

**INTEROFFICE COMMUNICATION
COUNTY OF MILWAUKEE**

DATE: November 20, 2015

TO: Theo Lipscomb Sr., Chairman,
Milwaukee County Board of Supervisors

FROM: Steven Huff, Pension Board Secretary, Reinhart Boerner Van Deuren s.c.,
Mark A. Grady, Deputy Corporation Counsel
Paul Bargren, Corporation Counsel

SUBJECT: Pension Board Request for Amendments to ERS Pension Ordinances;
sections 201.24(7.1) and (7.2) related to optional forms of benefit.

On behalf of the Pension Board, we request that you refer the attached resolution and proposed ordinance amendments requested by the Pension Board of the Employees' Retirement System of the County of Milwaukee ("ERS") to the Committee on Finance, Personnel and Audit (FPAC) and to the Pension Study Commission. At its meeting on October 21, 2015, the Pension Board approved a motion (7-1) to request that the County Board adopt these amendments.

The proposed amendments relate to the optional forms of pension benefit available to members of ERS upon retirement and would do three things.

- (1) The amendments eliminate one historical optional form of benefit that is rarely used currently, but the use of which could increase in the future and could create administrative concerns for ERS.
- (2) The amendments codify into the ordinances all of the remaining optional forms of benefit.
- (3) The amendments eliminate the Pension Board's existing discretionary authority to approve any other form of benefit.

A report is attached from the actuary indicating that the ordinance amendments have no actuarial effect on the system. A summary of the proposal follows.

Existing Structure for Forms of Benefit

Normal Benefit

The ordinances contain a “normal” or standard form of benefit which pays a monthly benefit for the life of the member, with no benefit to anyone after the member’s death (§5.1). This is commonly referred to as the “MAX” benefit. *No change is proposed to this form of benefit.*

Ordinance Option 1

Section 7.1 of the ordinances contains three optional forms of benefit (numbered 1, 2 and 3). *The proposed ordinance amendments request elimination of Option 1.* **Option 1** is currently defined as follows:

A reduced pension payable during his life, with the provision that the balance in his accumulated membership account as of the date of his retirement over the payments he has received that are attributable to that account, disregarding any post-retirement pension adjustment, shall be paid to his beneficiary.

Option 1 has existed for decades and logically relates to the existence, prior to 1971, of “voluntary” membership contributions and accounts. Such accounts have not existed for members hired after 1971. Although mandatory contributions by members have recently resumed, members hired since 1971 are not permitted to make additional voluntary contributions. There no longer are any current county employees hired prior to 1971.

The primary issues associated with Option 1 identified by the Pension Board are administrative concerns. All forms of benefit except for Option 1 are completely calculated and known at the time of the member’s retirement; the member knows the amount of his or her benefit, and the member and designated survivor beneficiary know the potential amount of the survivor’s benefit. Using factor tables provided to ERS by the actuary, an actuarial reduction is calculated based on the member’s and the designated survivor’s life expectancies and the option selected.

Unlike all other options, Option 1 requires ERS to conduct a complicated actuarial calculation based not only on life expectancies, but also based on the size of the member’s membership account. In addition, unlike all other options, Option 1 requires ERS to track the member’s benefits until the member’s death and to

conduct, at that time, perhaps decades later, another calculation comparing the member's lifetime benefits to the member's membership account balance to determine the difference remaining between the two. Thus, unlike all other options, the full Option 1 benefit to be paid to the member's survivor beneficiary is not known until the member's death. For these reasons, Option 1 is more difficult to administer and provides a greater opportunity for errors than the remaining options.

In addition, ERS cannot predict the lump sum amounts that will be paid with Option 1 benefits, and therefore cannot predict cash flow concerns, similar to those that have occurred with backdrop benefits.

Furthermore, the Pension Board has concerns about fulfilling its fiduciary function with respect to providing members information to allow them to fully understand this Option and to make an appropriate benefit choice at retirement. There is no way to predict the lump sum amount that will be paid to the beneficiary upon a member's death, and therefore ERS cannot provide information to a retiring member about choosing this benefit in the same manner that can be done with the other forms of benefit. Consequently, members may be more likely to select Option 1 benefits when it might be contrary to their financial interest to do so.

Because Option 1 is historically based on voluntary contributions that no longer exist, because it is more difficult to administer, because it is difficult for members to knowledgeably evaluate and because the nature of future lump sum payments cannot be known, the Pension Board recommends elimination of Option 1.

Ordinance Options 2 and 3

Section 7.1 of the ordinances contains two other options.

Option 2 is referred to as the "50%" option. Option 2 allows a member to name a survivor beneficiary at retirement who will receive a monthly benefit after the member's death of 50% of the member's benefit, if the beneficiary is still alive.

Option 3 is referred to as the "100%" option. Option 3 pays a survivor beneficiary a benefit equal to the benefit the member was receiving while alive.

The proposed amendments do not change these two options.

Rule Options 4, 5 and 6

Section 7.2 of the ordinances grants the Pension Board the authority, in its sole discretion, to approve any other form of benefit a member might request, as long as the benefit is actuarially neutral. Utilizing this authority, the Pension Board many years ago approved three additional “standard” options set forth in its Rule 1013.

As currently numbered, “Option 4” is a 25% survivor benefit and “Option 5” is a 75% survivor benefit. Both of these options work in the same fashion as the 50% and 100% options contained in section 7.1 of the ordinances.

“Option 6” (also referred to as the “ten year certain” option) is a monthly benefit payable for the life of the member, but guarantees that at least 10 years (120 months) of benefits will be paid. If the member dies before 10 years of benefits have been paid, the balance of the 10 years is paid to the member’s beneficiary, or, if the beneficiary has not survived the member, to the member’s estate. Essentially, benefit payments are guaranteed to be paid for the member’s life, or ten years, whichever is longer. An actuarial reduction is taken to reflect the 10 year guarantee.

The proposed amendments preserve these three options and codify them into the ordinances.

Option “7”

In addition to the options discussed above, section 7.2 grants the Pension Board the authority to approve any other form of benefit beyond these standard, or “pre-approved,” benefits. This discretion has become known as an “Option 7” benefit. *In the proposed ordinance amendments, the Pension Board requests that this discretion and this “option” be eliminated.* The result would be that members would be limited to the optional forms of benefit approved by the County Board and set forth in the ordinances.

In the past, members have requested Option 7 benefits in a couple of forms. Some members requested “5%,” “3%,” or even “1%” survivor options. After initially granting several of these requests, in 2006, the Pension Board amended its Rule 1013 to provide that it would not normally grant requests less than the 25% option. In addition, members have requested payment of their entire pension in a lump sum. The Pension Board has not granted such requests and in 2006 amended its Rule 1013 to provide that it would not normally do so as, among other things, the Pension Board believes the standard options provide sufficient options for

members. As noted, the Pension Board now requests in the proposed amendments that the County Board eliminate this Pension Board authority.

Summary of Optional Benefits if Ordinance Amendments are Adopted

In summary, if the proposed ordinance amendments are adopted, the Option 1 form of benefit would be eliminated. The possibility of an Option 7 form of benefit would also be eliminated.

Current Options 4, 5 and 6 contained in Pension Board Rule 1013 would be added to Options 2 and 3 listed in the ordinance.

Consequently, if the amendments are adopted, ERS members would be able to select from the following forms of benefit at retirement:

- MAX benefit for the member's life with no survivor benefit;
- 100% monthly survivor benefit after the member's death;
- 75% monthly survivor benefit after the member's death;
- 50% monthly survivor benefit after the member's death;
- 25% monthly survivor benefit after the member's death;
- Ten-year certain monthly benefit.

These six forms of benefit are the options that almost every member has selected over the past couple of decades. Since 2004, only 6 members have selected Option 1. Since 2005, the Pension Board has not granted any Option 7 forms of benefit.

These standard forms of benefit present fewer administrative and other concerns for the Pension Board and ERS. The Pension Board believes that any additional forms of benefit other than these six forms should be approved by the County Board and Executive rather than by the Pension Board, better preserving the distinction between the role of the Pension Board as an administrative agency and the role of the County Board as the plan sponsor and benefit-setting body. In summary, the Pension Board believes that the proposed ordinances amendments result in an administratively simpler and clearer retirement system.

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