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Options for New Plan Design- Transitioning New Hires to WRS

Milwaukee County Retirement Sustainability Taskforce

January 23, 2018

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Public Sector Retirement Systems Project**

The Pew Charitable Trusts

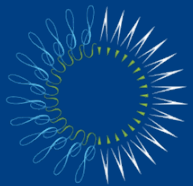
- More than 40 active, evidence-based research projects
- Projects include public safety, immigration, elections, transportation, pensions, and state tax incentives
- All follow a common approach: data-driven, inclusive, and transparent

Pew's Public Sector Retirement Systems Project

- Research since 2007 includes 50-state trends on public pensions and retiree benefits relating to funding, investments, governance, and employee preferences
- Technical assistance for states and cities since 2011

Presentation Overview

- **Basic Details**
- **Financial Metrics**
- **Retirement Security Metrics**
- **Issues to Consider**
- **Conclusion**



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Basic Details

Overview

- Today we are discussing and presenting analysis on closing the Milwaukee County Employee Retirement System to new hires and enroll all future employees of the County in the Wisconsin Retirement System.
- Employees would continue to receive a final average salary defined benefit pension, based on the Wisconsin Retirement System benefit parameters.
- This is just one of the potential changes we are examining at the request of the Milwaukee County Retirement Sustainability Task Force.
- The change analyzed is a soft freeze, applying to new hires only. Other analyses may consider changes that would also cover current employees if the Task Force requests it.

Core Concepts for New Plan Design

- Any plan design should put workers on a path to a secure retirement while being affordable and sustainable.
- Trade-offs between cost, risk, and benefit levels.
- Plan design is more important than plan type.
- Changing benefits for new workers does not eliminate the existing unfunded liability or the need to address it.
- No one-size-fits all, different states and cities have found success with a variety of plan designs.

Plan Provisions: General Workers

	Milwaukee Co. Employees Retirement System (ERS) (Employees hired on or after August 1, 2011)	Wisconsin Retirement System (WRS)
Multiplier	1.6%	1.6%
COLA	2.0%	Annuity adjustments are based on investment performance and other factors*
Employee Contribution (DB)	6.5%†	6.8%†
Vesting	5 years	5 years
Money purchase benefit	None	Yes, with 100% employer match‡
Normal Retirement	Age 64; 55 with 30 years of service	65 & any years of service, or 57 & 30 years of service
Final Average Salary (FAS)	3 years	3 years
Social Security?	Yes	Yes
Risk-Sharing	Employees are required to contribute half of the gross normal cost for actives, plus interest.	Employees contribute 50% of the total contribution rate. The annuity adjustment is based primarily on the investment returns of the plan's trust funds. Actuarial factors, such as mortality rates, also affect annuity adjustments.

Notes

† Rates for 2016; future rates based on actuarial analysis. Participants in ERS and WRS pay half of the normal cost and half of the active UAAL amortization.

‡ WRS calculates the retirement annuity using two methods: the formula method, which factors in years of service, age, salary and a benefit multiplier; and a separate money purchase method, which is calculated by multiplying a member's total employee contributions, an equal amount of employer contributions, and accrued interest by an actuarial factor based age and benefit effective date. Retirees receive whichever produces the higher amount.

Plan Provisions: Public Safety Workers

	ERS (Deputy sheriffs hired after January 1, 1994)	WRS (Protective Occupation Employees)
Multiplier	1.5 - 2.5%*	2.0 - 2.5%*
COLA	2.0%	Annuity adjustments are based on investment performance and other factors**
Employee Contribution (DB)	6.5 to 7.4%†	6.8%†
Vesting	10 years, or age 57	If you first began WRS employment on or after July 1, 2011, 5 years. Prior, vested at date of employment.
Money purchase benefit	None	Yes, with 100% employer match‡
Normal Retirement	Age 57 or age 55 with 15 years of service;	Age 54 with <25 years of service; Age 53 with 25+ years of service
Final Average Salary (FAS)	5 year average	3 year average
Participates in Social Security?	Yes	Yes***
Risk-Sharing	Employees are required to contribute half of the gross normal cost for actives, plus interest	Employees contribute 50% of the total contribution rate. The annuity adjustment is based primarily on the investment returns of the plan's trust funds. Actuarial factors, such as mortality rates, also affect annuity adjustments.

Notes

*For ERS, depends on bargaining agreement and date of hire, max benefit of 80% salary. For WRS varies based on hire date/participation in Social Security.

† Rates for 2016; future rates based on actuarial analysis. Participants in ERS and WRS pay half of the normal cost and half of the active UAAL amortization

‡ WRS calculates the retirement annuity using two methods: the formula method, which factors in years of service, age, salary, and a benefit multiplier; and a separate money purchase method, which is calculated by multiplying a member's total employee contributions, an equal amount of employer contributions, and accrued interest by an actuarial factor based age and benefit effective date. Retirees receive whichever produces the higher amount.

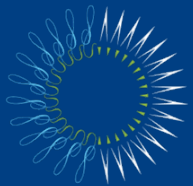
***Some firefighters under protective occupation hired/rehired after March 31, 1986 do not participate in social security.

Different Methods to Closing a Defined Benefit Plan

Method selected can significantly impact worker benefits

Types of Defined Benefit Plan Freezes	Description
Soft freeze	A pension plan is closed to new hires, while active participants in the plan continue to accrue benefits under the plan.
Partial freeze	Benefit accruals is halted for some, but not all participants based on age, tenure, or job classification.
Hard freeze	Service accruals for all active participants are suspended and new employees are not permitted into the plan. Assets remain in the plan and are paid out when participants retire or leave, but the participants' benefits do not grow with additional years of service.

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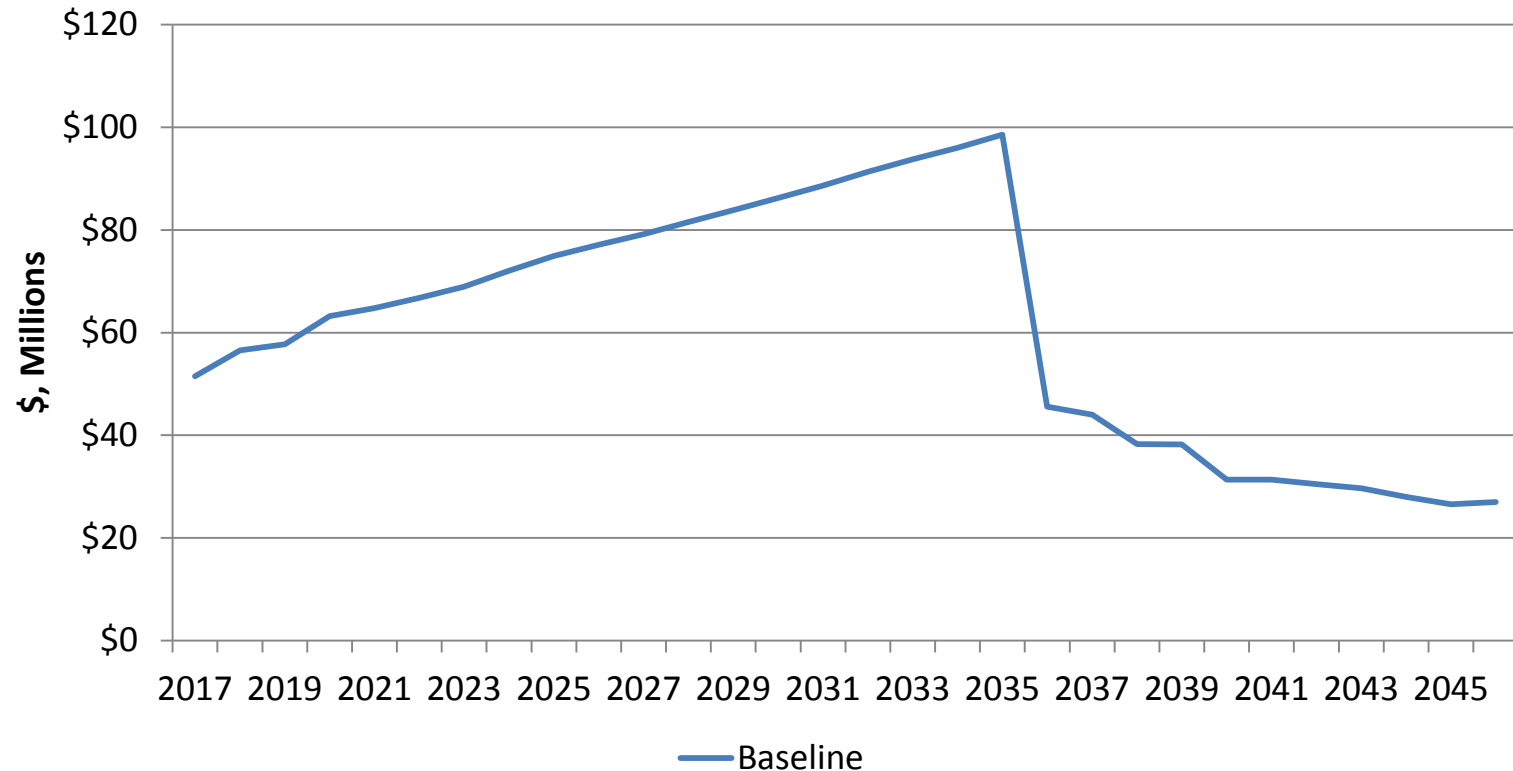


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Financial Metrics

Expected Employer Costs Under Current Policy

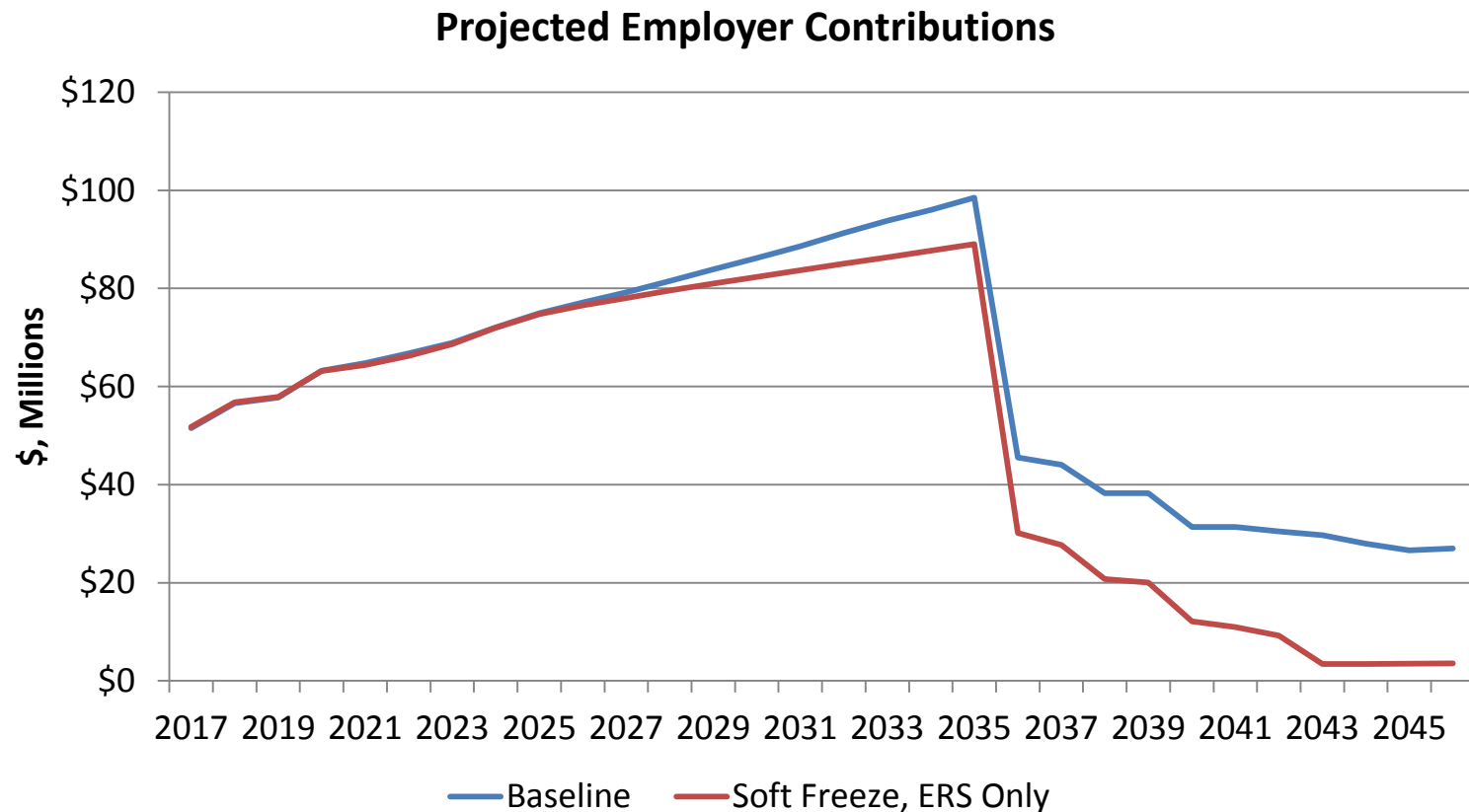
Projected Employer Contributions



Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions

Expected Employer Costs for ERS after Soft Freeze

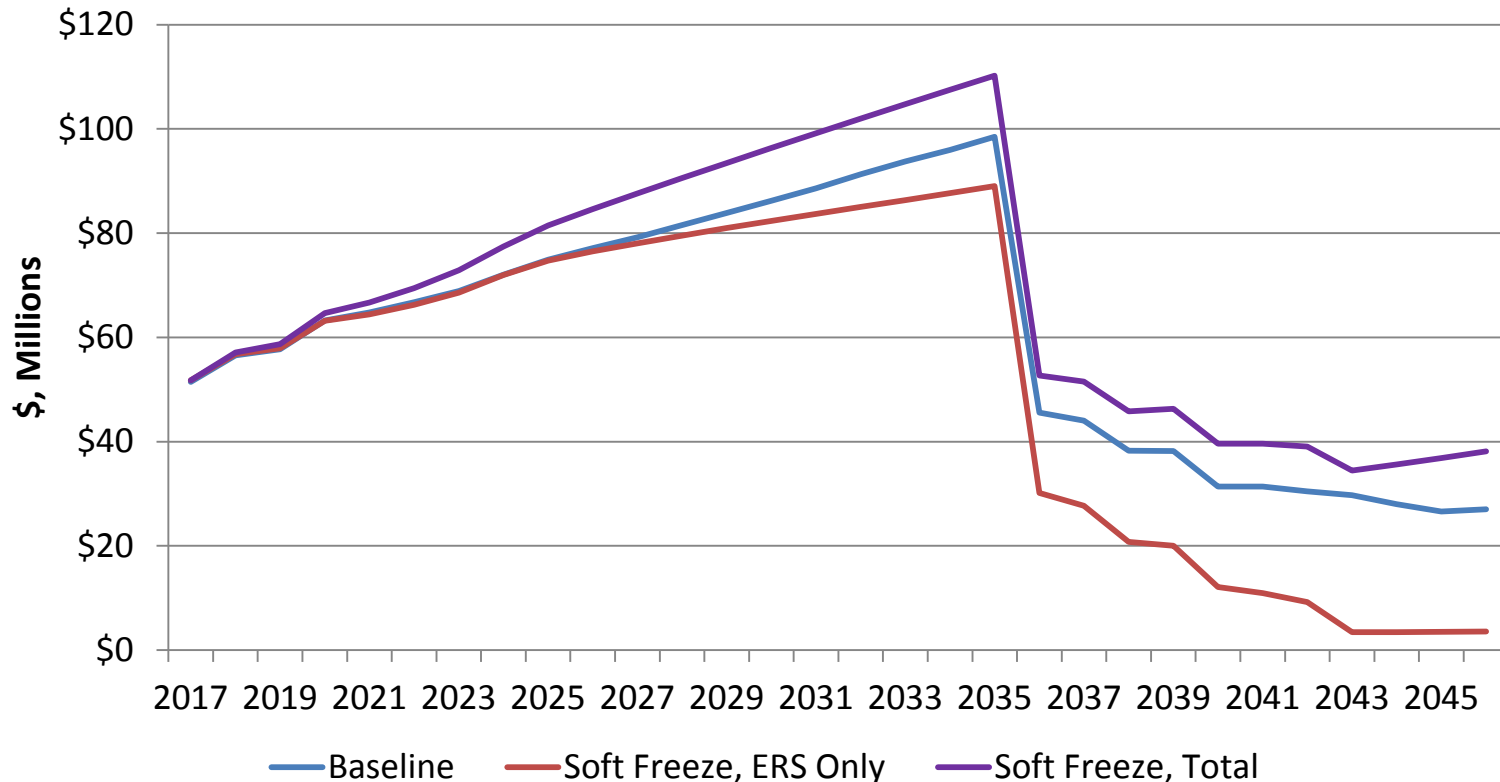


Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions

Expected Employer Costs for ERS and WRS Combined

Projected Employer Contributions

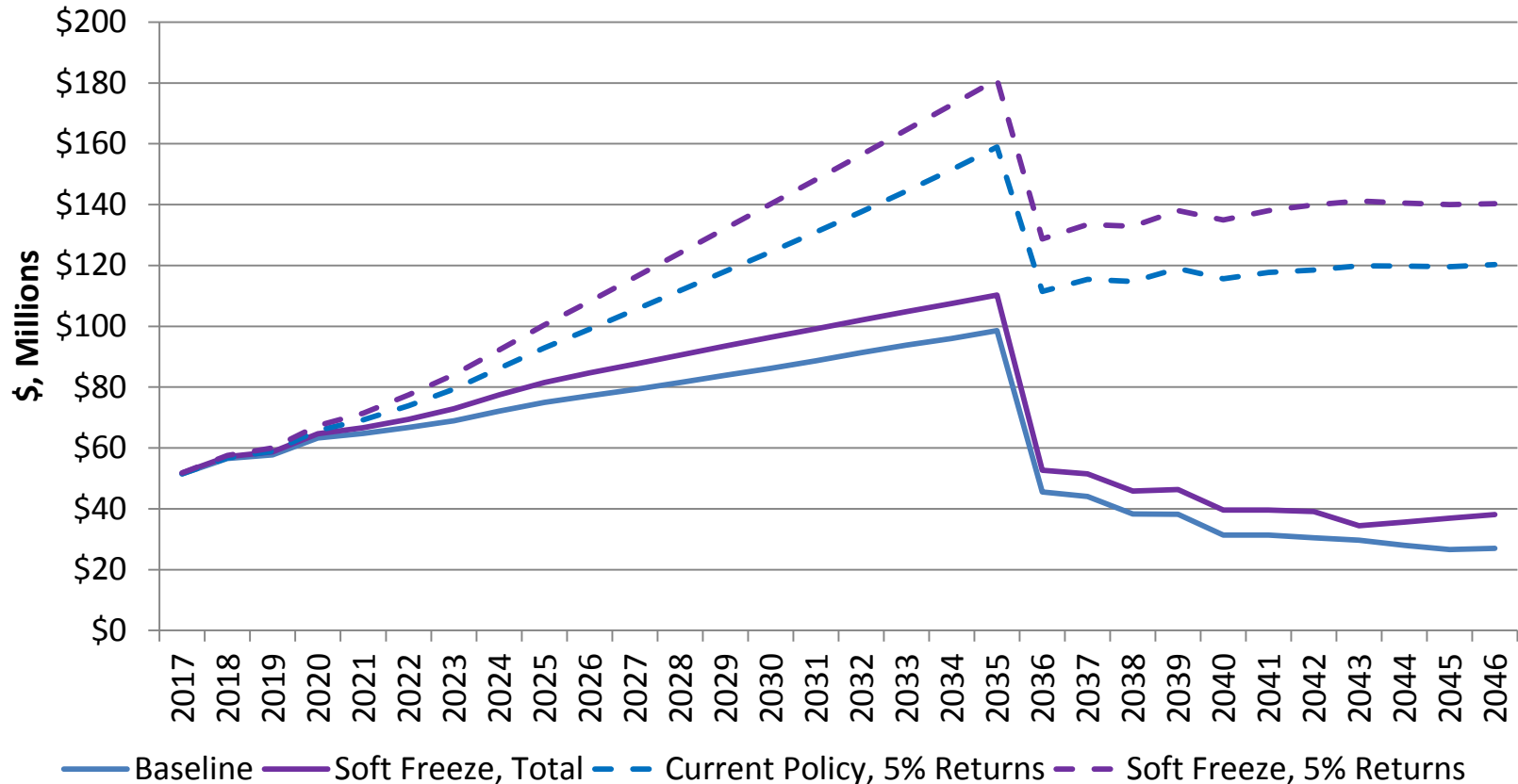


Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions and WRS plan assumptions.

Employer Costs in a 5% Return Scenario

Projected Employer Contributions, 5% Returns



Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions

Risk reduction from WRS

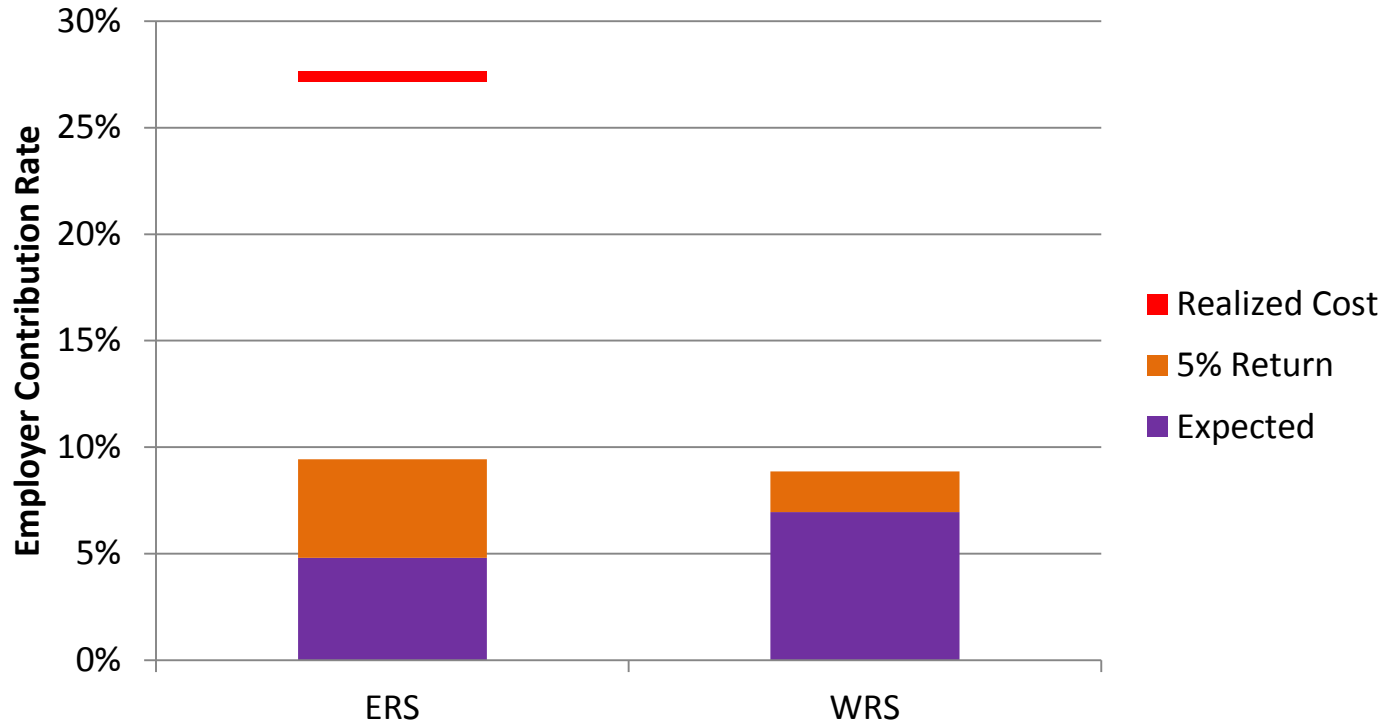
- Both ERS and WRS have the same risk sharing features for active employee liabilities—a 50/50 split in costs between employer and employee.
- Once someone retires in WRS, their benefit can fluctuate based on investment performance. As a result, the employer effectively faces no risk for retiree liabilities.
- In contrast, ERS has no risk sharing for retiree liabilities.
- Because the difference in risk mitigation policies is on the retiree liabilities, there will be limited impact over the 30 year projection period from the additional WRS risk reduction.
- Over the long-run we would expect a switch to WRS to reduce overall risk for Milwaukee County.

How Risk Is Shared in ERS and WRS

	Employer Risk Mitigation	
	Liabilities for Active Participants	Liabilities for Inactive Participants
ERS	50%	0%
WRS	50%	100%

Normal Cost Sensitivity

Employer Normal Cost Sensitivity, ERS and WRS



Notes:

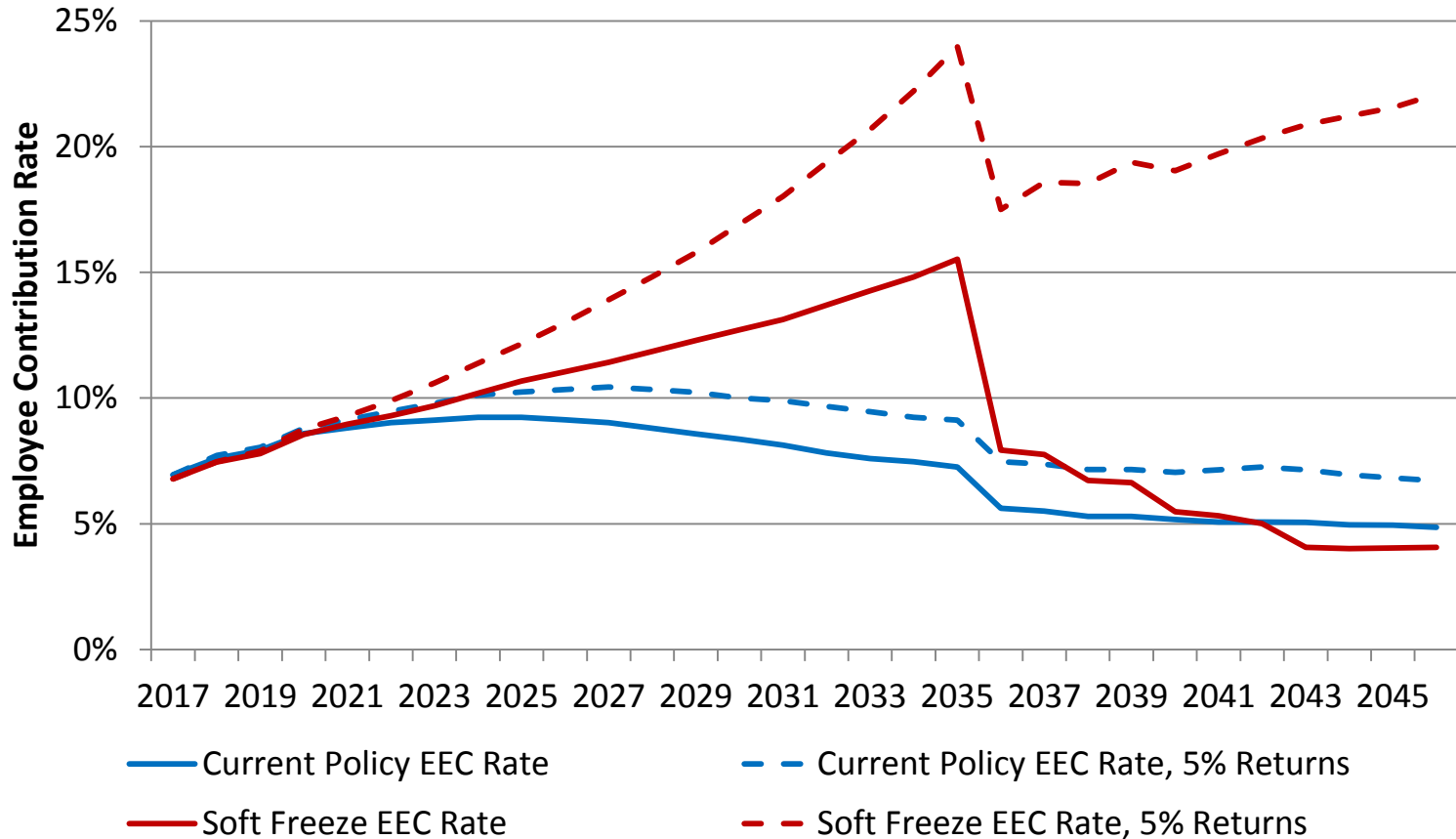
ERS expected normal cost based on 7.5% discount rate. WRS expected normal cost based on 7.2% discount rate. Both employer normal cost estimates based on 50/50 split in total normal cost between employer and employee.

Last Man Standing Issue

- Right now the cost of active employee benefits is split between ERS employees and the County.
- In a soft-freeze, both active employee liability and payroll will decline over time.
- If ERS is closed, the employee contribution rate for workers still in the legacy plan could potentially go up to high levels if payroll declines faster than active employee liabilities.
- Our modeling suggests this would be the case.
- Key consideration will be how to address this—there are several options.

Employee Contribution Rates Can Spike in Soft Freeze

Projected Employee Contribution Rates

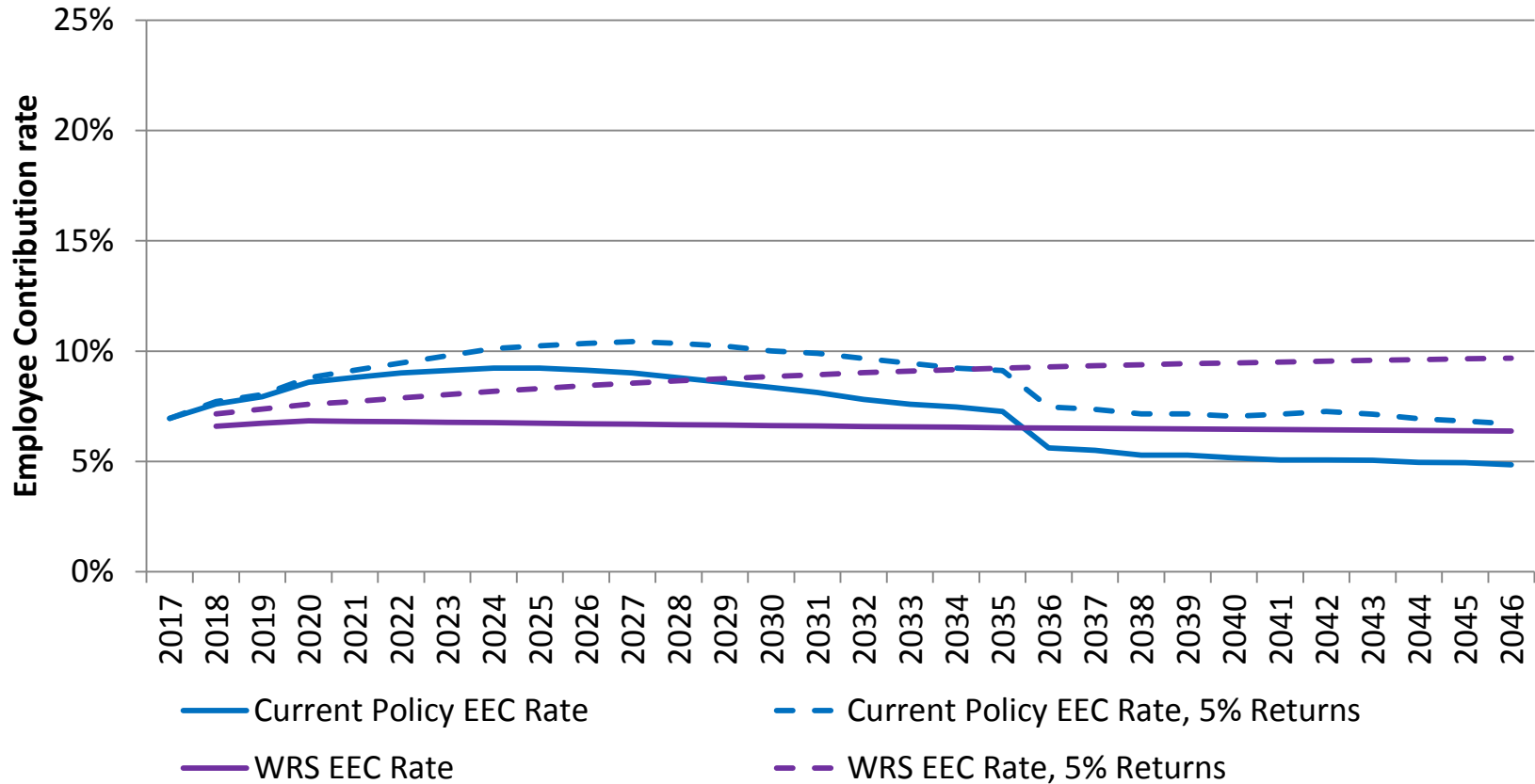


Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions and WRS plan assumptions.

Employee Contribution Rates in WRS

Projected Employee Contribution Rate

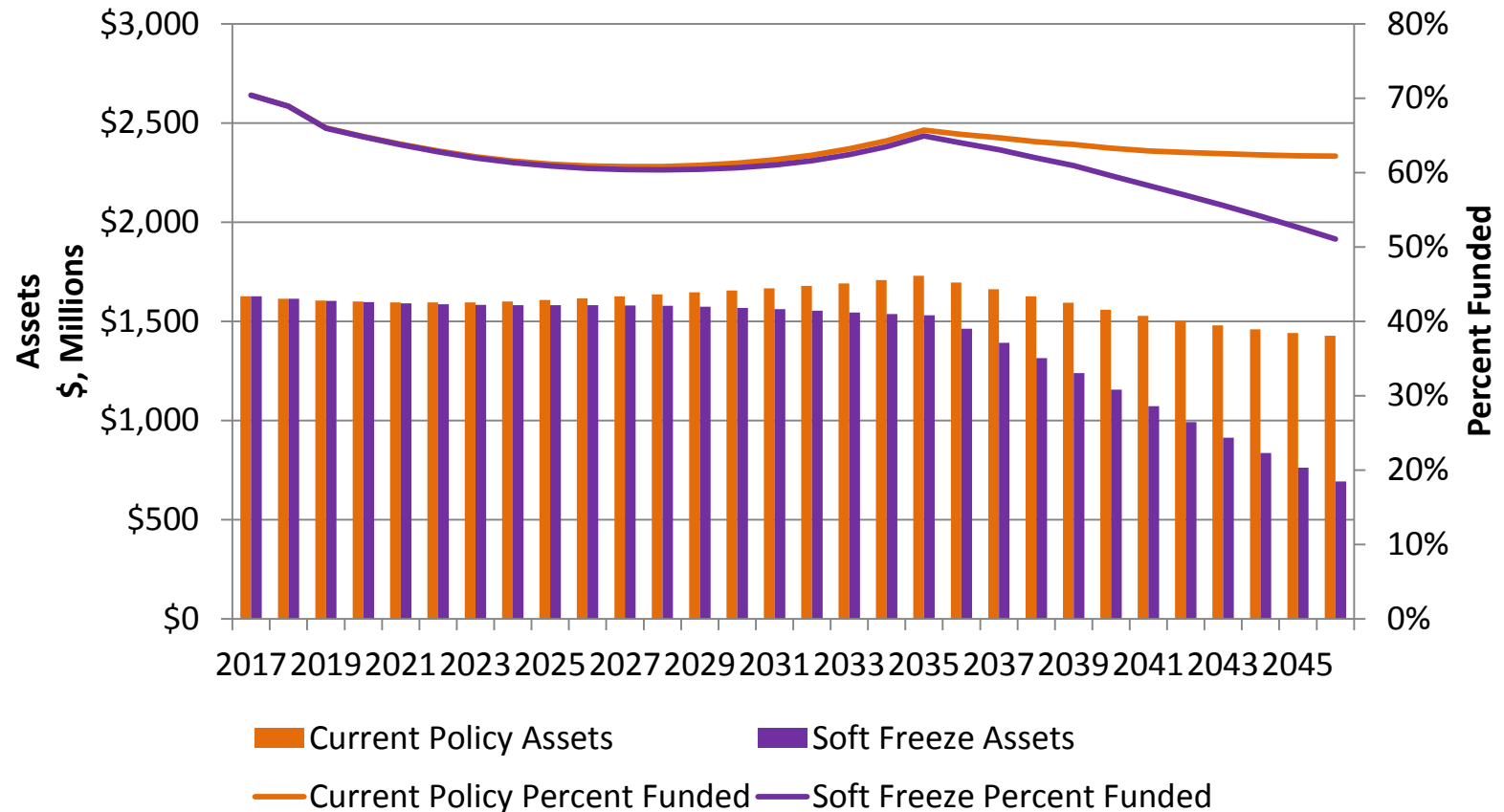


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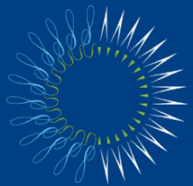
Assets and Funding Levels in a Closed ERS Plan in a 5% Return Scenario

Assets and Percent Funded in a 5% Return Scenario



Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions.



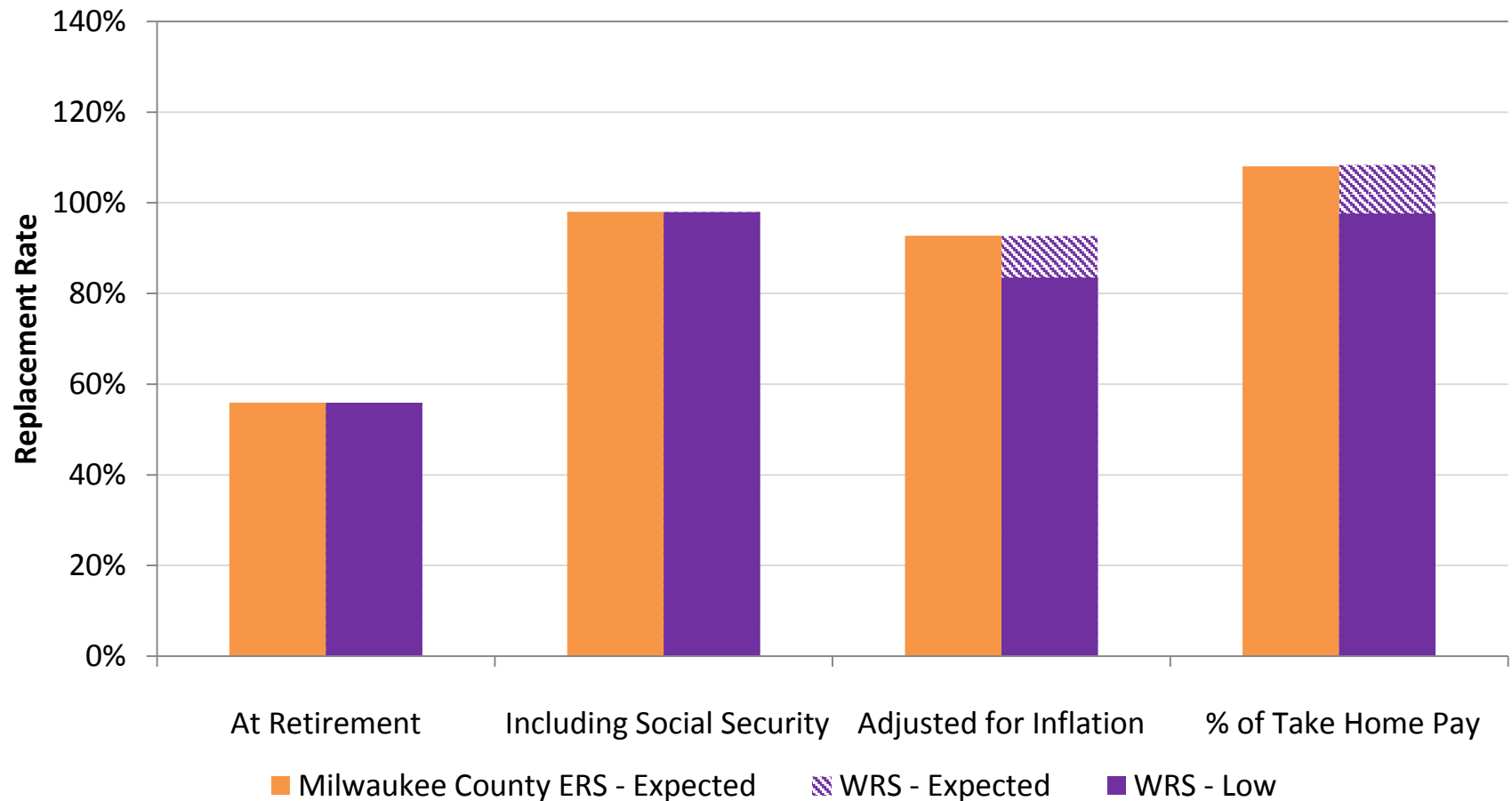
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Retirement Security Metrics

Measuring Retirement Security: Three Important Metrics

- **Potential replacement income.** What percentage of career-end take-home pay is replaced by retirement income?
- **Value of lifetime benefits.** What is the total amount of government-sponsored retirement income an employee can expect to receive over a lifetime?
- **Retirement savings rate.** What percentage of salary is available to a worker who leaves public service before reaching retirement age eligibility?

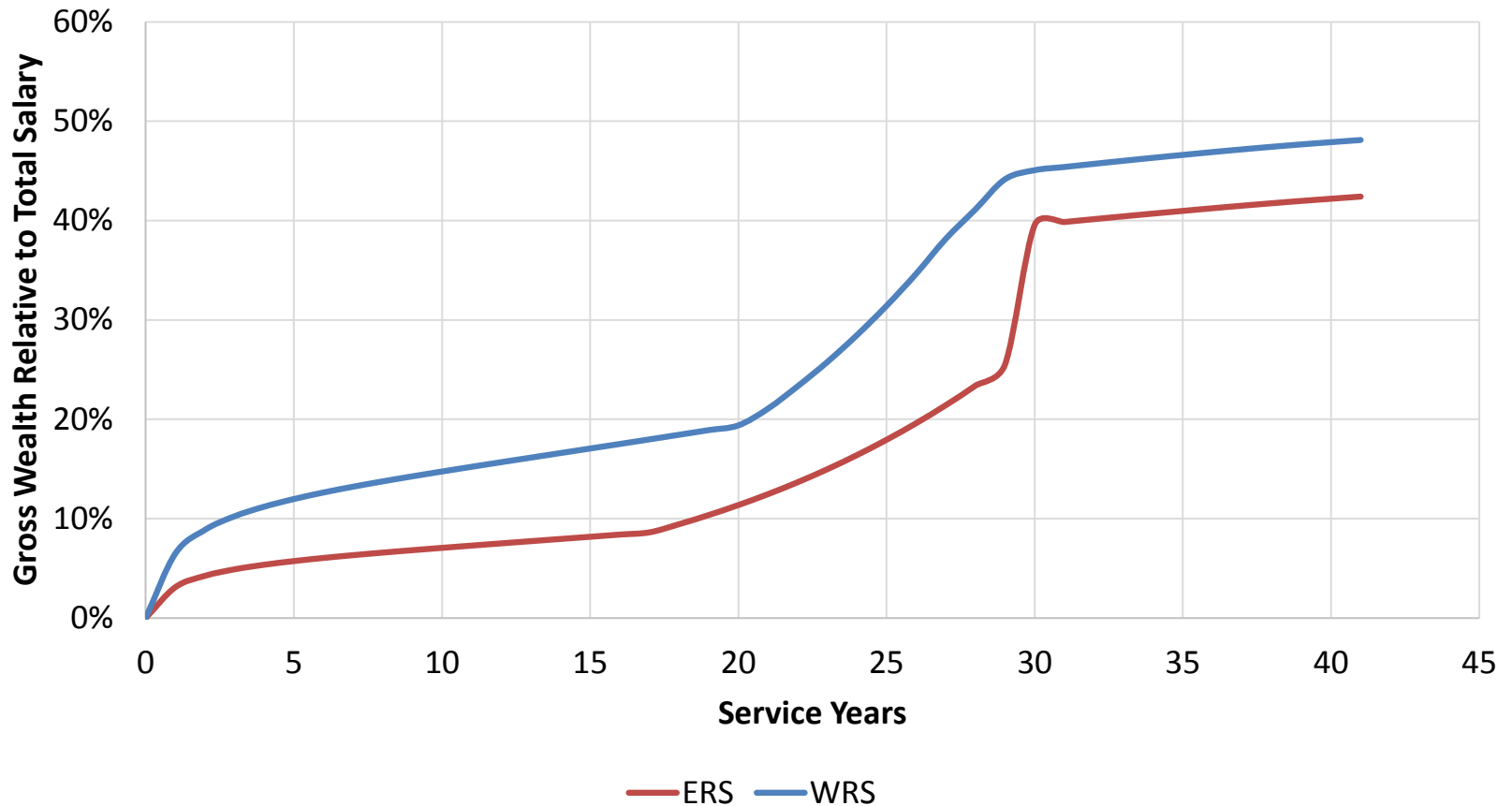
Projected Replacement Income



Notes: Projections assume general employee with a start age of 28 and a retirement age of 64. Low return scenario assumes 5% returns. WRS benefits can also be higher than model if investment returns exceed plan assumptions due to the variable COLA.

Value of Lifetime Benefits

Gross Wealth Relative to Total Salary

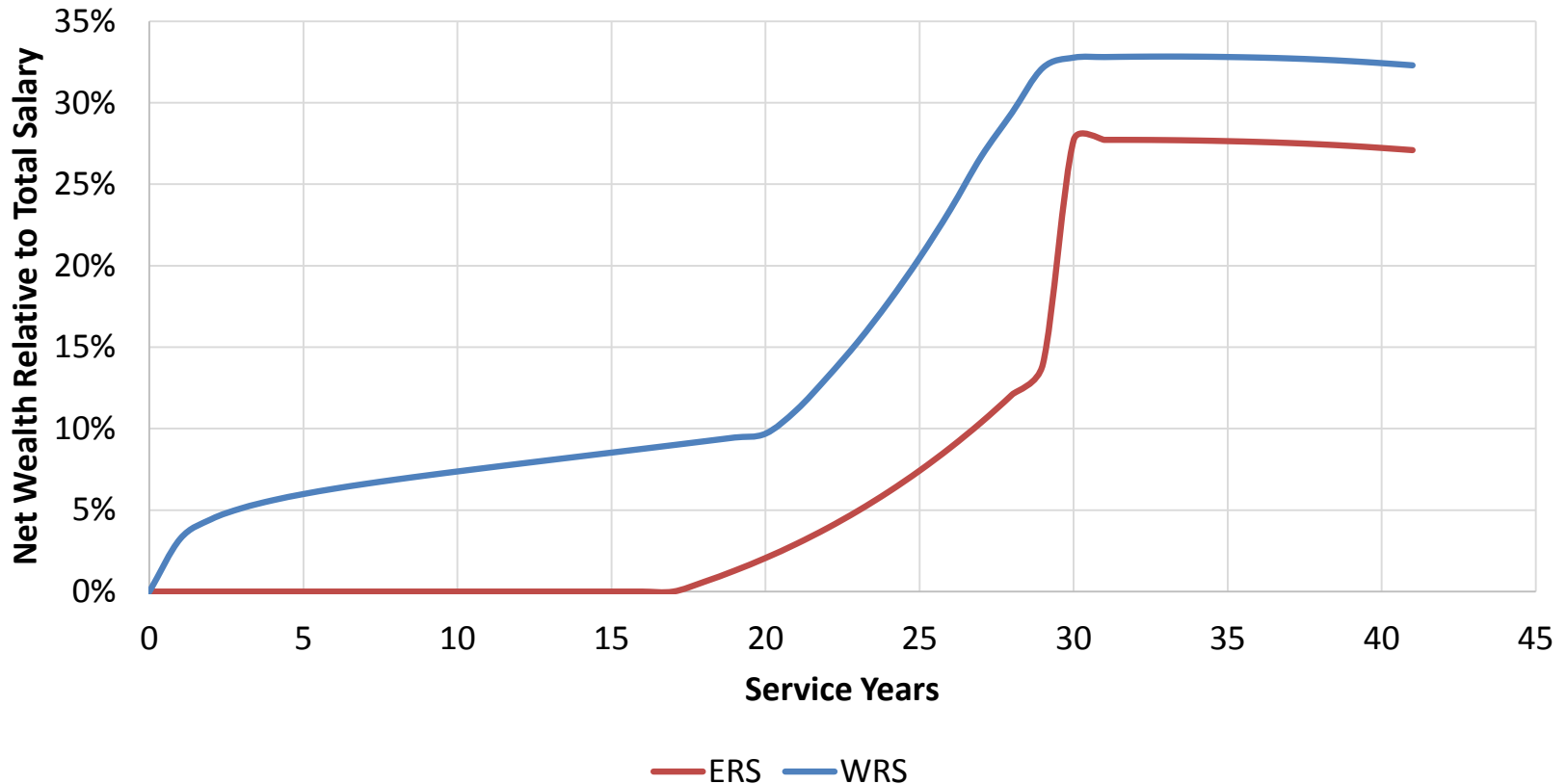


Notes:

Projections done by the Urban Institute, assuming a general employee with a start age of 28.

Value of Lifetime Benefits, Net of Employee Contributions

Net Wealth Relative to Total Salary

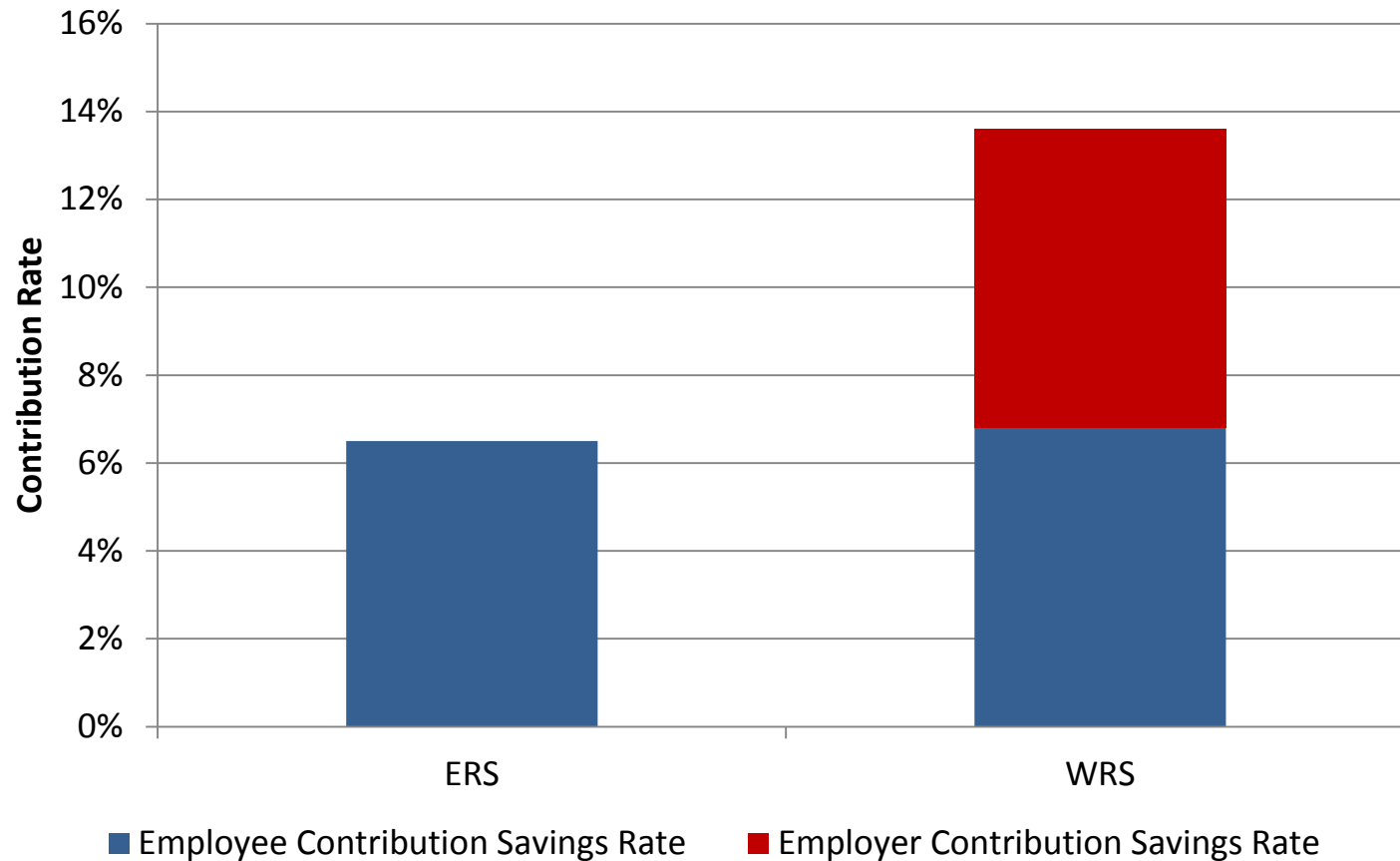


Notes:
Projections done by the Urban Institute, assuming a general employee with a start age of 28. Uses 2017 employee contribution rate of 6.5% for ERS and 6.8% for WRS.

Explanation of Money Purchase Benefit

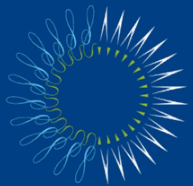
- The Wisconsin Retirement System allows participants to receive the higher of the benefit under the final average salary formula or the money purchase benefit.
- The money purchase matches the accumulated employee contributions (including interest) with employer contributions and converts that amount into an annuity.
- Traditional final average salary defined benefit plans risk leaving short- and medium-term workers with insufficient savings. A money purchase option helps ensure all workers get put on a path towards a secure retirement.
- The money purchase benefit attached to the WRS plan design is one reason it has a higher expected normal cost than the ERS benefit.

Retirement Savings Rate



Notes:

Based on 2016 employee contribution rates. Employee contribution rates for ERS and WRS vary based on actuarial projections..



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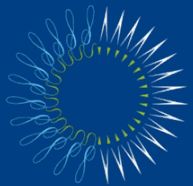
Issues to Consider

Considerations Going Forward

- **How to balance short-term and long-term?** We estimate that a soft-freeze of the ERS and a transition to WRS will increase employer costs through 2046. It will also reduce risk over the long-term and achieve the goal of transitioning Milwaukee County over time from directly running a pension plan.
- **A soft-freeze does not appear to cause solvency risk.** Even in a low-return scenario, we do not see indications that plan closure could cause asset drops that would put ERS in danger of insolvency. This assumes policymakers stick to current contribution policies.
- **A soft-freeze can cause employee contributions to grow to high levels.** In a low return scenario, workers in ERS could end up contributing a quarter of their pay. Solutions include:
 - Setting a fixed employee contribution or setting a max.
 - Having the ERS participant contribution rate match the WRS contribution rate.
 - Changing the calculation of the ERS employee contribution rate.

Questions for a Hard Freeze

- **How to manage reciprocity between plans?** Under current policy, there is reciprocity between plans for participants in Milwaukee County ERS and Wisconsin Retirement System. Would that continue to apply in a hard freeze and over which benefit provisions?
- **Is there solvency risk from hard freeze?** Our analysis suggests a soft freeze does not create solvency risk. Does that apply in a hard freeze?
- **How to manage employee contributions in a hard freeze?** Under current policy, employees are paying for a share of the unfunded liability facing ERS. If employee ERS payroll goes to zero, does that entail that the full cost of the ERS pension debt will be borne by Milwaukee County? Or are there changes to the employee contribution calculation that would be made in a hard freeze?

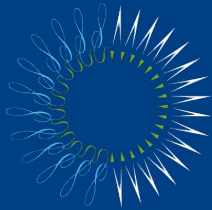


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Conclusion

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- The bulk of the pension costs for Milwaukee County are for existing liabilities to current employees and retirees. Changing the plan design for new hires is about achieving long-term fiscal sustainability.
- Closing ERS to new hires and transitioning future employees into WRS will increase expected costs but reduce risk over the long-run. Short- and medium-tenure employees will get a more robust benefit.
- A soft freeze does not appear to create a risk of insolvency. It does appear to cause a sharp increase in ERS employee contribution rates that would need to be addressed.
- New plan design will not eliminate the need to have a credible plan to pay for existing promises.



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