

Milwaukee County Retirement Sustainability Taskforce

National Pension Overview and Milwaukee County Fiscal Assessment

September 26, 2017

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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

- **Introduction**
 - Principles for Fiscal Sustainability and Retirement Security

- **National Perspective**
 - Funding
 - Investments
 - Plan Design

- **Milwaukee County ERS Fiscal Assessment**
 - Overview
 - Key Findings

Principles for Fiscal Sustainability and Retirement Security

- No one-size-fits-all solution, but **key principles** can guide any reform process.

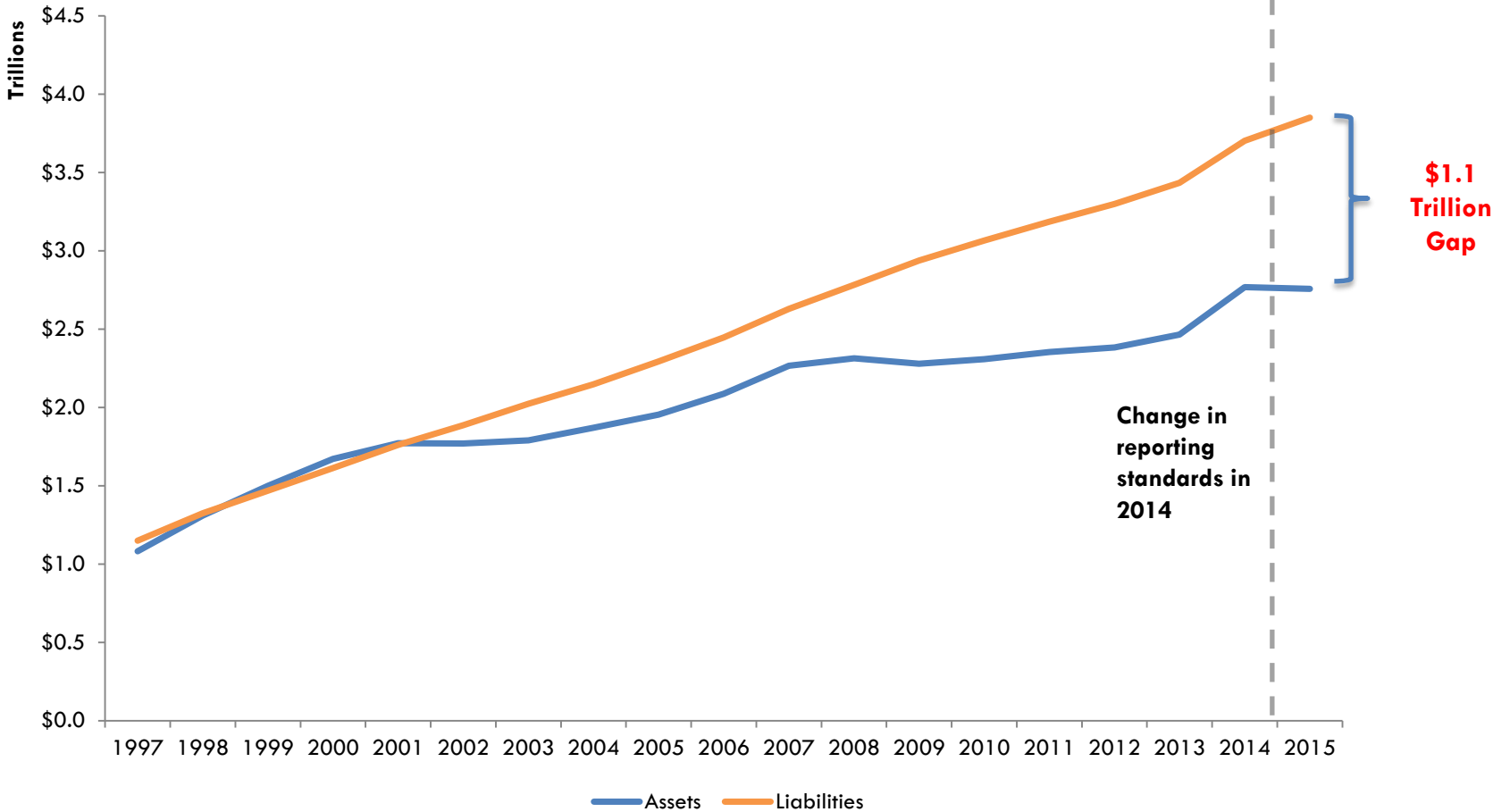
- **Fiscal sustainability principles**
 - Commit to fully funding and paying for pension promises.
 - Manage investment risk and cost uncertainty.
 - Follow sound investment governance and reporting practices.

- **Retirement security principles**
 - Target sufficient contributions and savings to help put employees on a path to a secure retirement.
 - Invest assets in professionally managed, pooled investments with low fees and appropriate asset allocations.
 - Provide access to lifetime income in retirement.

National Perspective

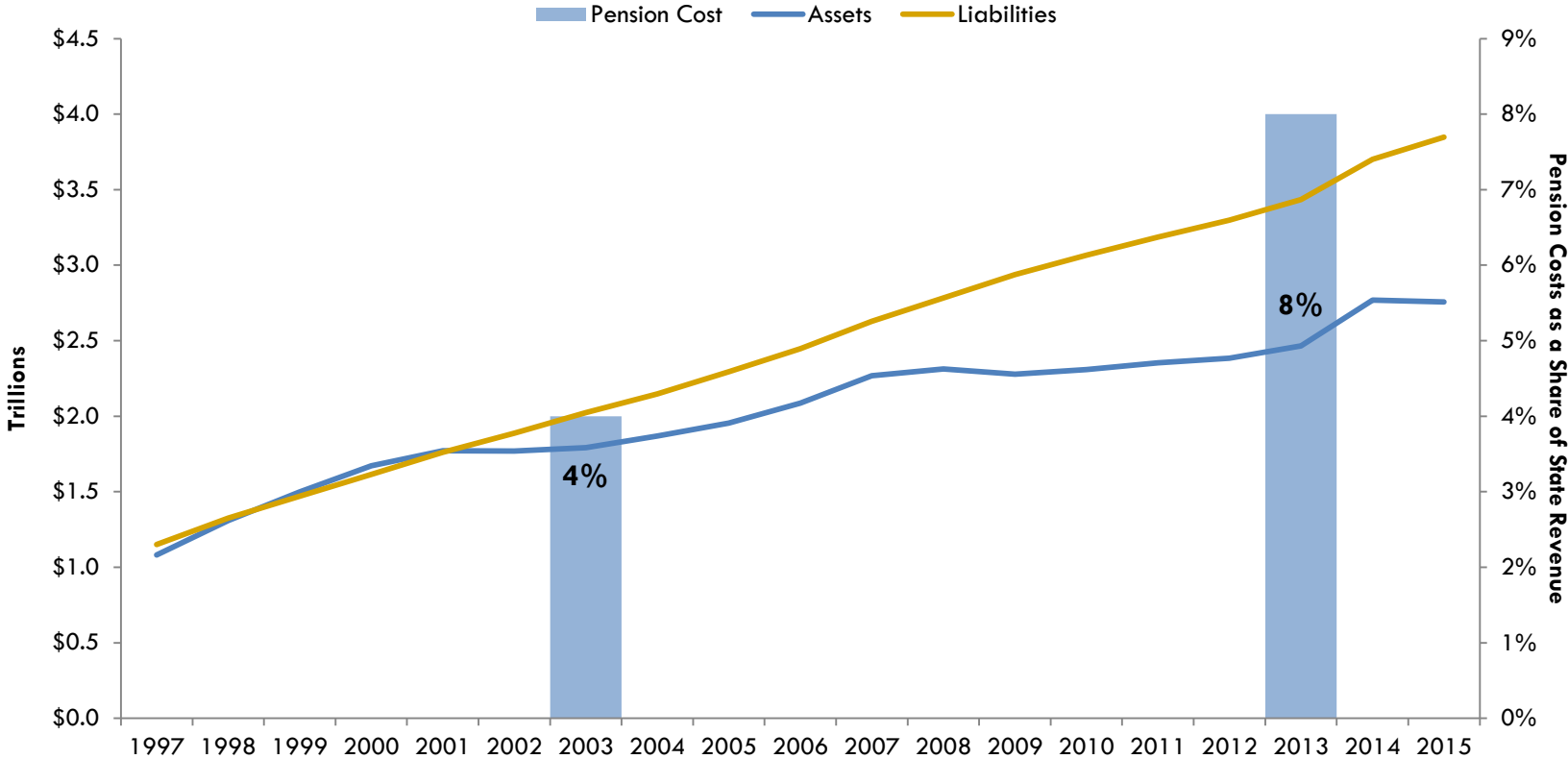
Funding, Investments, Plan Design

2015 State Pension Funding Gap (Aggregate of 50 States)



Sources: Comprehensive Annual Financial Reports (CAFRs), actuarial reports and valuations, or other public documents, or as provided by plan officials.

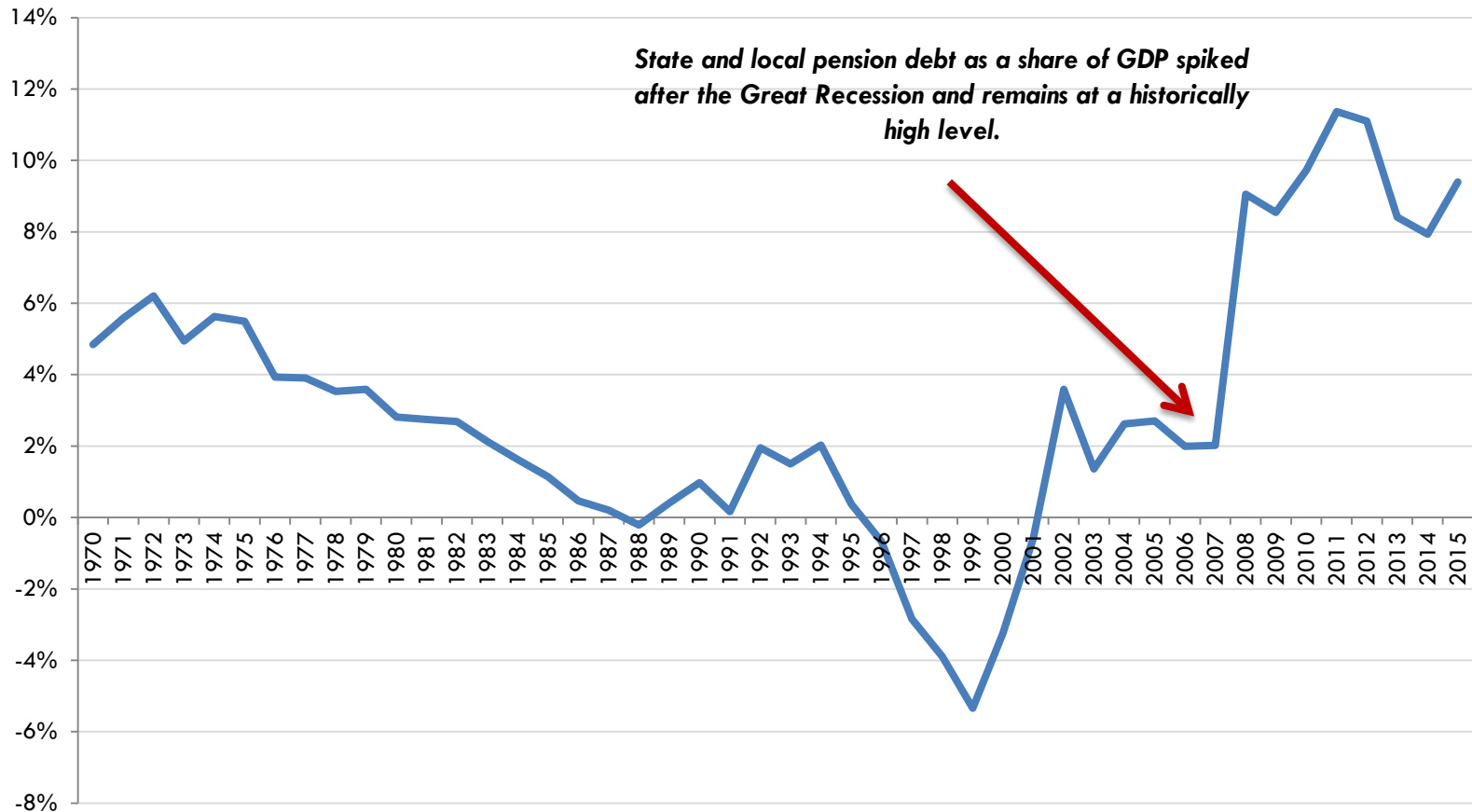
2015 State Pension Funding Gap (Aggregate of 50 States)



Note: GASB reporting standards changed in 2014; Pension costs are based on the Annual Required Contributions (ARC) reported by the state.

Source: Data for this graph were collected from Comprehensive Annual Financial Reports (CAFRs), actuarial reports and valuations, or other public documents.

State and Local Pension Debt as a Share of Gross Domestic Product



Source: The Federal Reserve and U.S. Department of Commerce Bureau of Economic Analysis

Investments – Key Trends: More in Stocks and Less in Bonds

Public Pension Investments, 1954-2014

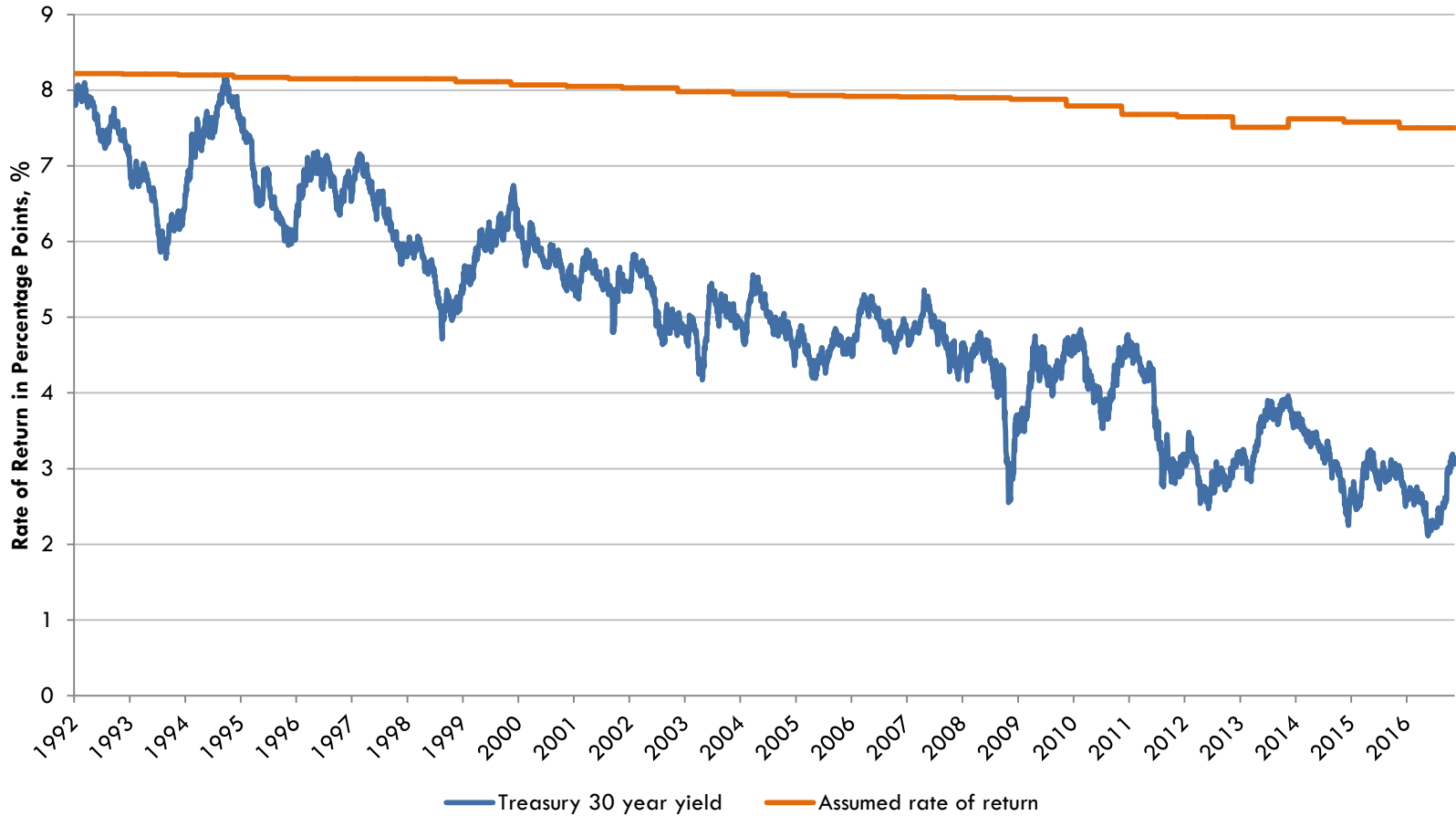
Allocations to equities and alternative investments have increased, while those to fixed-income investments have declined



Source: U.S. Board Of Governors of the Federal Reserve System, *Financial Accounts of the United States*, 1954 to 2014; Pew Analysis of State Financial Reports

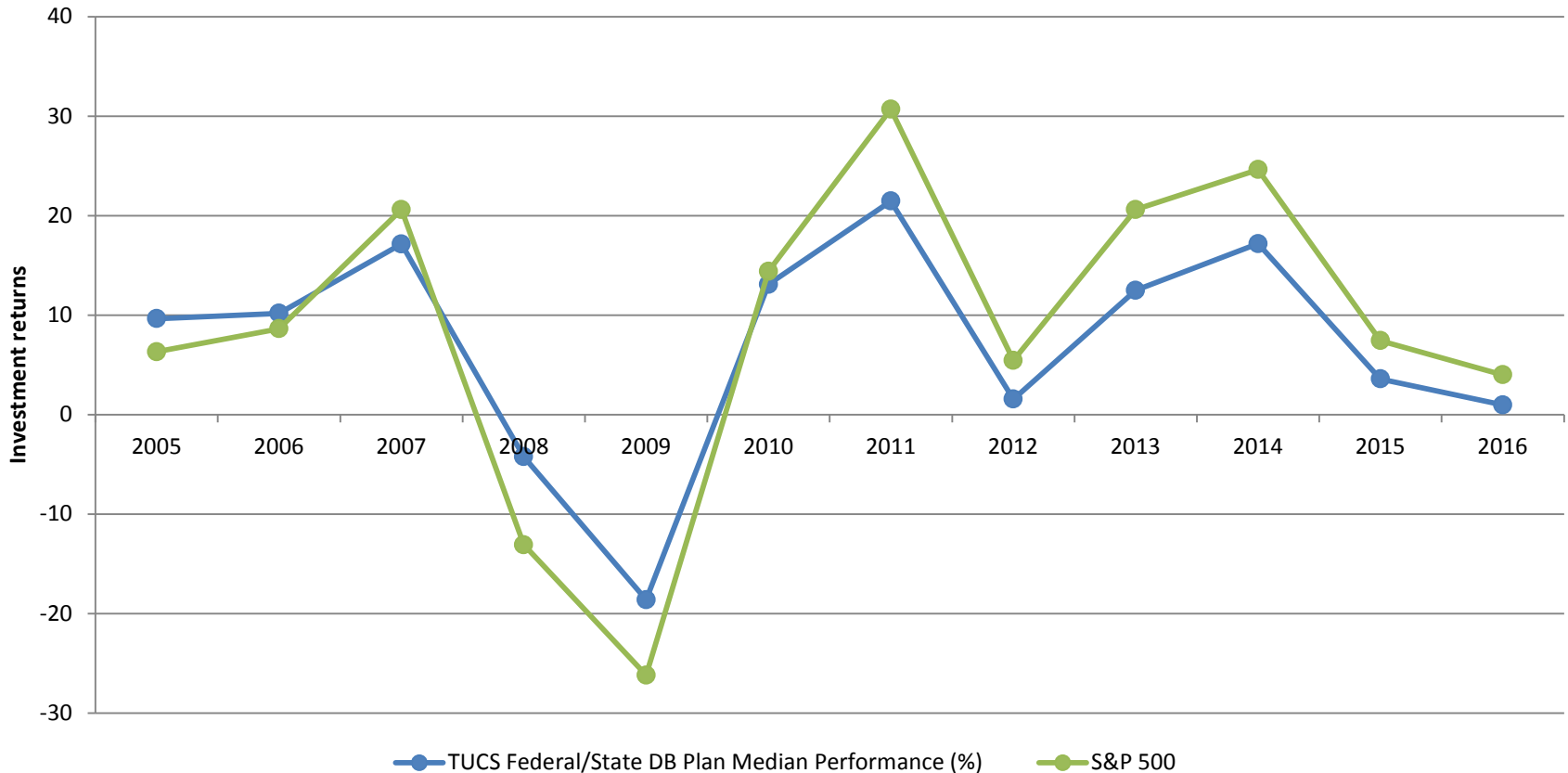
Pension Fund Risk Premium at Historic High

US Public Fund Average Increasing Risk Premium – Plan's Assumed Rate of Return Remains Relatively Stable, While Bond Yields Have Declined



Average Annual Stock Market and Pension Fund Returns

Equity investments and pension fund returns are highly volatile



Note: TUCS data is reported gross of fees.

Sources: Wilshire®, Trust Universe Comparison Service®

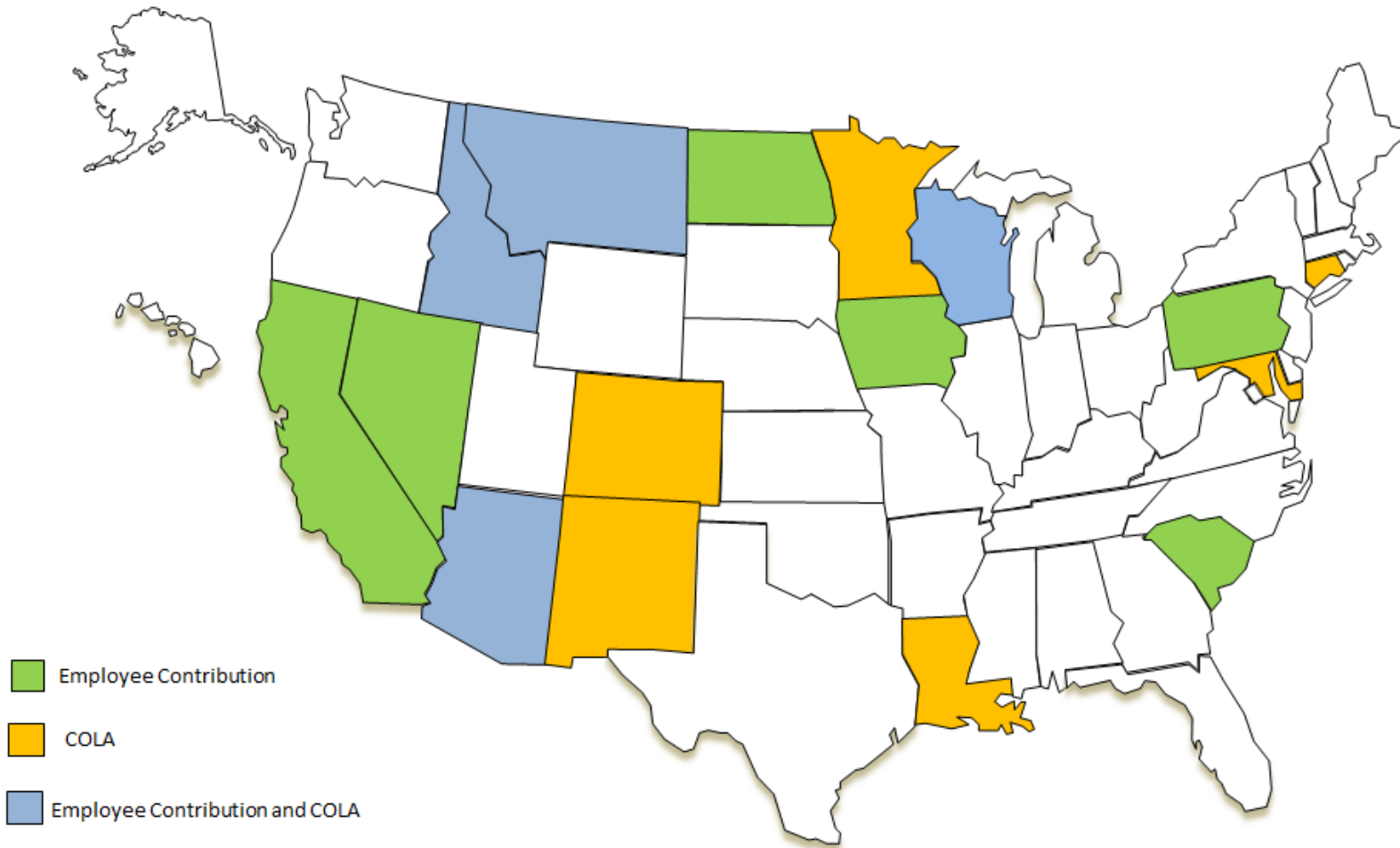
50 State Reform Summary

- 49 states have implemented some kind of reform between 2009 and 2015.
- Many reforms changed plan provisions for new workers, but kept the basic structure of the plan.
- A number of states passed reforms that affected current workers or retirees between 2009 and 2015:
 - 30 states reduced COLAs for active and/or retired members.
 - 37 states increased employee contributions for either current or new members.
- Between 2009 and 2015, 9 states passed reforms that changed the mandatory benefit design for new employees. Overall, 21 states have a mandatory or optional alternative benefit design.

Source: National Council of State Legislatures, NASRA, The Pew Charitable Trusts

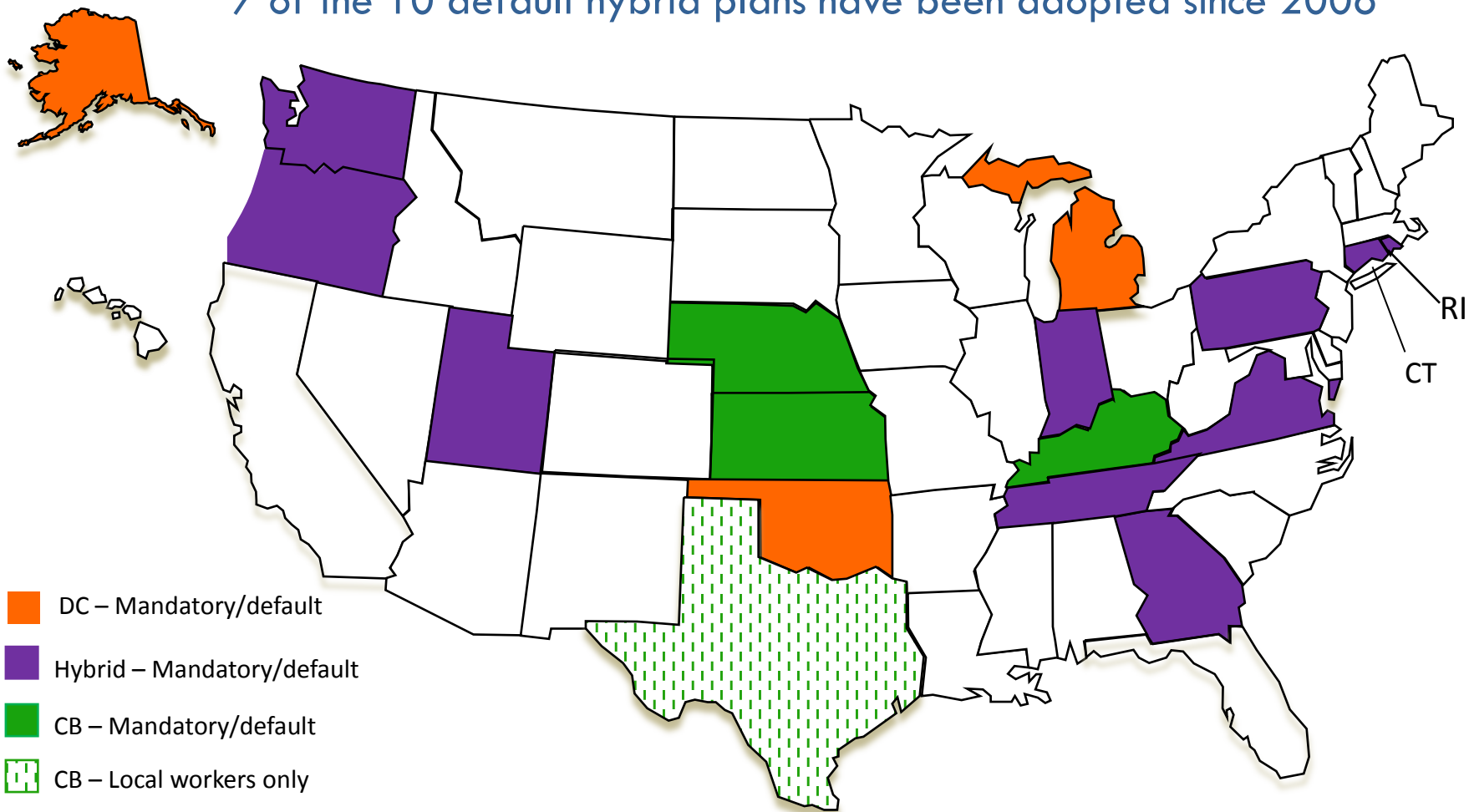
Cost Sharing is Used in Traditional DB Plans

29 DB plans in 17 states have formal cost sharing plans



Alternative Plans are the Default or Mandatory Option in 16 states

7 of the 10 default hybrid plans have been adopted since 2006



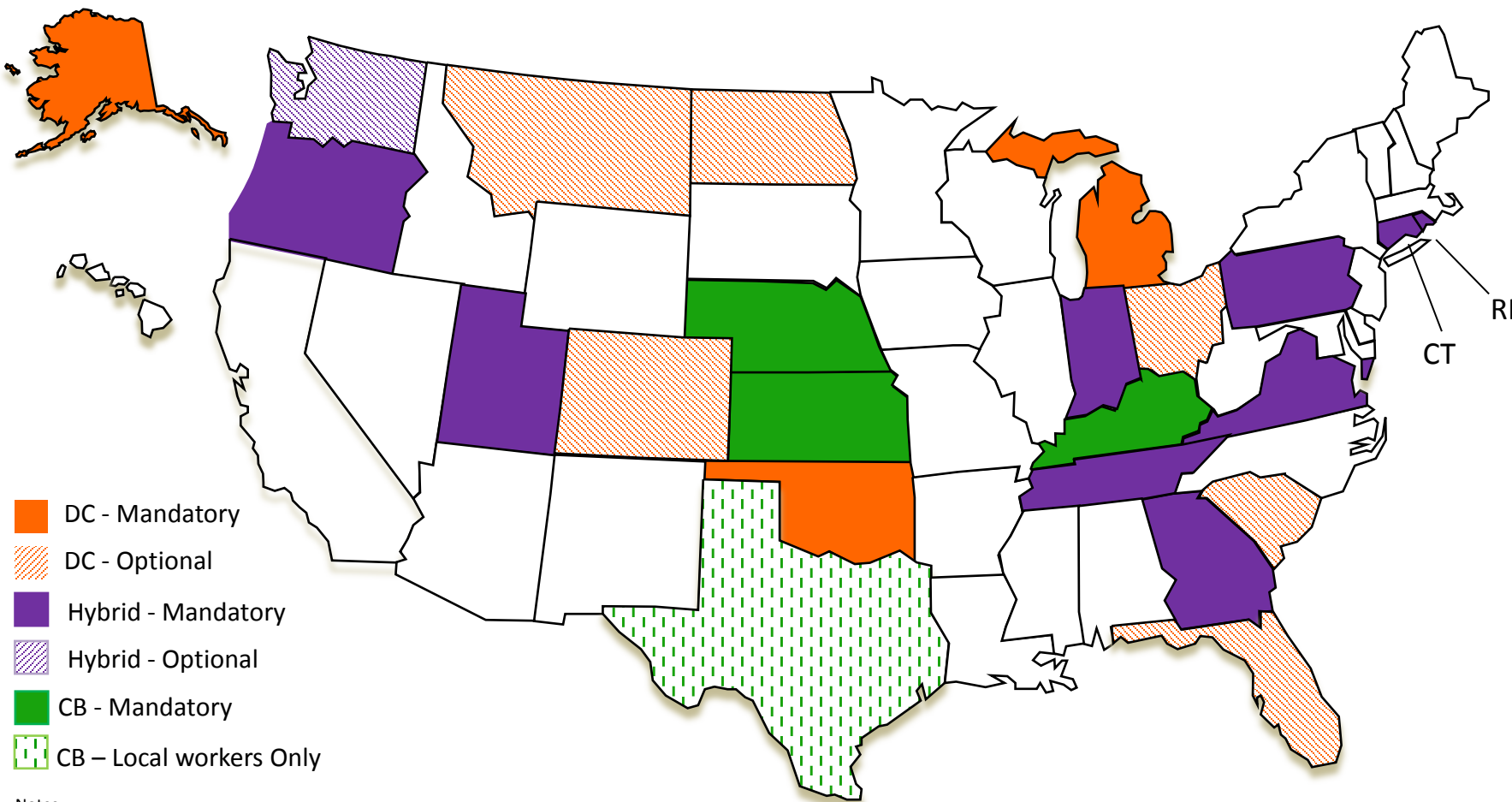
Notes:

- In cases where a state has more than one alternative plan, the plan type with the greater number of participants is marked on the map. This includes Indiana where workers choose between a hybrid and DC plan, Michigan where state workers are in a DC plan and teachers choice between a DC or hybrid plan, and Utah where workers choose between a hybrid and DC plan. Twelve states total offer a default or optional hybrid plan.
- Texas provides a cash balance plan to over 400,000 local workers through the state’s Texas Municipal Retirement System and Texas County and District Retirement System.

Sources: NASRA, NCSL

Growing Number of States with Alternative Public Sector Retirement Plans

23 states have implemented an alternative plan for workers.



Notes

- In cases where a state has more than one alternative plan, the plan type with the greater number of participants is marked on the map. This includes Indiana where workers choose between a hybrid and DC plan, Michigan where state workers are in a DC plan and teachers have a choice between a DC and hybrid, and, Ohio where workers choose between a DB, hybrid or DC plan, and Utah where workers choose between a hybrid and DC plan.
- Texas's cash balance plan is only available to local workers.
- In addition, California provides an optional cash balance plan for part-time workers and adjunct educational employees.

Sources: NASRA, NCSL

Fiscal Assessment: Milwaukee County ERS

Key Findings

Fiscal Assessment: Overview

- The goal of a fiscal assessment is to identify the level and sources of fiscal distress in a pension plan.
- Pew's approach involves an extensive review of historical actuarial valuations and financial reports, concentrating on central data points related to funding, contributions, benefit payments and membership.
- We also work with an actuarial partner to develop a 30 year projection model that allows us to estimate funding and contribution impacts going forward.
- Analyzing this data over time and in relation to other jurisdictions in our 50 state and 33 city database allows us to assess a plan's health and identifies areas that require additional analysis.
- **Our review of ERS found that while the plan is well-funded based on standard measures of fiscal position, the operating cash flow measure - a better indicator of the possibility for fiscal distress- warns of challenges ahead.**

Fiscal Assessment: Key Findings

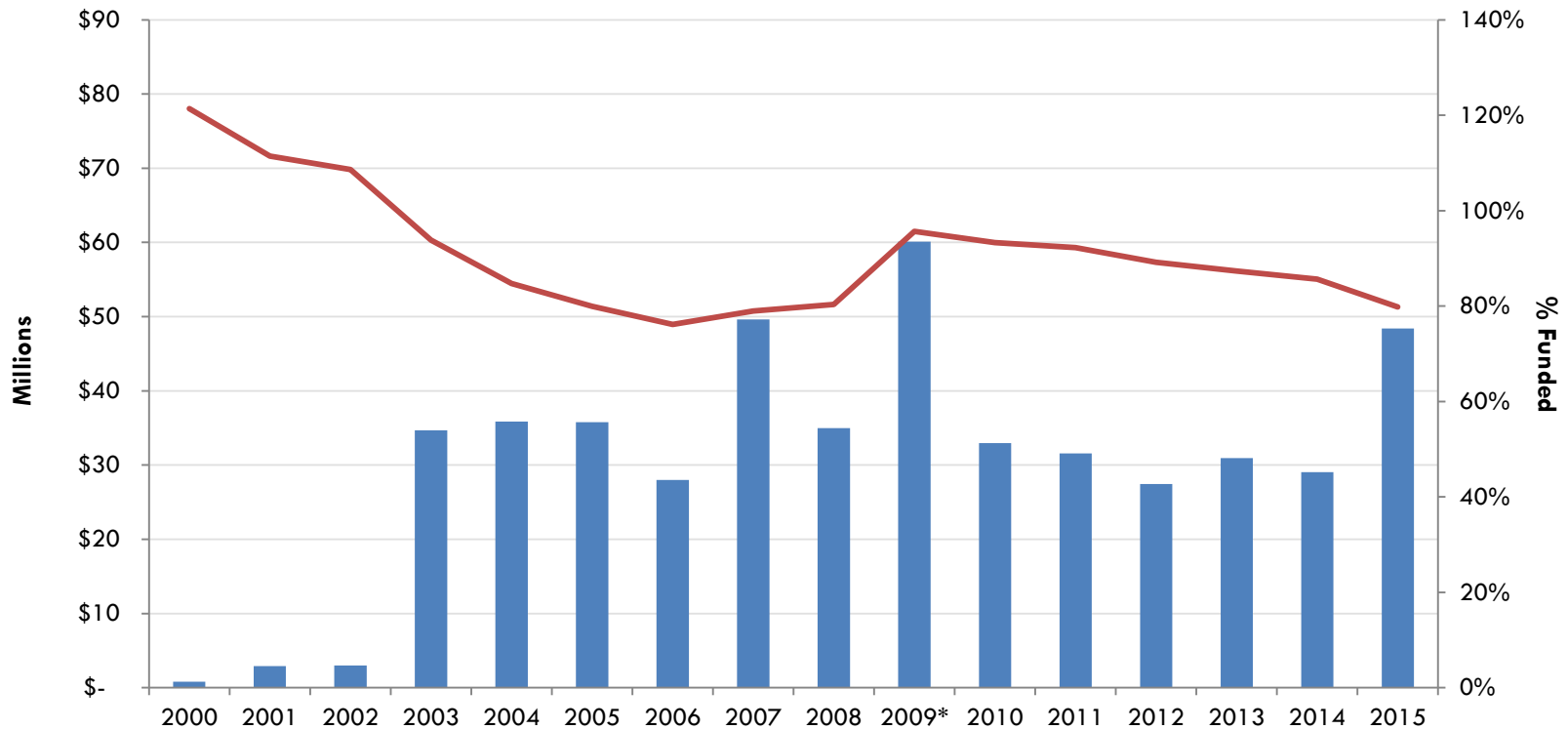
1. The 2015 ERS funded ratio was slightly above the national average for FY 2015 and FY 2014. Fully funded in the early 2000s, the declining funded ratio follows a trend line that is similar to the nation as a whole.
2. While well-funded based on standard measures of fiscal position, the plan's -8% ratio of operating cash flow (benefit payments-contributions) to assets warns of challenges ahead. This was lower than all states in FY 2015 and all but two cities -Detroit and Chicago- in FY 2014. Our analysis indicates that a declining County workforce and unusual benefit provisions are the likely cause.
3. At 35%, Milwaukee County ERS has the lowest percentage of active employees as a share of total membership compared to the states, and the second lowest compared to cities.
4. The BackDROP and Rule of 75 are two benefit provisions that stand out from the typical plan and likely contribute to the relatively high ERS benefit payments as a share of liabilities.
5. Total contributions are projected to rise over the next two decades, improving plan funding and operating cash flow but placing fiscal pressure on both the county and employees. A low investment return scenario exacerbates the fiscal pressure while limiting improvements to plan funding and operating cash flow.

Finding #1

The 2015 ERS funded ratio was slightly above the national average for FY 2015 and FY 2014. Fully funded in the early 2000s, the declining funded ratio follows a trend line that is similar to the nation as a whole.

ERS Contributions and Funded Ratio Over Time

Funded status declined while required contributions increased and fluctuated dramatically.



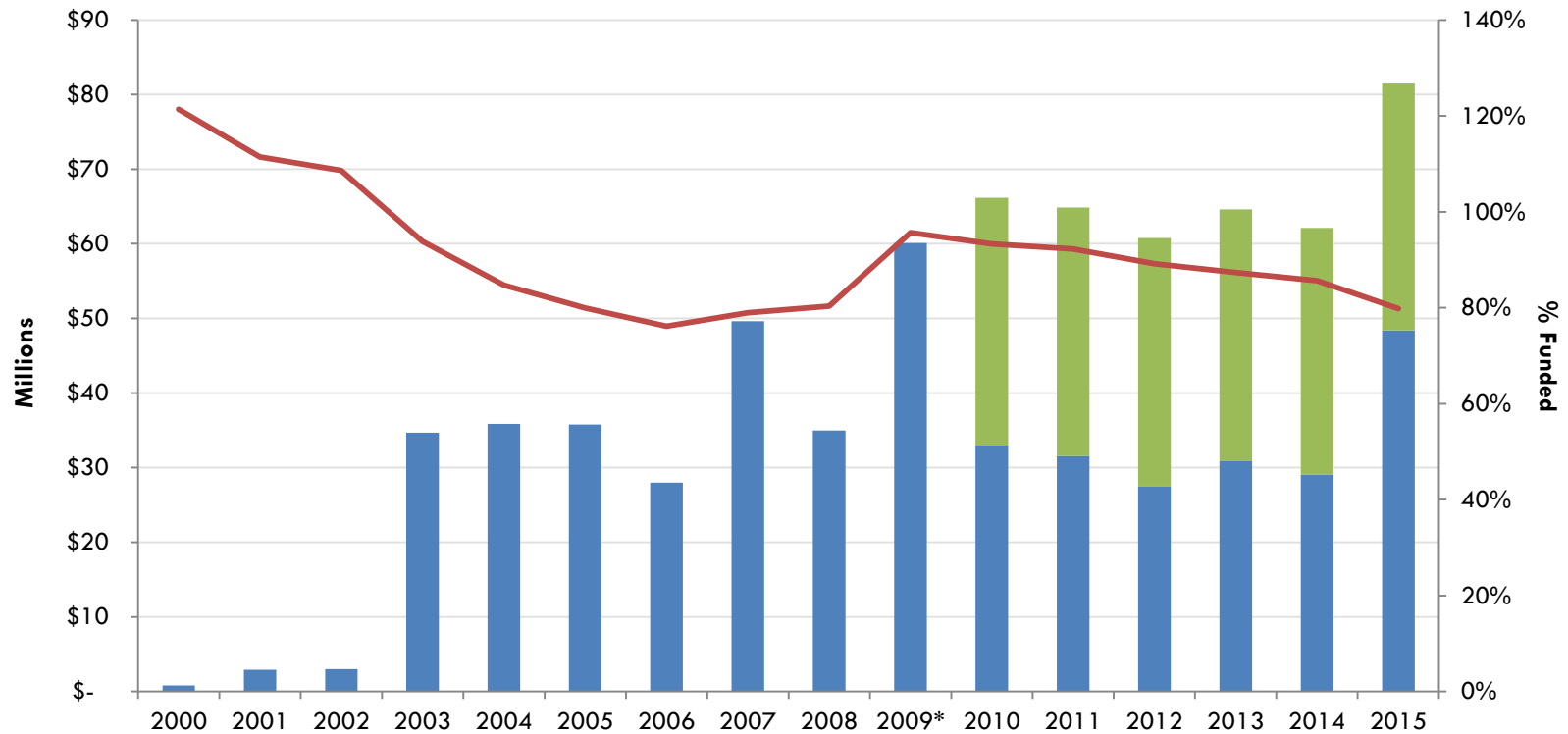
■ Total Contributions — Funded ratio

Note: 2009 contribution excludes \$397.8 M pension obligation bond proceeds

Source: ERS Annual Reports and Actuarial Valuations

ERS Contributions and Funded Ratio Over Time

Funded status declined while required contributions increased and fluctuated dramatically.

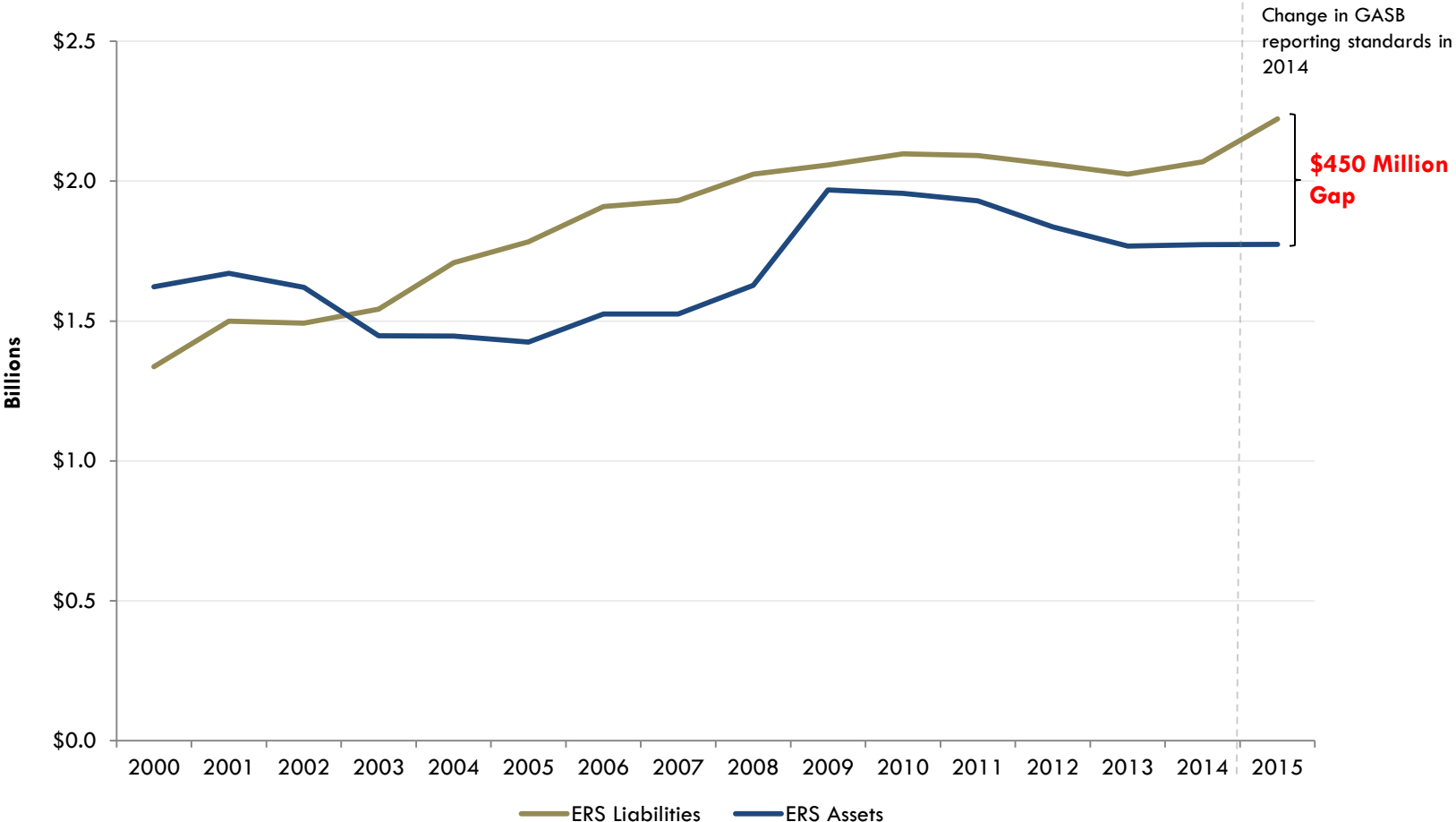


■ Total Contributions
 ■ POB Debt Service
 — Funded ratio

Note: 2009 contribution excludes \$397.8 M pension obligation bond proceeds

Source: ERS Annual Reports and Actuarial Valuations

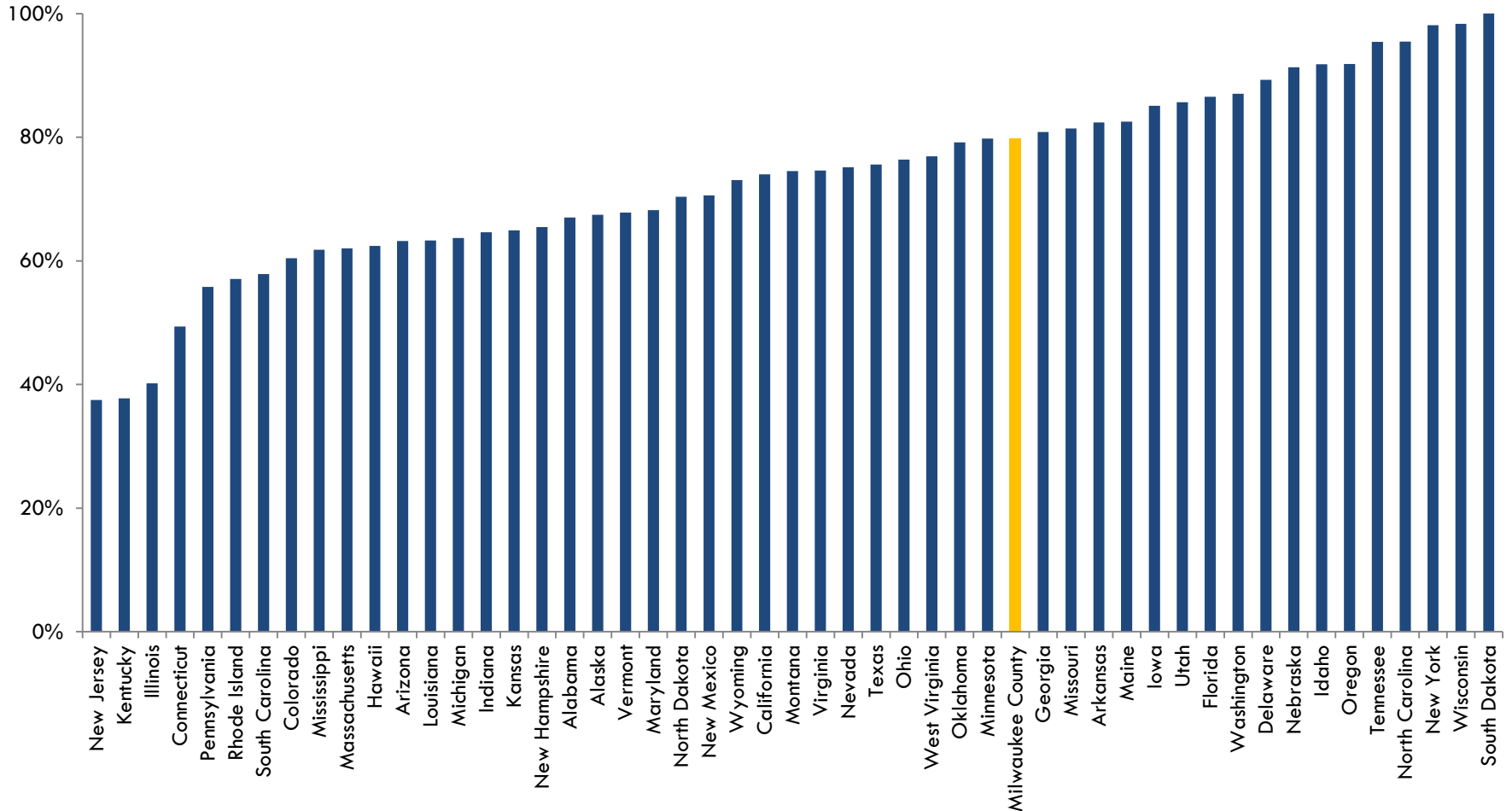
2015 Pension Funding Gap: ERS



Source: ERS Annual Reports and Actuarial Valuations

Comparative Analysis: State Funded Ratio (FY 2015)

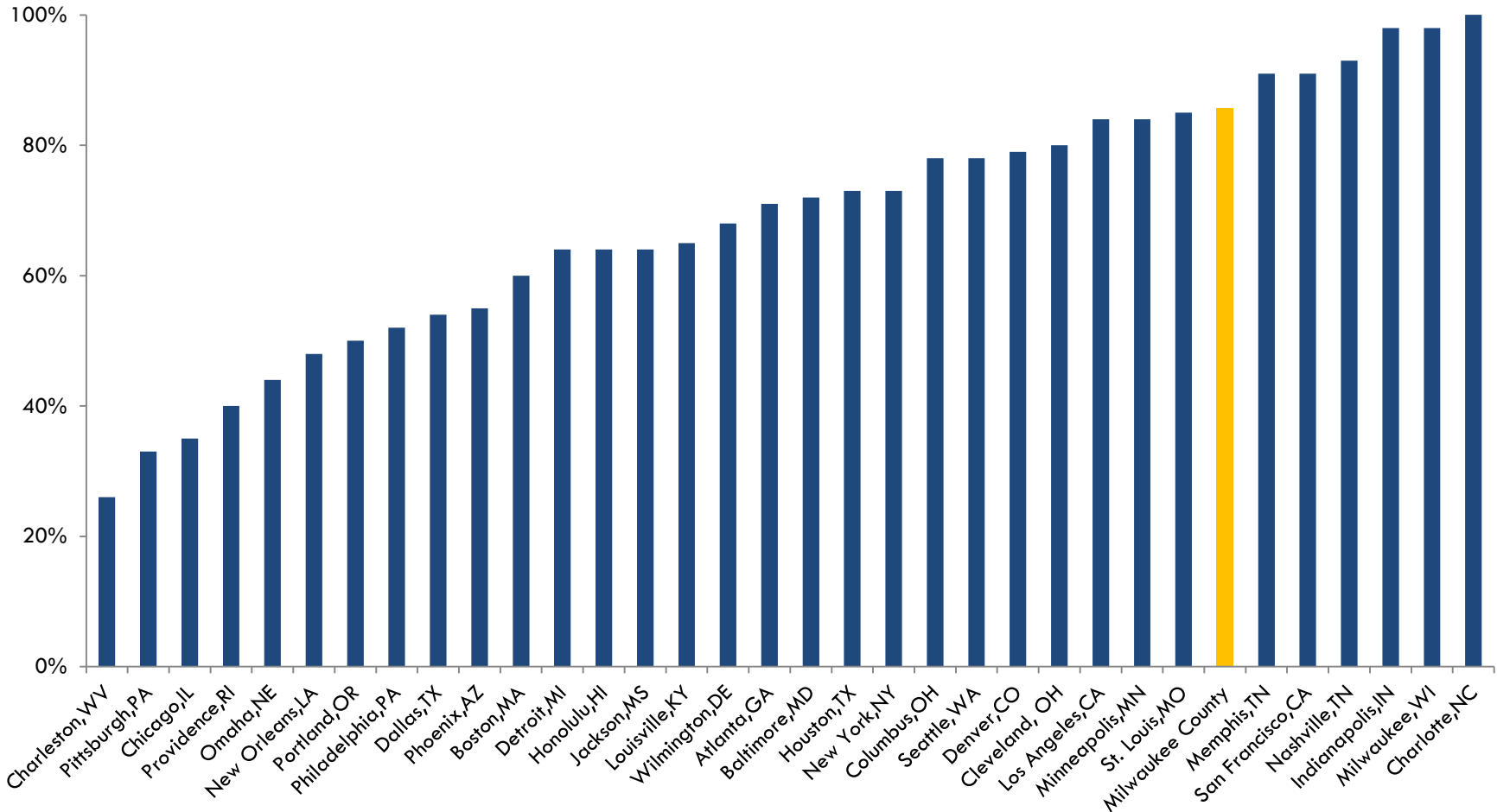
Milwaukee County ERS funded ratio higher than 33 states.



Source: Comprehensive Annual Financial Reports (CAFRs), actuarial reports and valuations, or other public documents, or as provided by plan officials.

Comparative Analysis: City Funded Ratio (FY 2014)

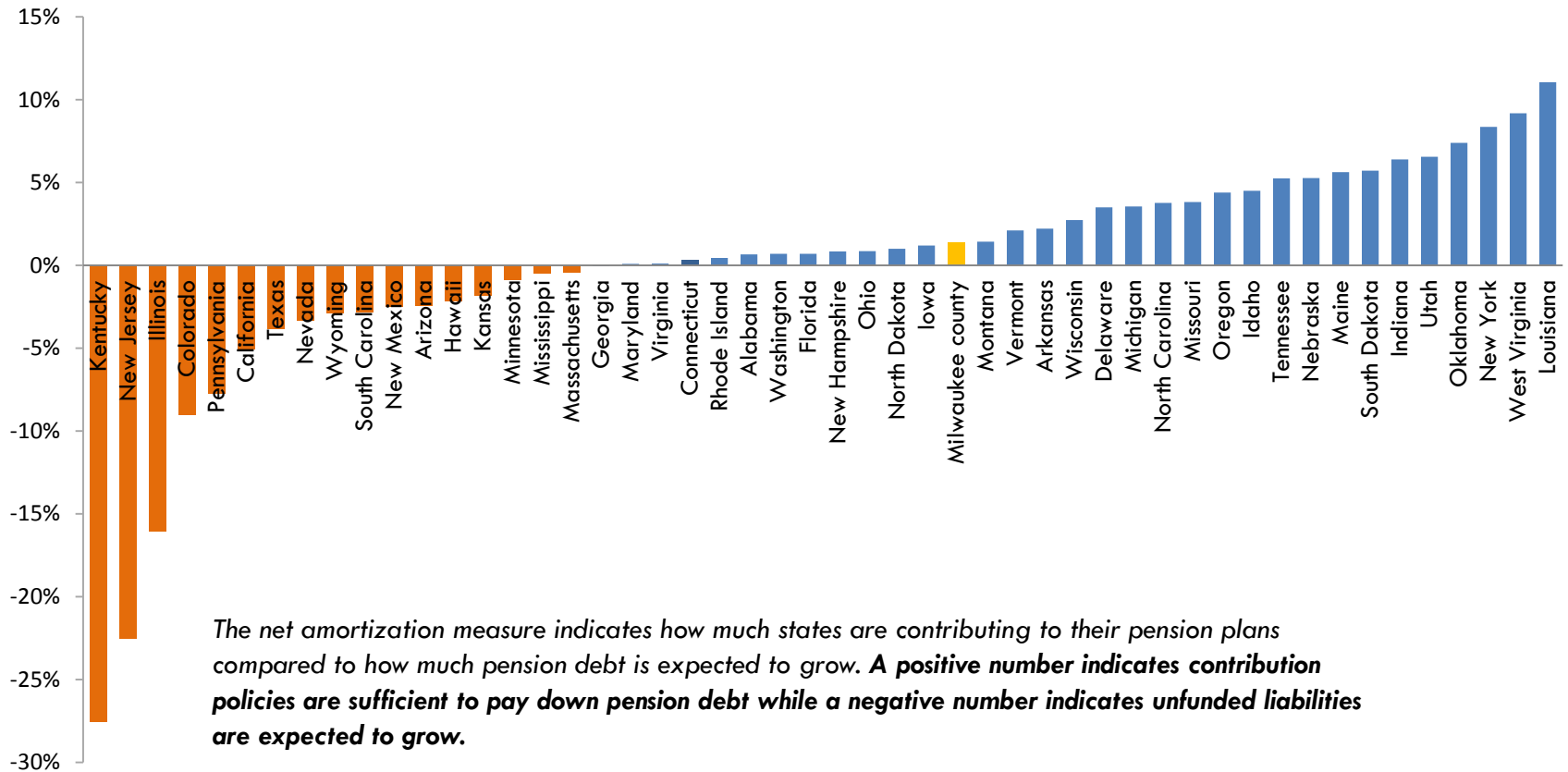
Milwaukee County ERS funded ratio higher than 27 cities.



Source: Comprehensive Annual Financial Reports (CAFRs), actuarial reports and valuations, or other public documents, or as provided by plan officials.

Net Amortization as a Share of Covered Payroll – FY 2015

At 1.4%, Milwaukee County ranked 22nd among the 50 states.



Note: Excludes Alaska at 121%.

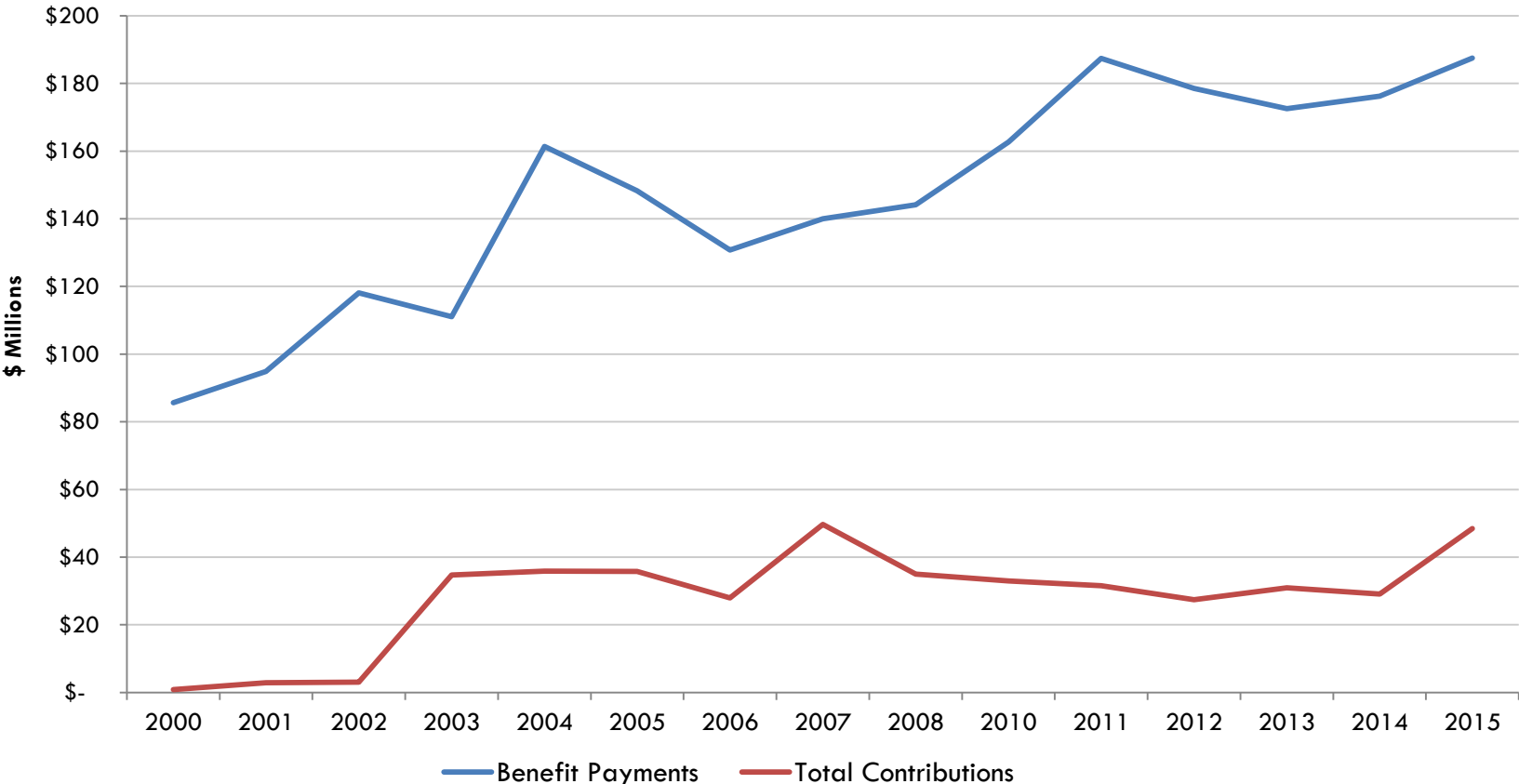
Source: Comprehensive Annual Financial Reports (CAFRs), actuarial reports and valuations, or other public documents, or as provided by plan officials.

Finding #2

While well-funded based on standard measures of fiscal position, the plan's -8% ratio of operating cash flow (benefit payments-contributions) to assets warns of challenges ahead.

This was lower than all states in FY 2015 and all but two cities -Detroit and Chicago- in FY 2014. Our analysis indicates that a declining county workforce and unusual benefit provisions are the likely cause.

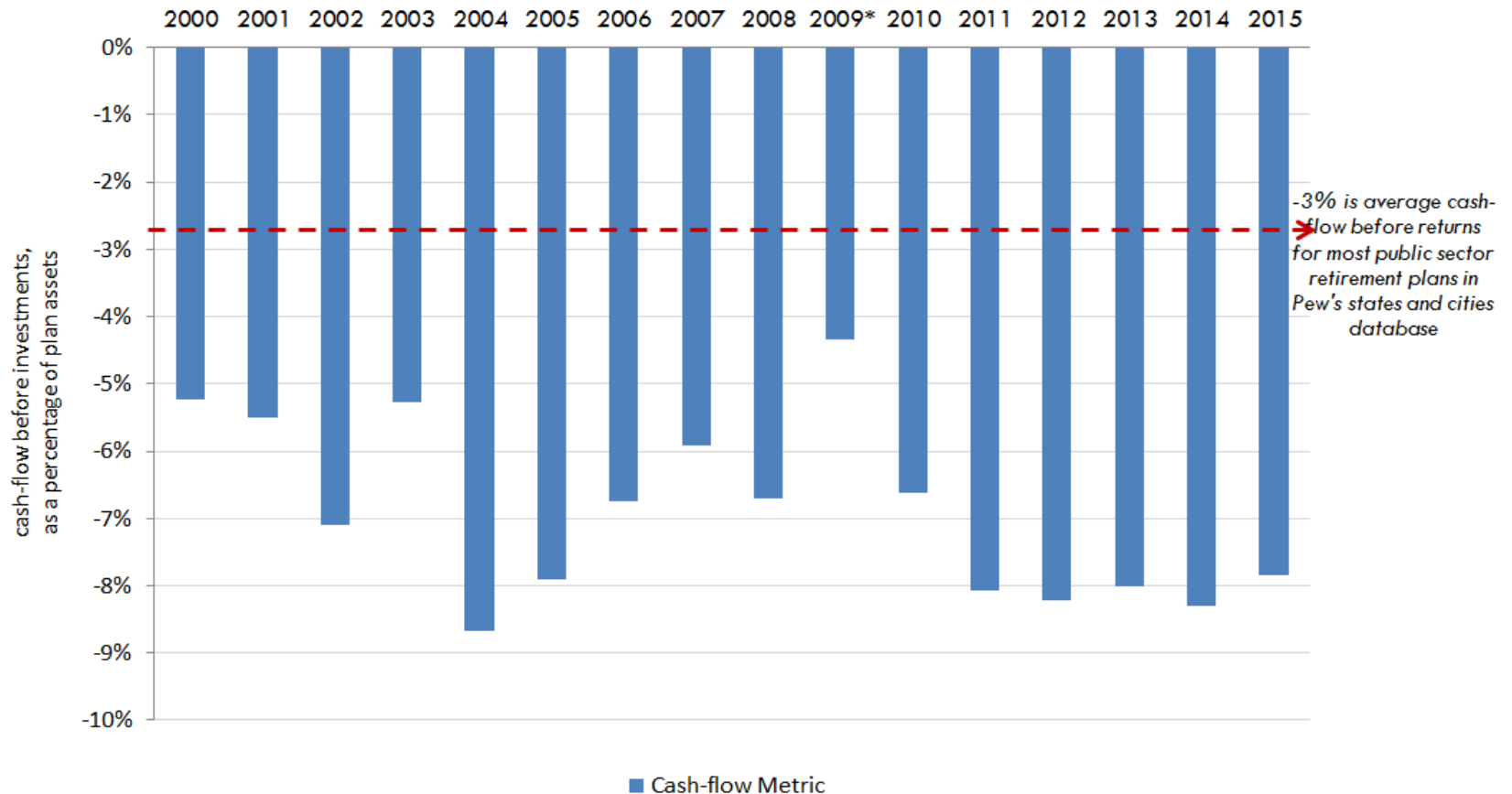
ERS Benefit Payments and Contributions: 2000-2015



Note: Excludes POB proceeds from 2009
Source: ERS Annual Reports

ERS Operating Cash Flow as a Share of Assets 2000-2015

Average annual operating cash flow was negative 5.6%

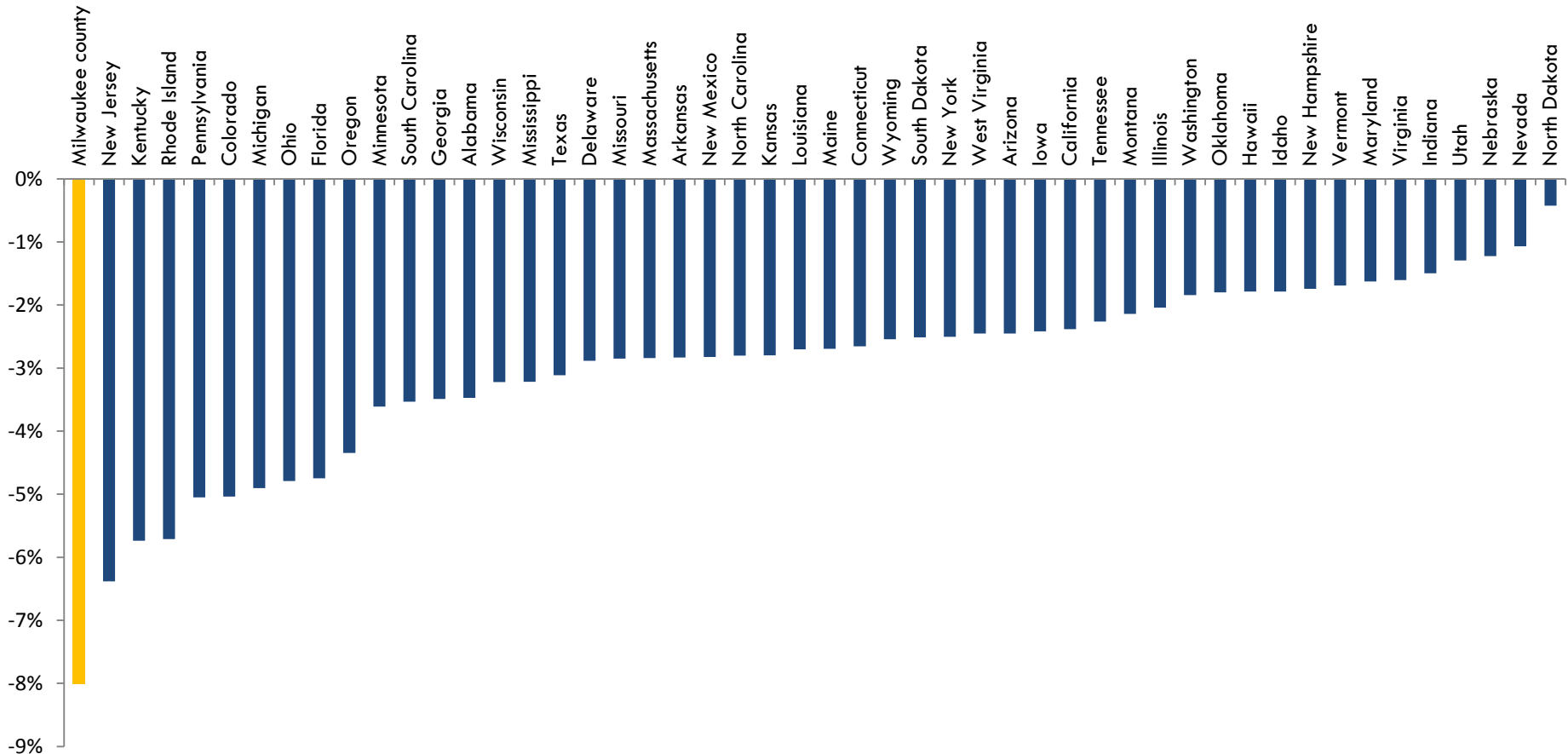


Note: Excludes the proceeds of the 2009 POB for visual purposes but includes the proceeds for the calculation of the 15 year average. If excluded from the calculation, the average falls to negative 6.9%.

Source: ERS Annual Reports

Comparative Analysis: State Operating Cash Flow as a Share of Assets (FY 2015)

Milwaukee County ERS paced behind all 50 states.



Source: Comprehensive Annual Financial Reports (CAFRs), actuarial reports and valuations, or other public documents, or as provided by plan officials.

Comparative Analysis: City Operating Cash Flow as a Share of Assets (FY 2014)

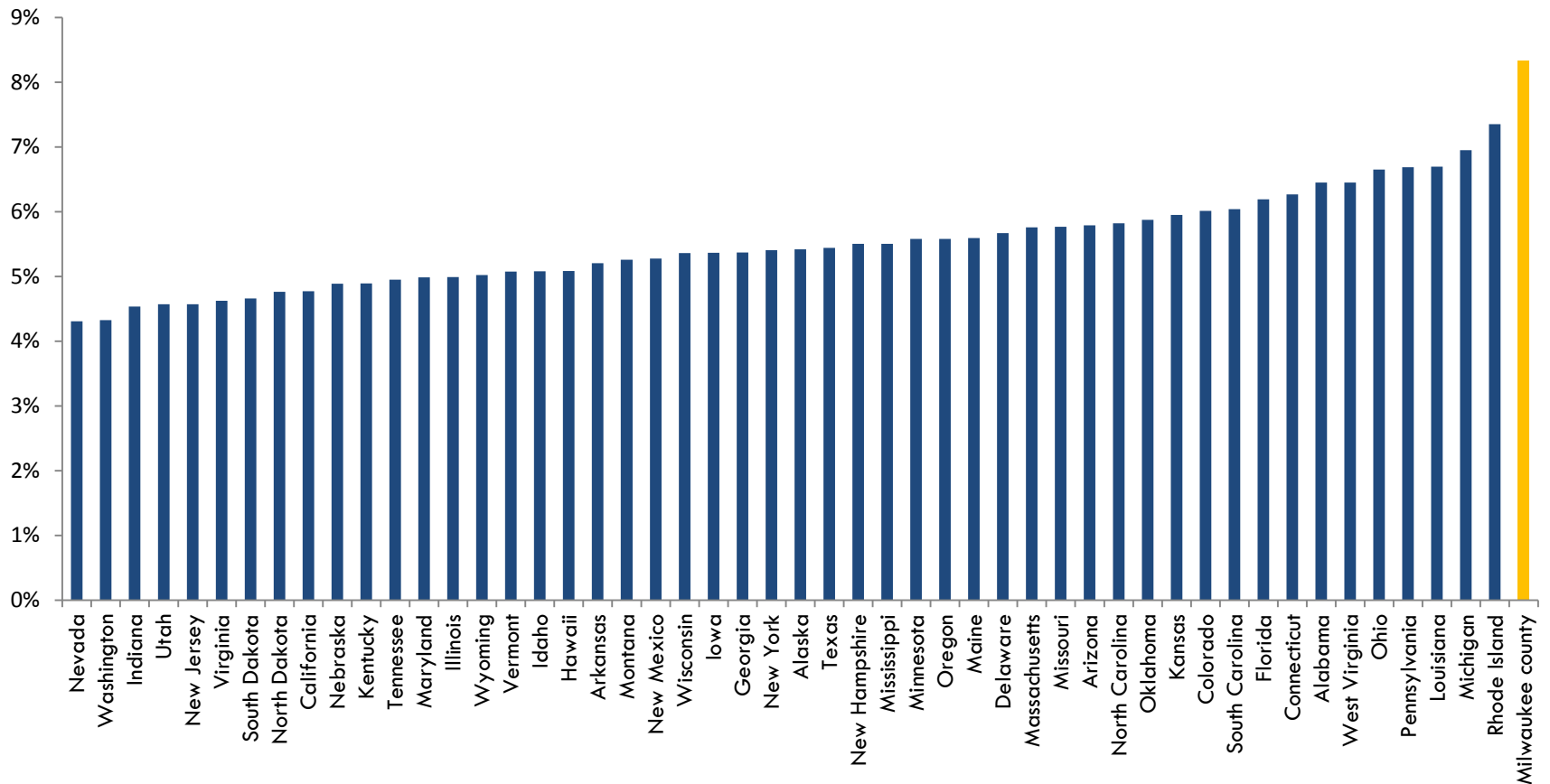
Only Detroit and Chicago had lower operating cash-flow than ERS.



Source: Comprehensive Annual Financial Reports (CAFRs), actuarial reports and valuations, or other public documents, or as provided by plan officials.

Benefit Payments as a Share of Liabilities

Milwaukee County ranked first among the states in terms of benefit payments as a share of liabilities



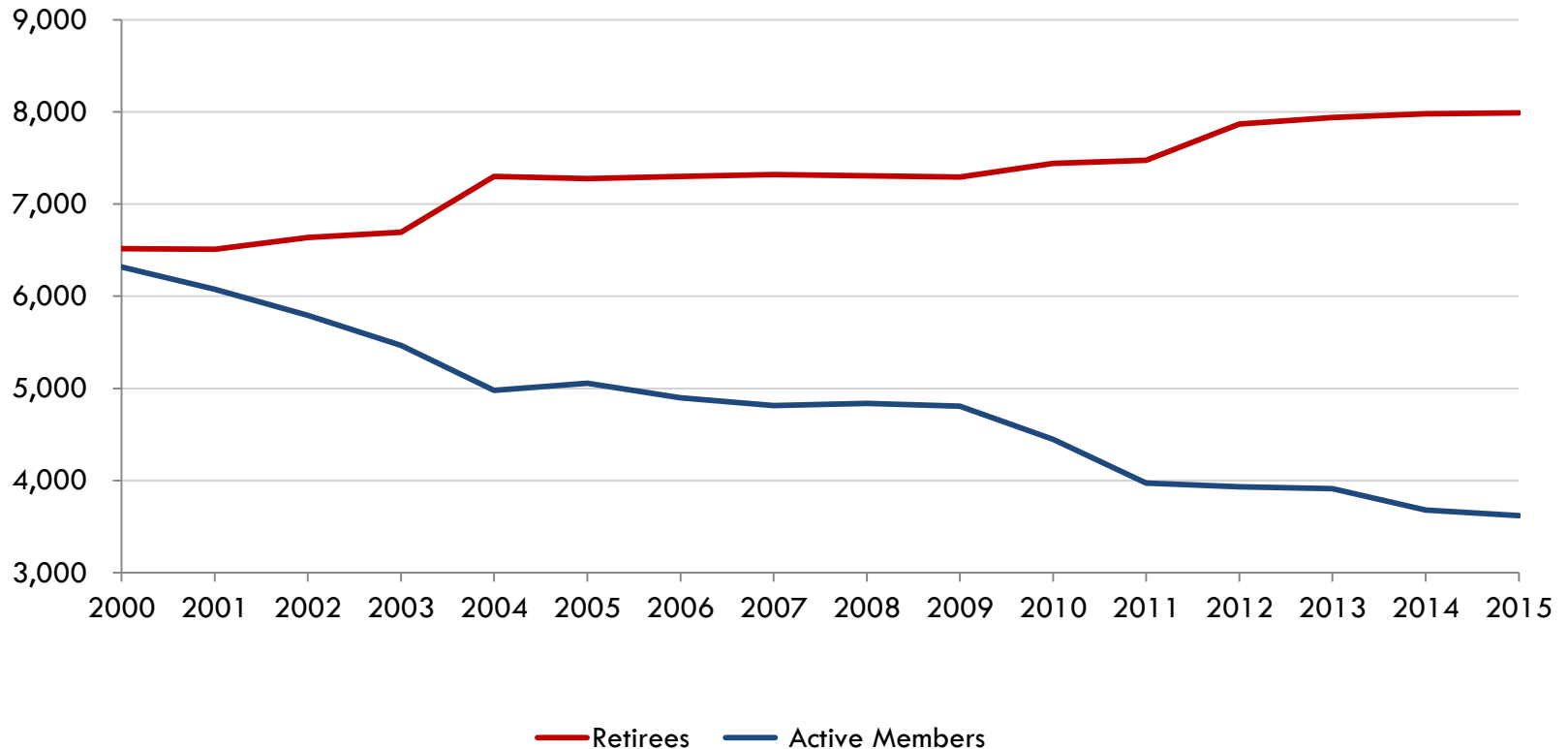
Source: Comprehensive Annual Financial Reports (CAFRs), actuarial reports and valuations, or other public documents, or as provided by plan officials.

Finding #3

At 35%, Milwaukee County ERS has the lowest percentage of active employees as a share of total membership compared to the states, and the second lowest compared to cities.

ERS Membership over Time

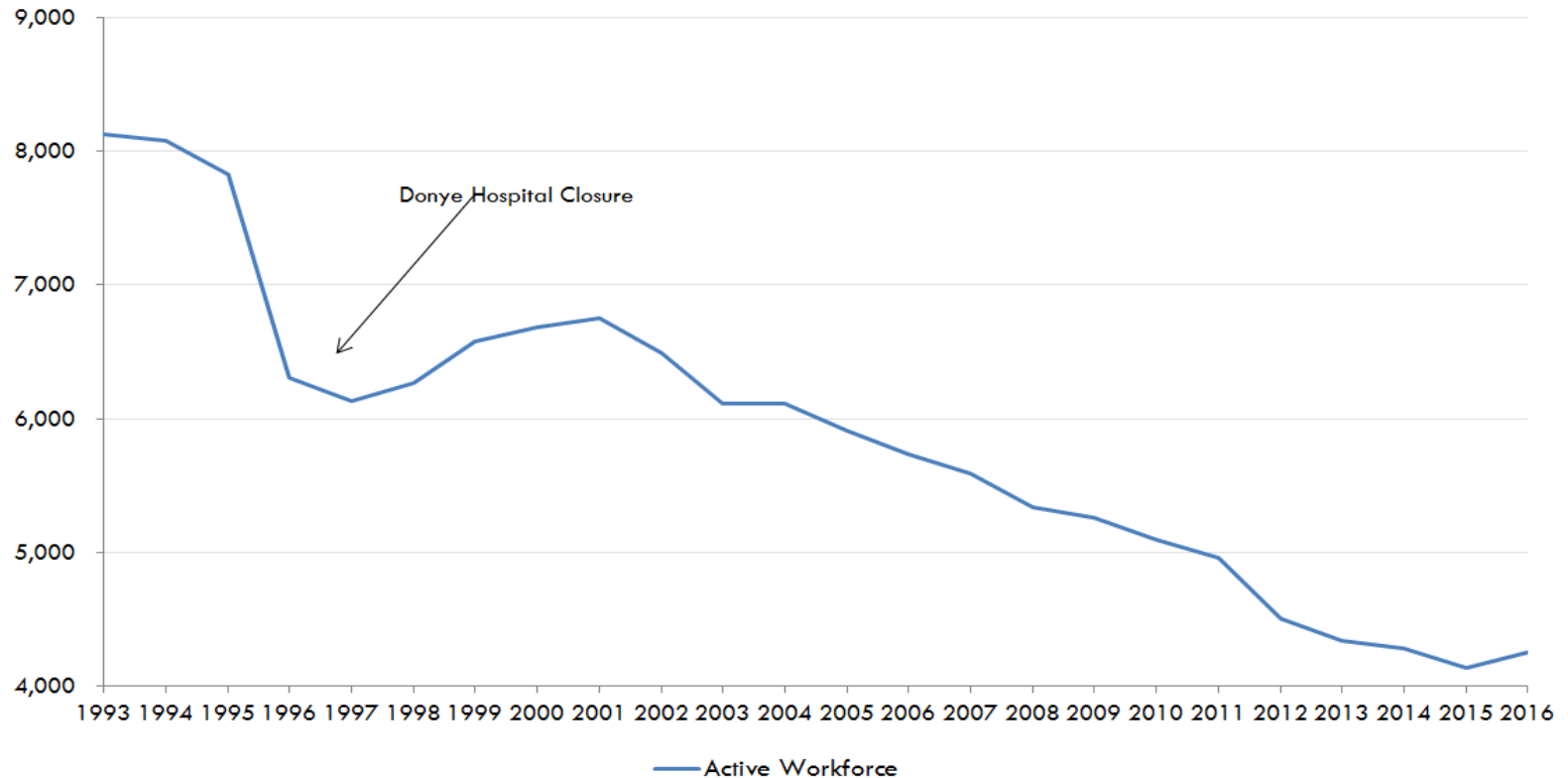
As retired workers receiving benefits have grown over time, the number of active employees has declined.



Source: ERS Annual Reports and Actuarial Valuations

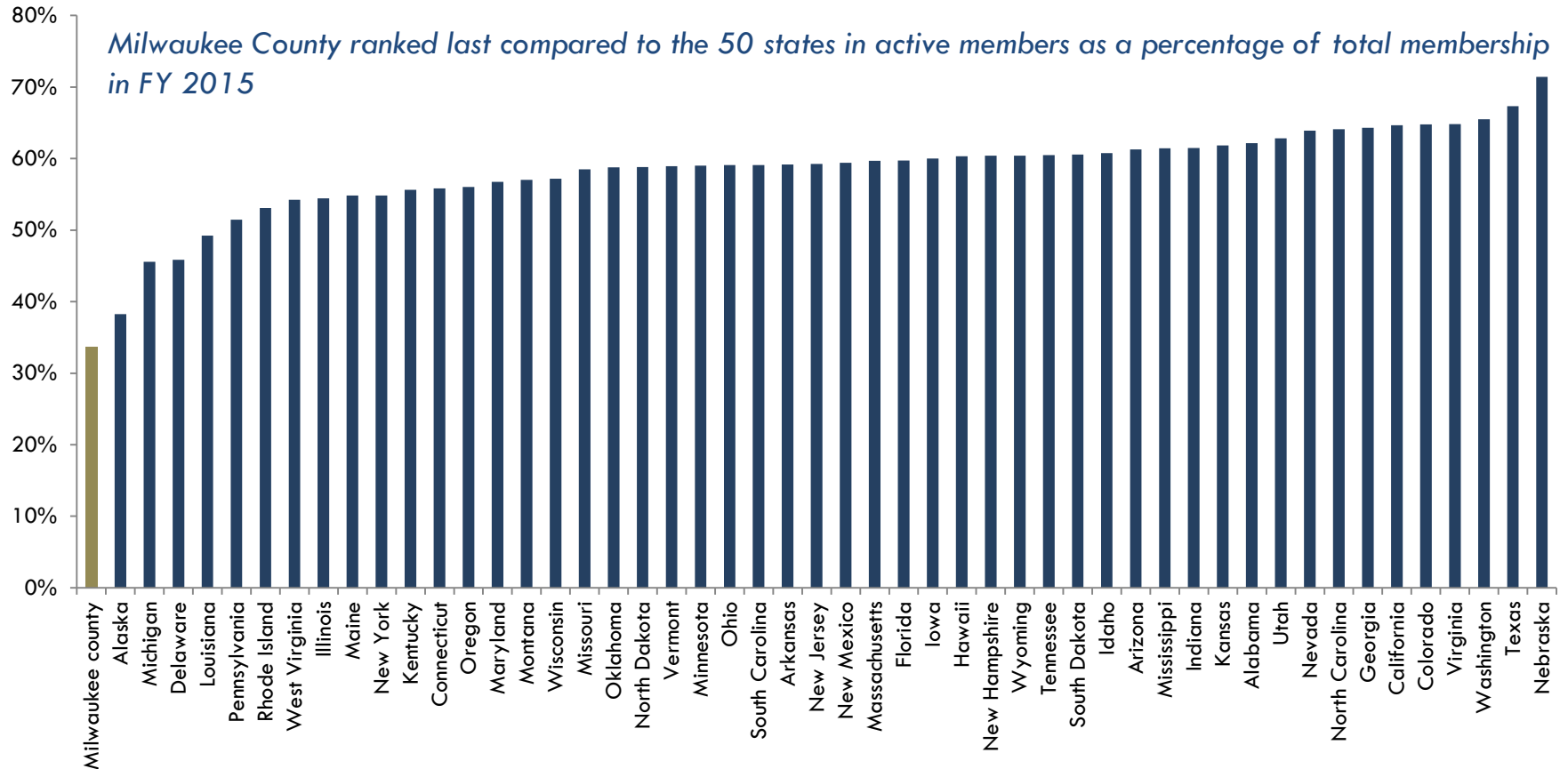
Milwaukee County Active Employee Population Over Time

County has seen significant and steady drop in active employment over the course of 25 years.



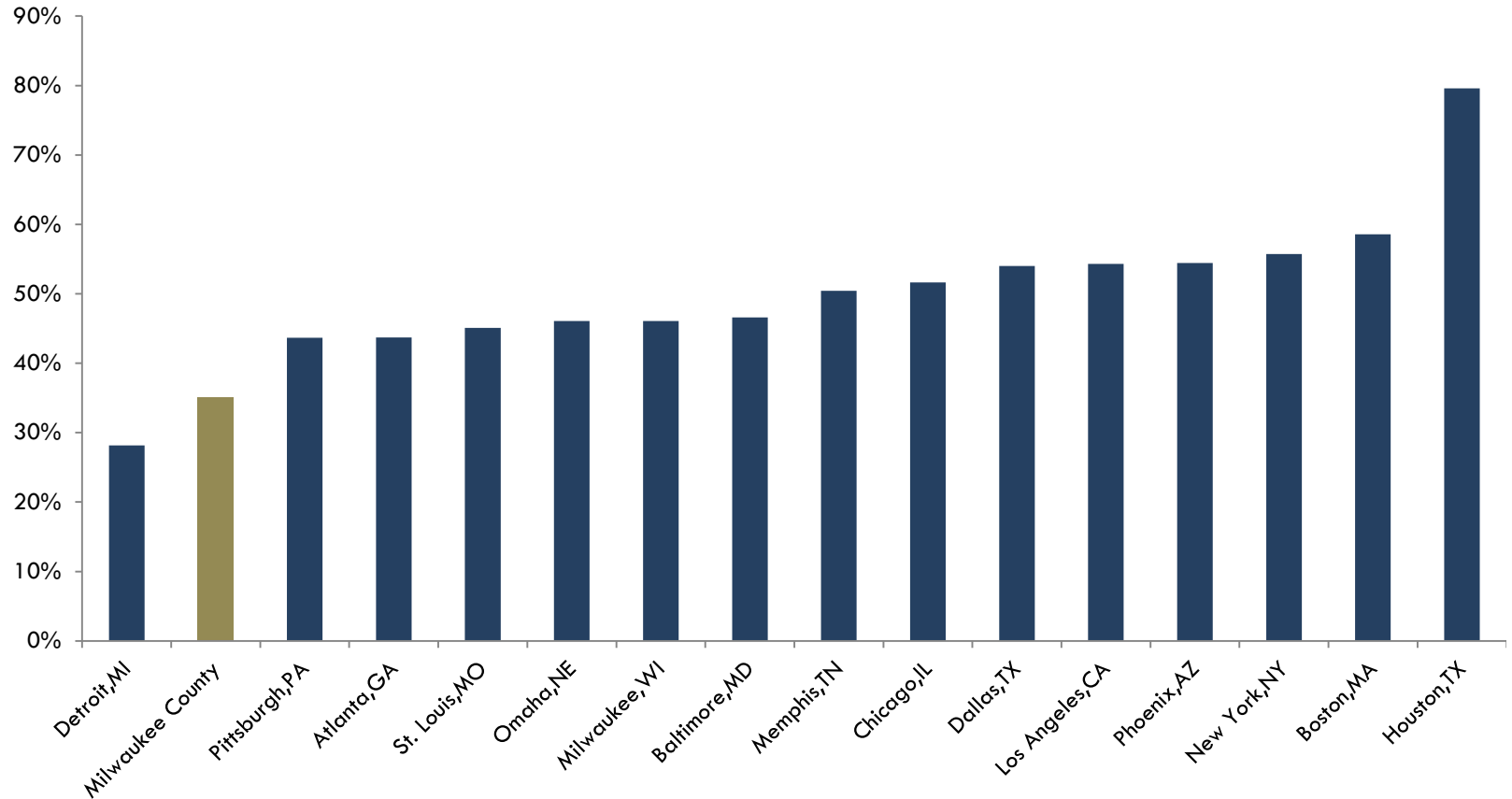
Source: Source: ERS actuarial reports and valuations, or other public documents, or as provided by plan officials.

Percentage of Actives as a Share of Total Plan Membership (States, 2015)



Source: Analysis by The Pew Charitable Trusts using Pew's states and cities database and publicly available comprehensive annual financial reports and valuation reports

Percentage of Actives as a Share of Total Plan Membership (Cities, 2014)



Note: This chart includes the 15 cities in our database that report this data.

Source: Analysis by The Pew Charitable Trusts using Pew's states and cities database and publicly available comprehensive annual financial reports and valuation reports

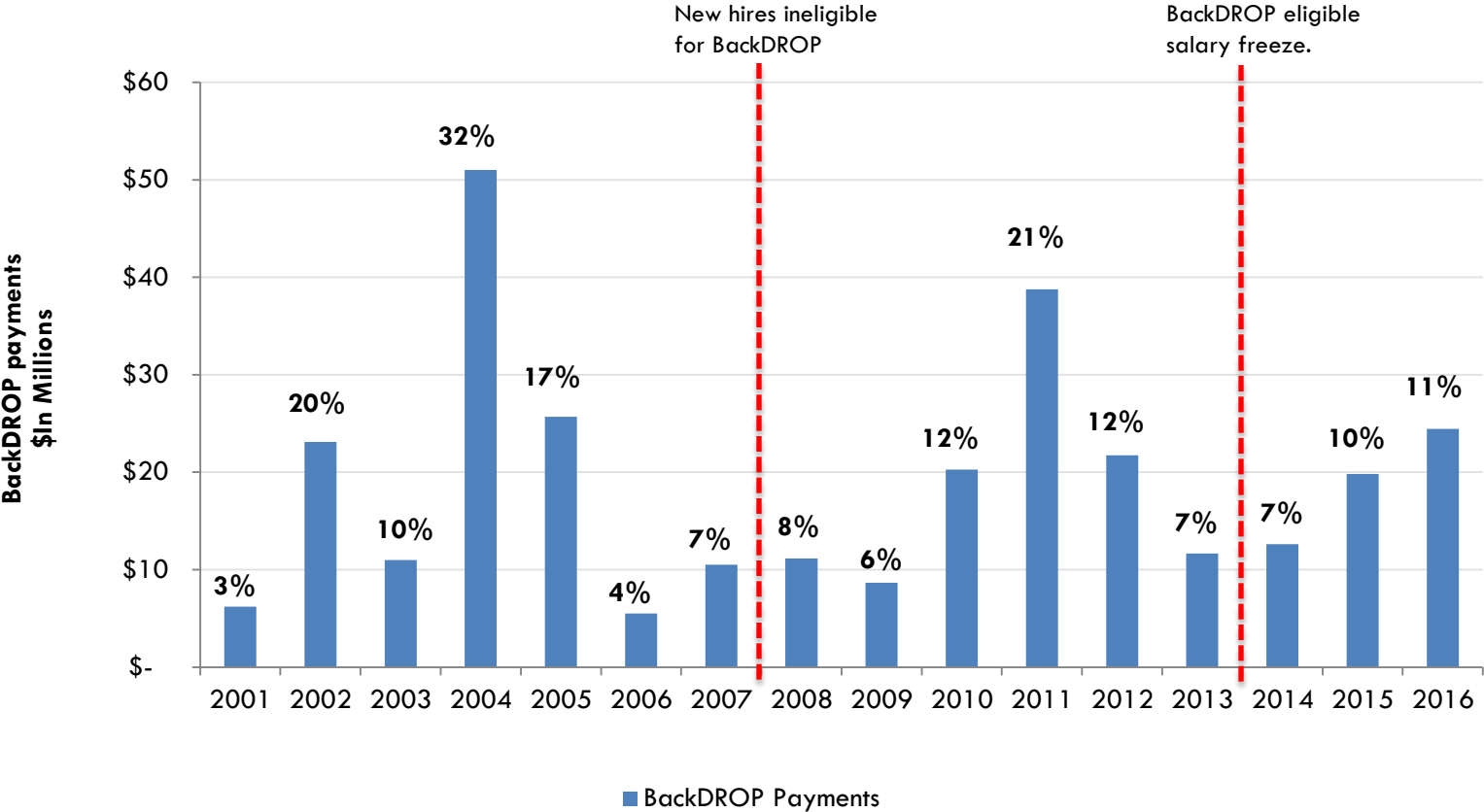
Finding #4

The BackDROP and Rule of 75 are two benefit provisions that stand out from the typical plan and likely contribute to the relatively high ERS benefit payments as a share of liabilities.

Retention Incentive: BackDROP

- In 2001, Milwaukee County established a BackDROP plan that allows employees who work beyond their normal retirement date to collect a lump sum payment, along with a reduced monthly pension benefit.
- Similar to a DROP plan, which is the more commonly used approach to providing workers with a lump sum at retirement, the key factors that determined the size of BackDROP payment are the interest rate and the number of years an employee may continue to work during the BackDROP period.
- Our review of 28 public safety DROP plans found an average interest rate guarantee of 2% and an average participation period of 5 years.
- For the ERS BackDROP, the interest rate is equal to the assumed rate of return (currently 8% and dropping to 7.5% by 2020) and the maximum BackDROP period is 10 years.

BackDROP Payments: Total and as a Percentage of Overall Benefits



Source: ERS actuarial reports and valuations, or other public documents, or as provided by plan officials.

Retirement Eligibility: Rule of 75

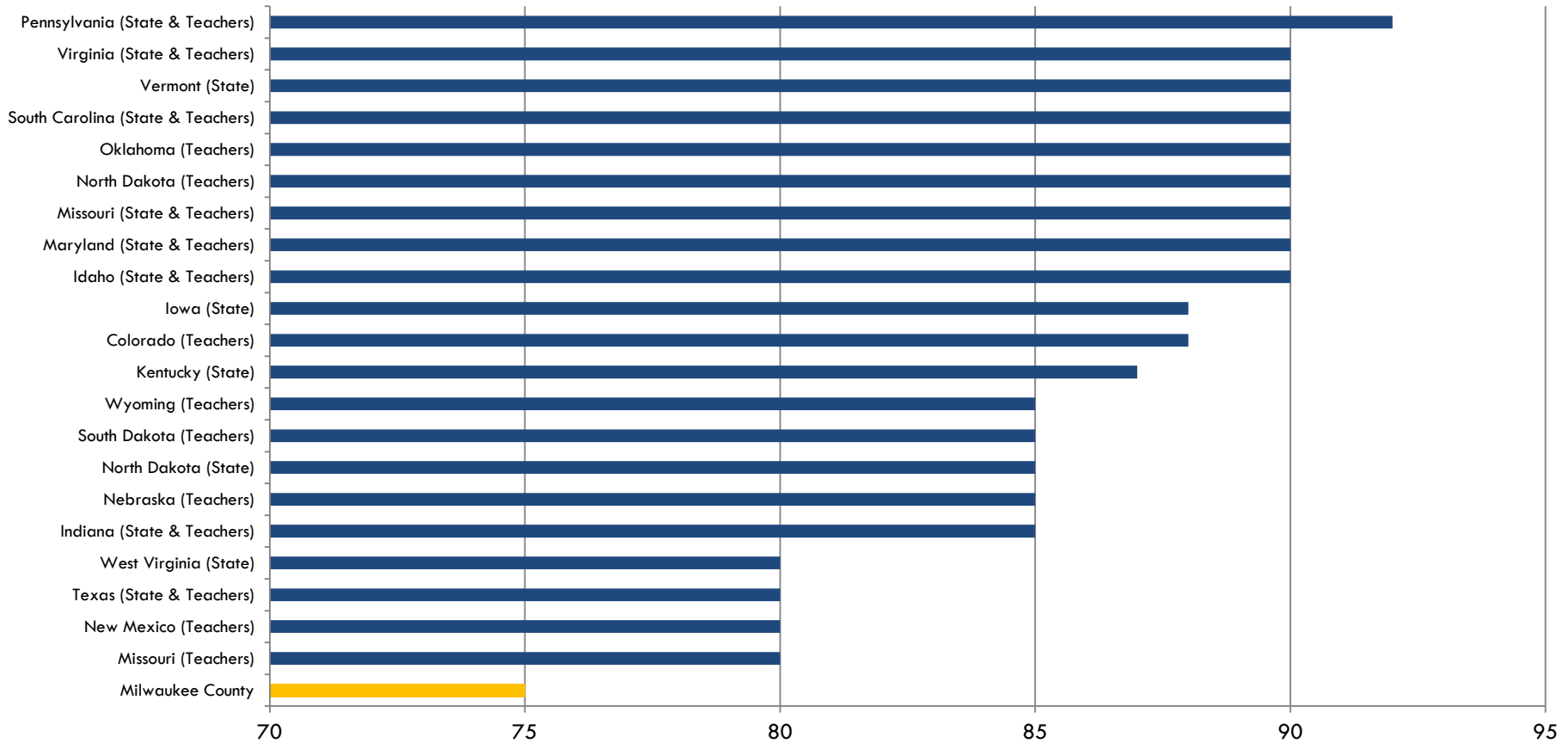
- Depending on date of hire, there are a range of normal retirement eligibility rules that apply to employees in ERS.

Age Only	Age + YOS Rule (with minimums)	Age + YOS Rule (no minimum)
57	Rule of 65 (Age 60 + 5 YOS)	Rule of 75
60	Rule of 69 (Age 54 + 5 YOS)	-
64	Rule of 70 (Age 55 + 15 YOS)	-
-	Rule of 85 (Age 55 + 30 YOS)	-

- Nationwide, Age + YOS rules are common with around 35% of state employee and teacher plans taking this approach. Rule of 88 is the average threshold among these plans.
- Rule of 75 is no longer available to new hires, but around 25% of active employees remain eligible based on date of hire.

Retirement Eligibility: Age + YOS Rules

The Rule of 75 is the lowest retirement eligibility threshold compared to state and teachers plans

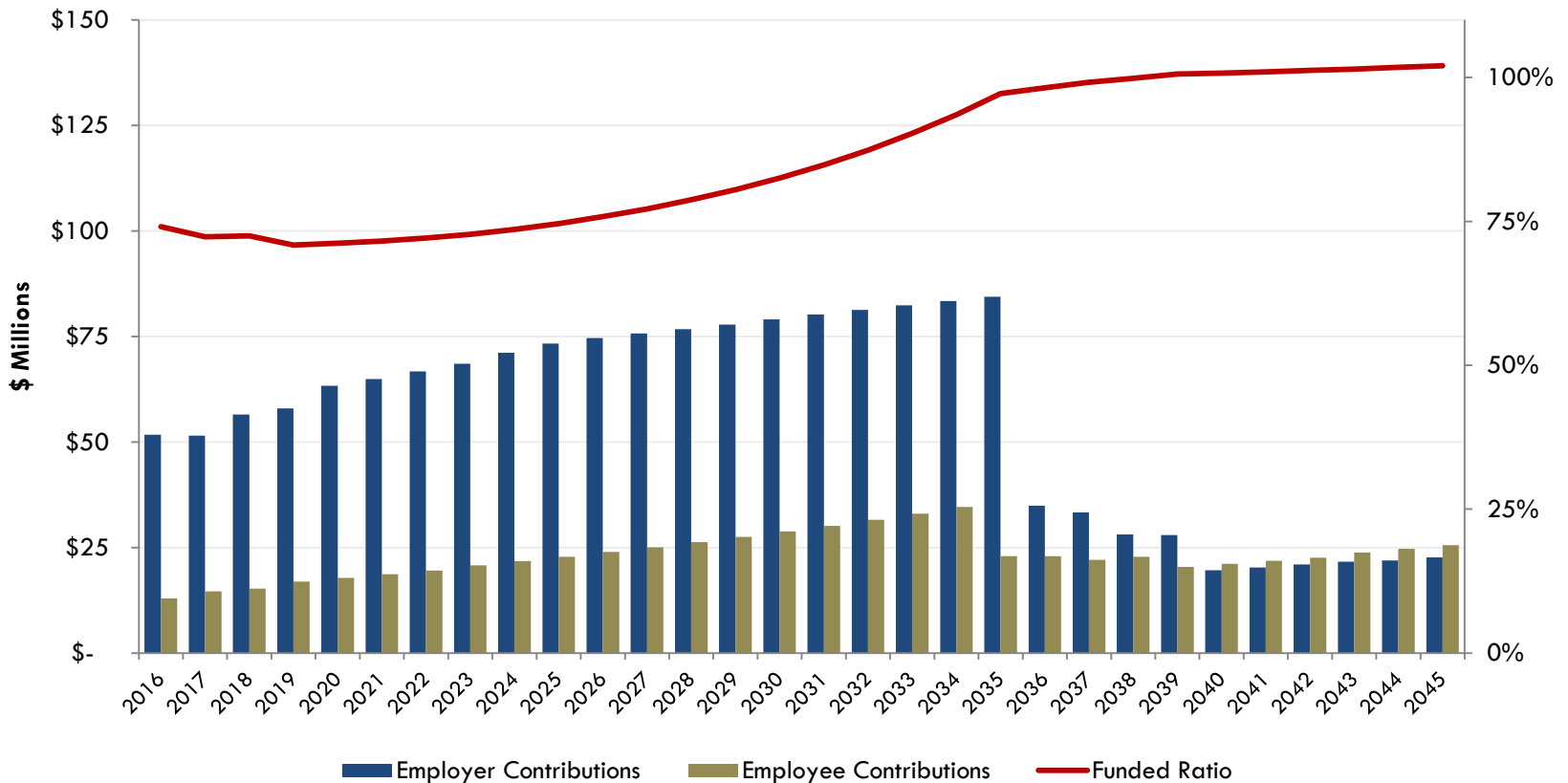


Source: *Pew analysis of the most recent tier of state and teacher plans (107 plans) in the Urban Institute database of state and local pension plans.*

Finding #5

Total contributions are projected to rise over the next two decades, improving plan funding and operating cash flow but placing fiscal pressure on both the county and employees. A low investment return scenario exacerbates the fiscal pressure while limiting improvements to plan funding and operating cash flow.

Long-term Projection of Contributions and Funded Status (Expected investment returns)

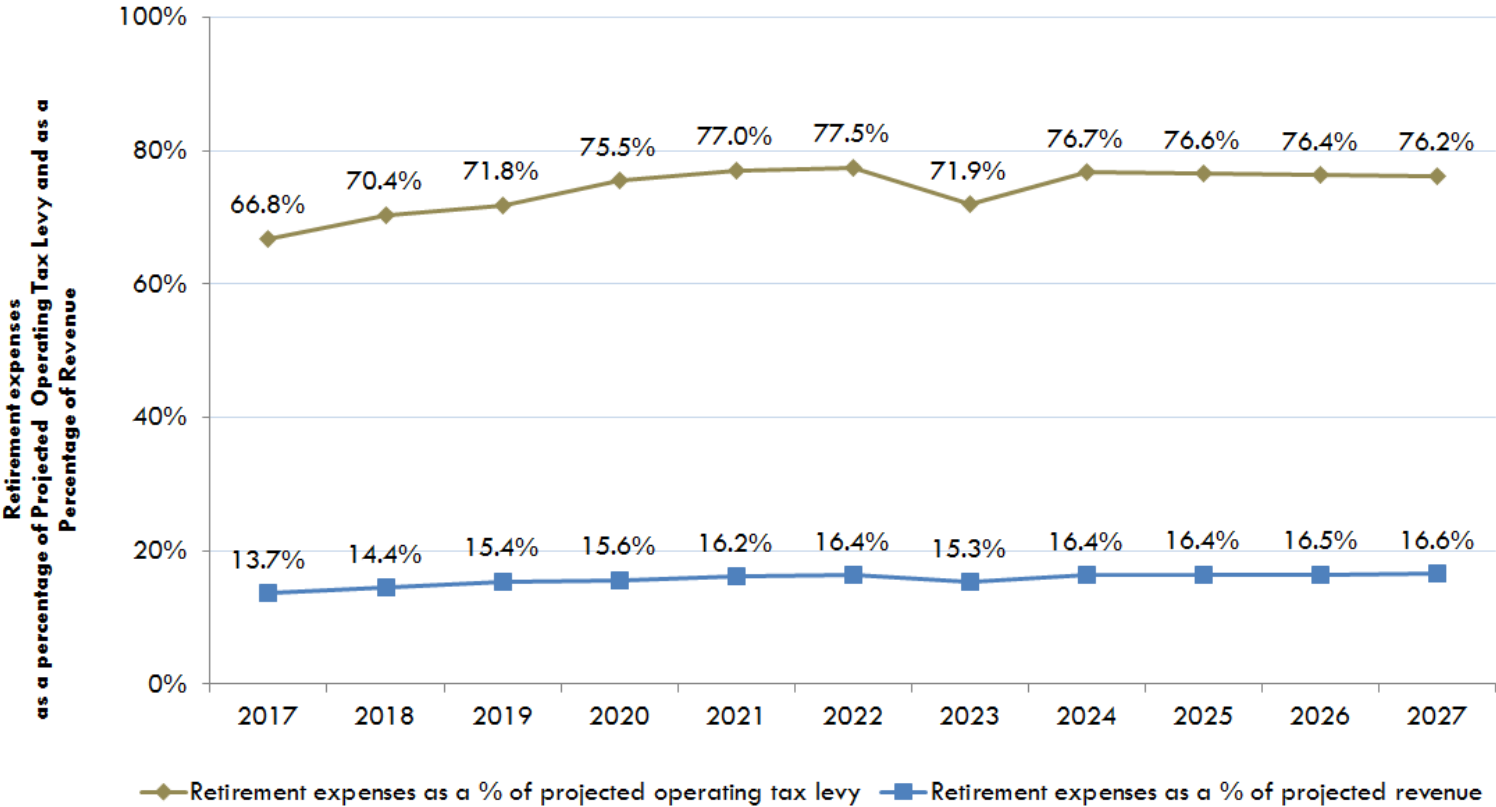


Note: Expected returns follow planned ERS schedule to lower discount rate gradually from 8% to 7.75% on 1/1/2018 and again to 7.50% on 1/1/2020.

Source: Projections by Pew and the Terry Group using a financial simulation model created using data from ERS Annual Reports, Actuarial Valuations and other documents provided by county and plan officials.

Forecast of Milwaukee County Retirement Expense

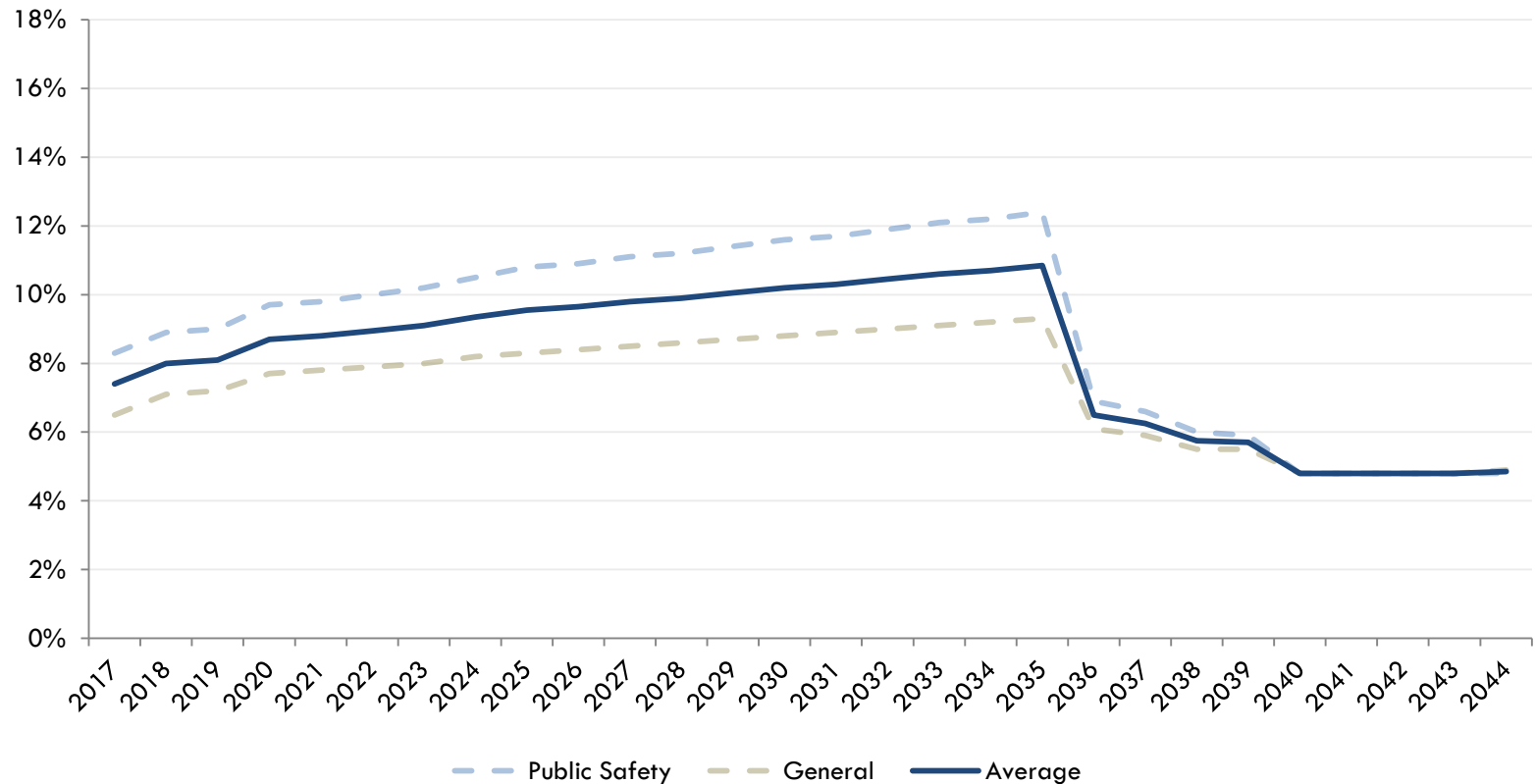
Percentage of Projected Tax Levy and Total County Revenue



Note: "Retirement expenses" include county contributions to ERS, the annual POB payment, and retiree healthcare costs.
Source: ERS projections by Pew and the Terry Group using a financial simulation model created using data from ERS Annual Reports, Actuarial Valuations and other documents provided by county and plan officials. Retiree healthcare, POB costs and projected revenues provided by County.

Projected Employee Contribution Rates Over Time

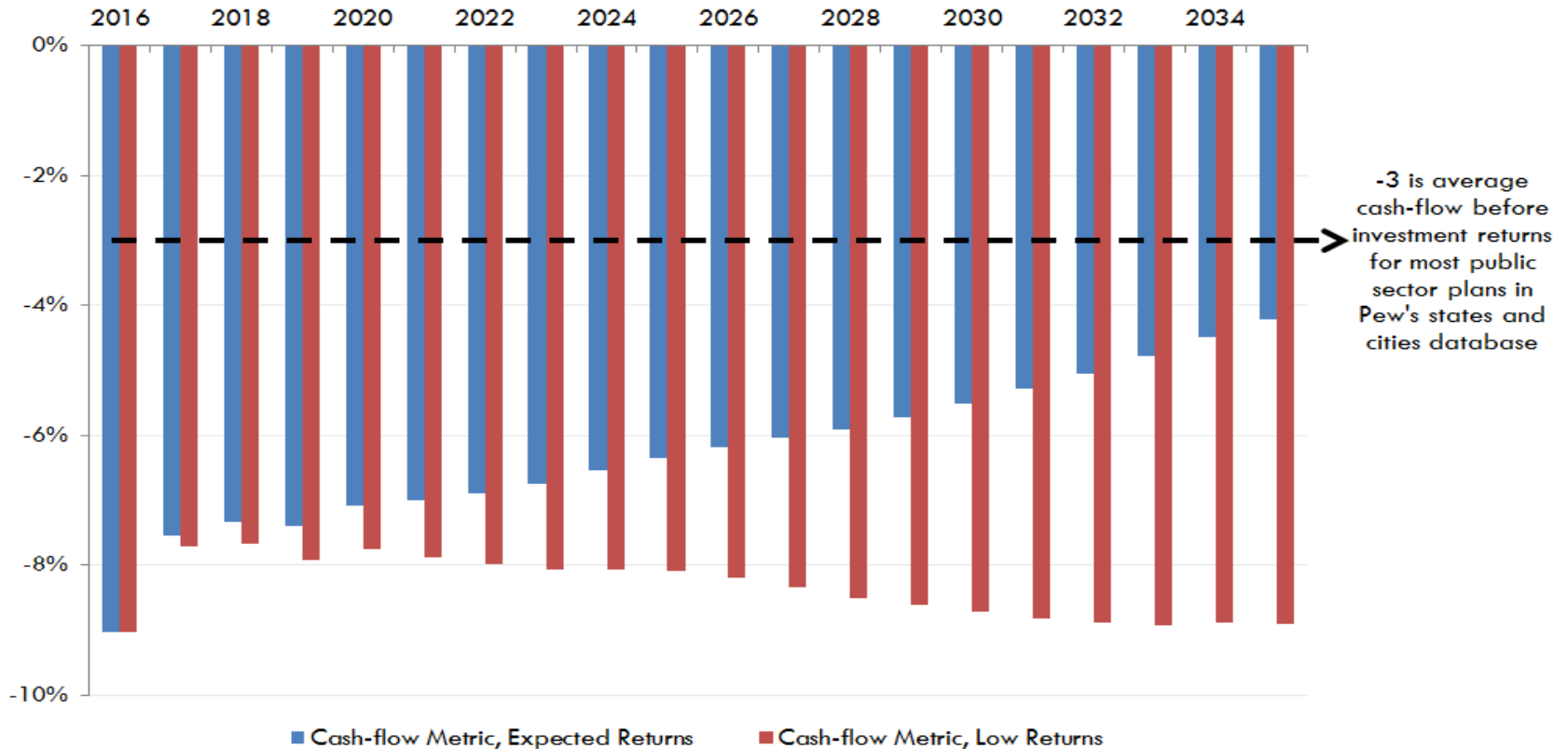
(Expected investment returns)



Note: Expected returns follow planned ERS schedule to lower discount rate gradually from 8% to 7.75% on 1/1/2018 and again to 7.50% on 1/1/2020.
Source: Projections by Pew and the Terry Group using a financial simulation model created using data from ERS Annual Reports, Actuarial Valuations and other documents provided by county and plan officials.

ERS Twenty Year Cash Flow Projections

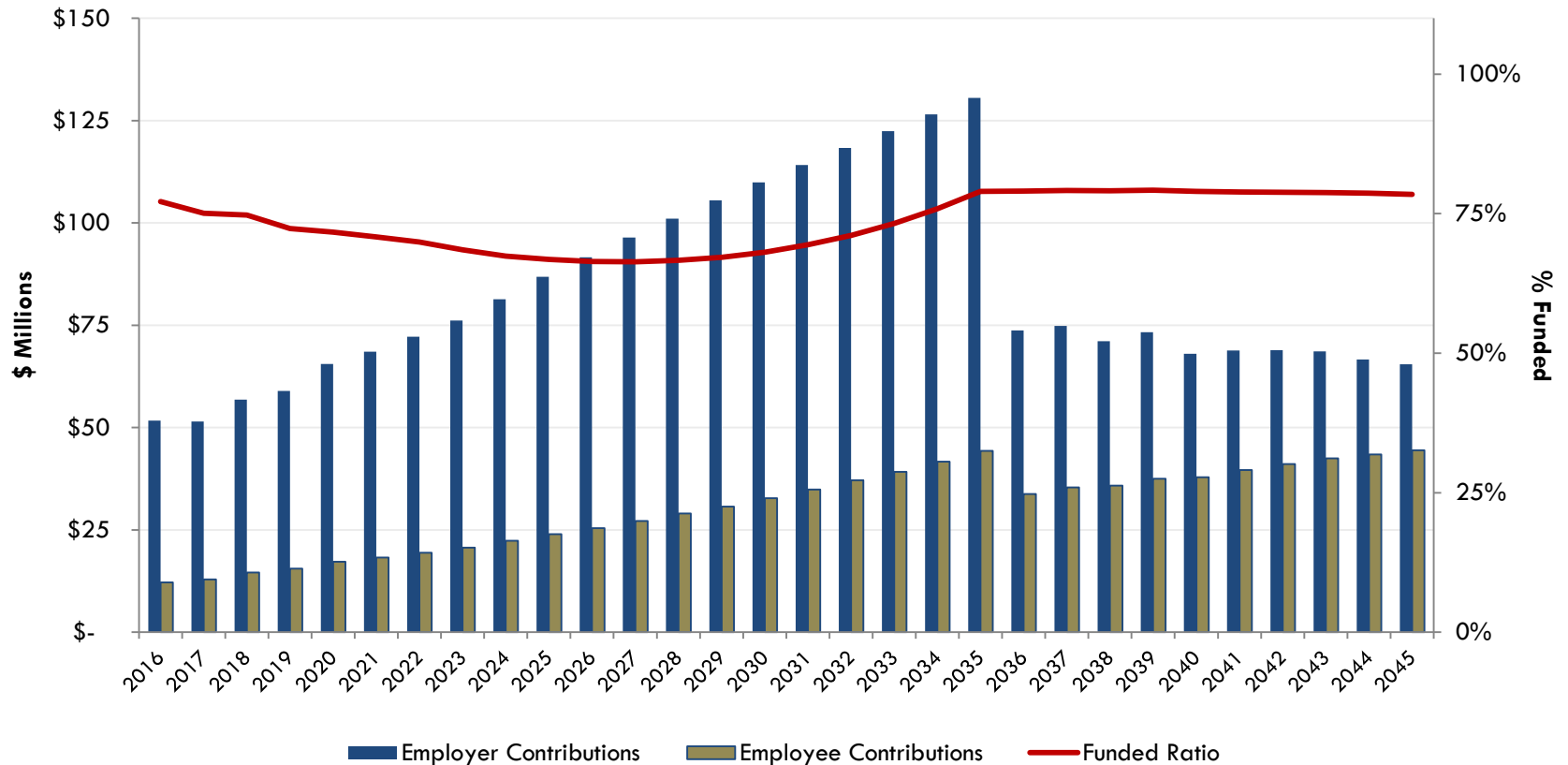
(Expected and low investment returns)



Note: Contributions held constant in scenarios. Expected returns follow planned ERS schedule to lower discount rate gradually from 8% to 7.75% on 1/1/2018 and again to 7.50% on 1/1/2020. Low returns at 5.50%.

Source: Projections by Pew and the Terry Group using a financial simulation model created using data from ERS Annual Reports, Actuarial Valuations and other documents provided by county and plan officials.

Long-term Projection of Contributions and Funded Status (Low investment returns)

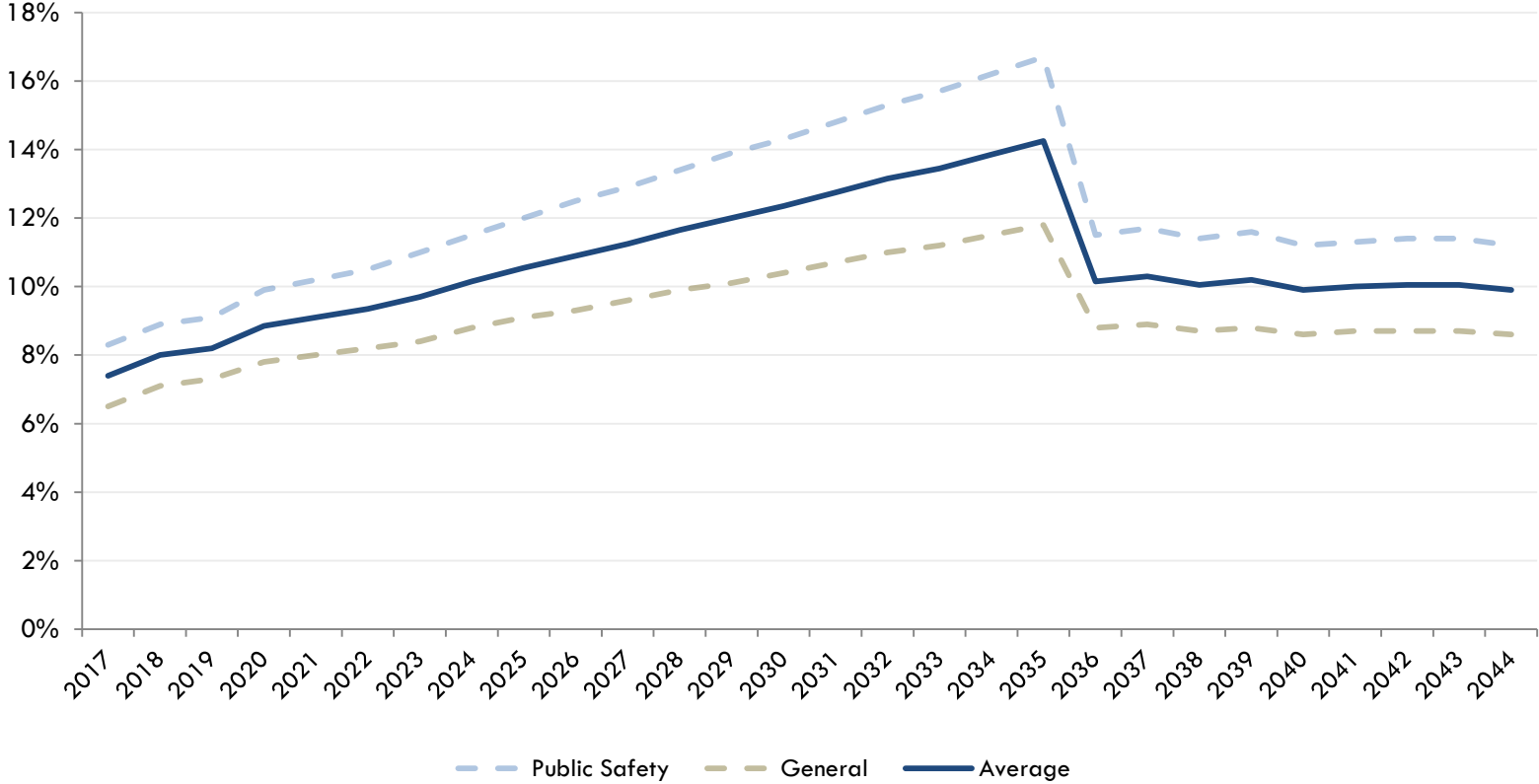


Note: projections assume long-term investment return rate of 5.50%

Source: Projections by Pew and the Terry Group using a financial simulation model created using data from ERS Annual Reports, Actuarial Valuations and other documents provided by county and plan officials.

Projected Employee Contribution Rates Over Time

(Low investment returns)



Note: projections assume long-term investment return rate of 5.50%

Source: Projections by Pew and the Terry Group using a financial simulation model created using data from ERS Annual Reports, Actuarial Valuations and other documents provided by county and plan officials.

Questions?