County's intention is to make these salary savings permanent, which indicates that salary savings will exceed the 3 to 5 year period, a longer period could be considered and we recommend that a 15 year period be adopted. Shorter periods are recommended if salary savings are not permanent. Regardless of the amortization period chosen for amortizing the cost of the Window, the amortization for all other unfunded actuarial accrued liabilities can remain the same.

It should be noted that the above costs have been developed assuming that all 46 eligible DSA members will elect the Window. The number of DSA members that elect the Window cannot be estimated with any level of certainty. That being said, to estimate the impact on the ERS of one-half of the membership electing the Window, it is reasonable to multiply the results of our analysis by one-half.

For purposes of this analysis, we have only isolated the potential impact on the Retirement System. The impact on other benefit programs has not been included in this analysis and should be developed to determine the overall impact on the County of the Window.

The GFOA has a Recommended Practice regarding Early Retirement Incentives that we encourage the appropriate staff to read. We have attached a copy of the recommended practice to the cover email.

Unless otherwise noted, this analysis is based on the actuarial assumptions and methods used to prepare the January 1, 2011 actuarial valuation. The results shown in this report reflect what the January 1, 2011 actuarial valuation would have shown had the Window been implemented and all 46 members elected the window.

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.

Please call if you have any questions.

Sincerely,

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

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cc: Mark Grady