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Options for New Plan Design- Transitioning New Hires and Current Employees to WRS

Milwaukee County Retirement Sustainability Taskforce

February 27, 2018

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Public Sector Retirement Systems Project**

The Pew Charitable Trusts

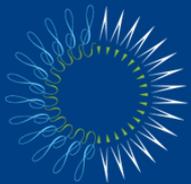
- More than 40 active, evidence-based research projects
- Projects include public safety, immigration, elections, transportation, pensions, and state tax incentives
- All follow a common approach: data-driven, inclusive, and transparent

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

- **Updated analysis of new hire transition to WRS**
- **Considerations for transitioning current employees to WRS**
- **Fiscal Metrics**
- **Retirement Security Metrics**
- **Issues to Consider**
- **Conclusion**



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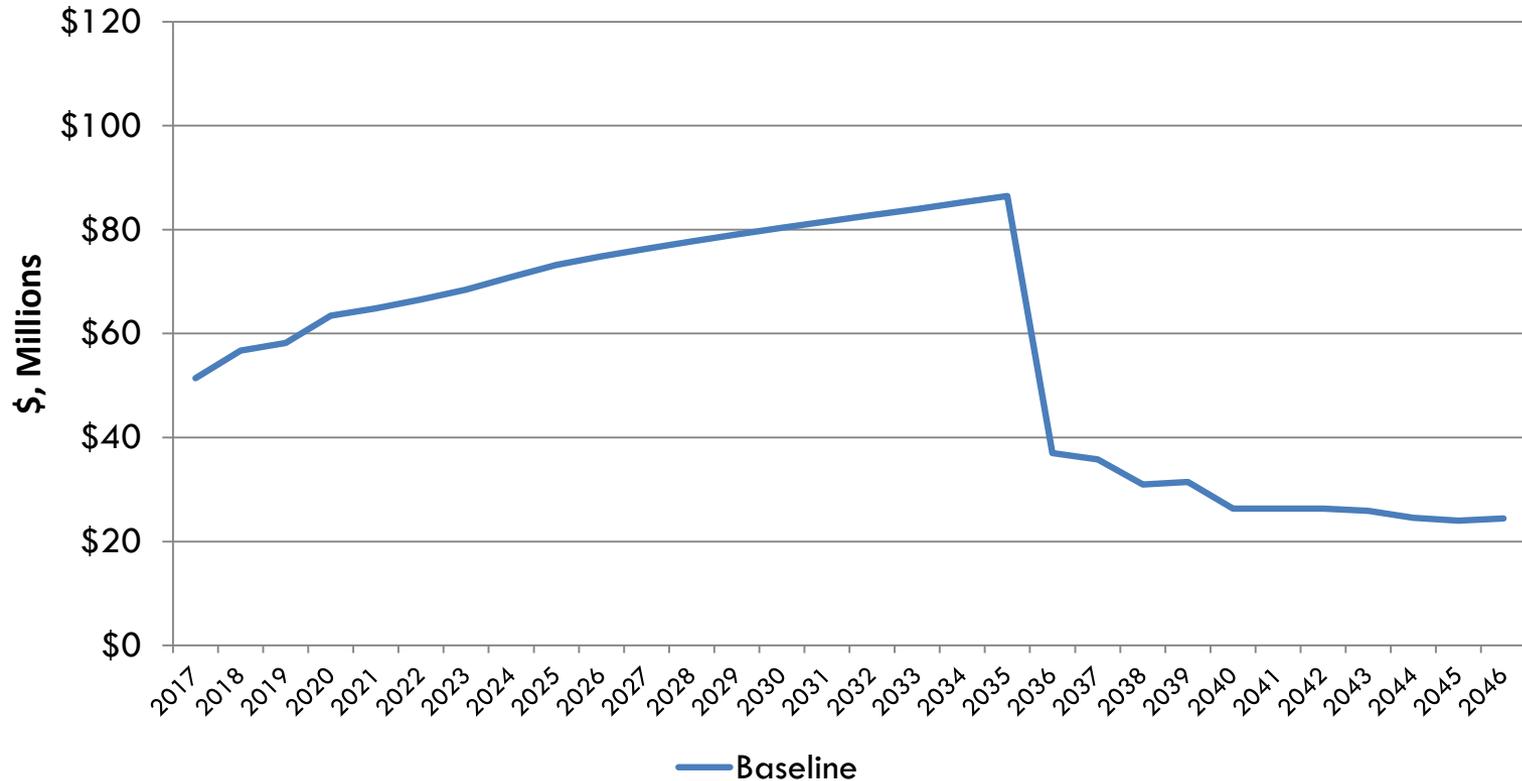
Updated Analysis of New Hire Transition to WRS

Updates to Analysis

- We received data from Segal, the ERS actuary, to help our actuaries model a transition of current employees to WRS; this also allowed them to update the soft freeze analysis from last month with more precise estimates.
- Task force members expressed interest at the previous meeting as to the breakdown of the cost changes from transition of current employees to WRS.
- Overall findings remain unchanged.

Expected Employer Costs Under Current Policy

Projected Employer Contributions

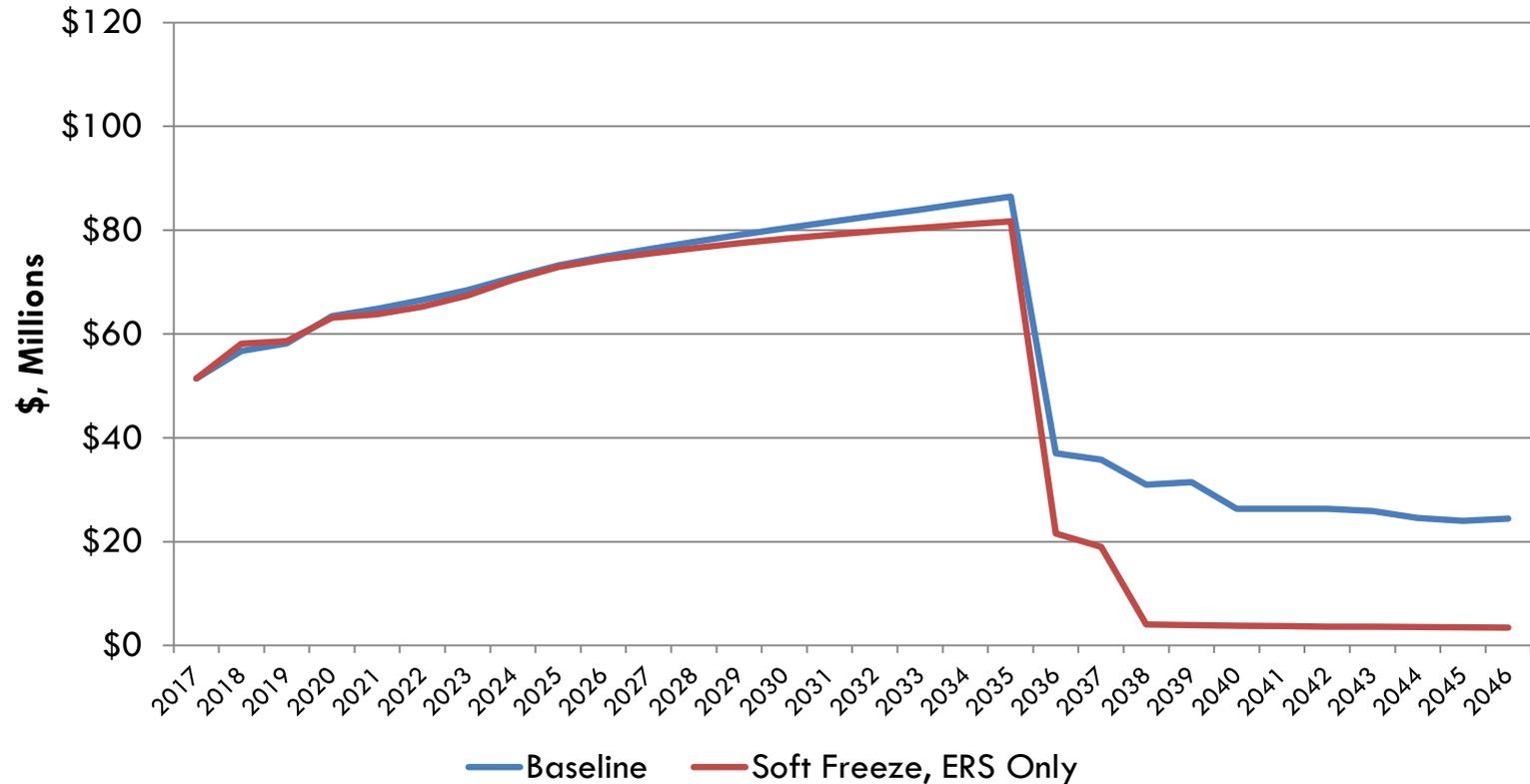


Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

Expected Employer Costs for ERS after Soft Freeze

Projected Employer Contributions, Soft Freeze

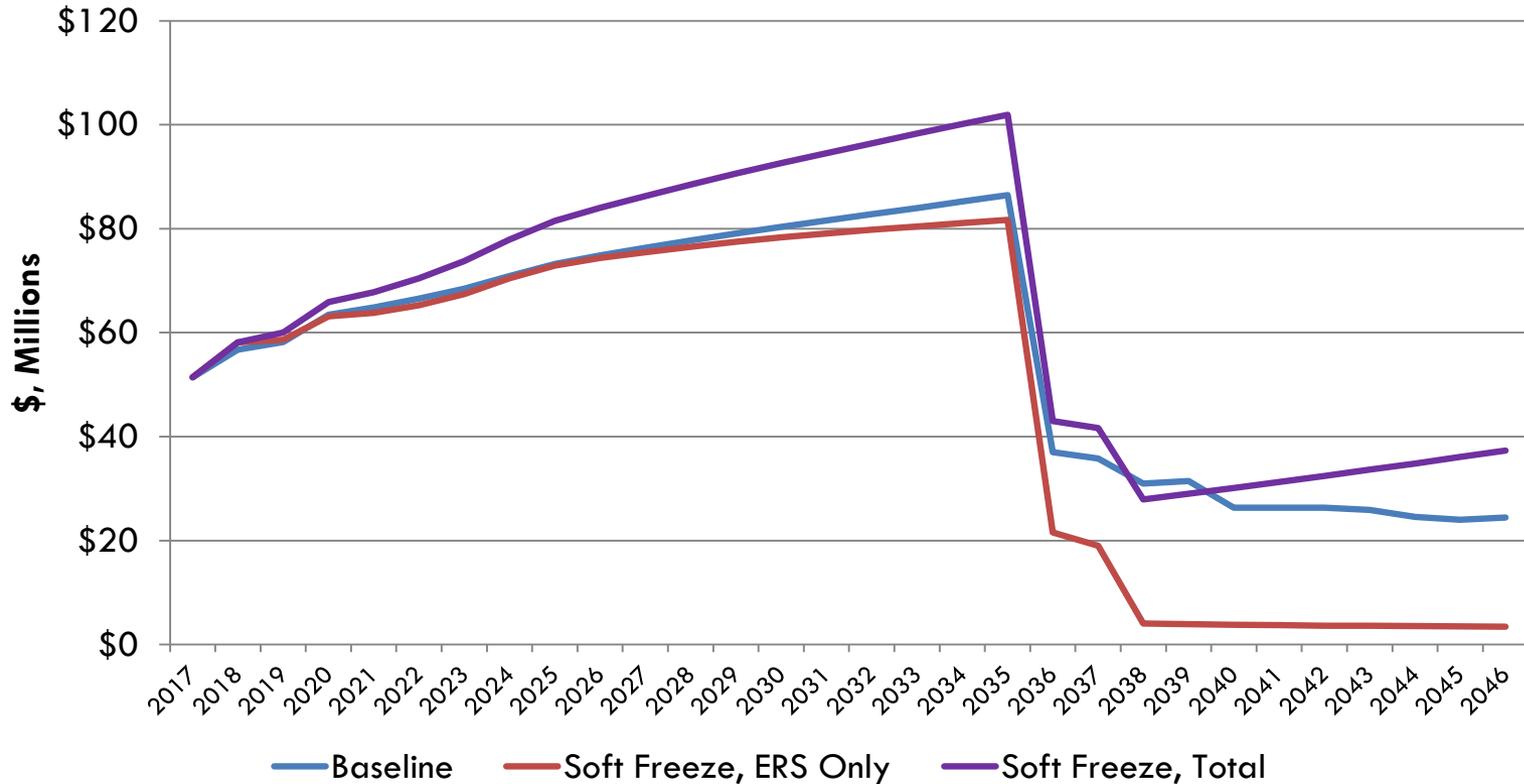


Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

Expected Employer Costs for ERS and WRS Combined

Projected Employer Contributions, Soft Freeze

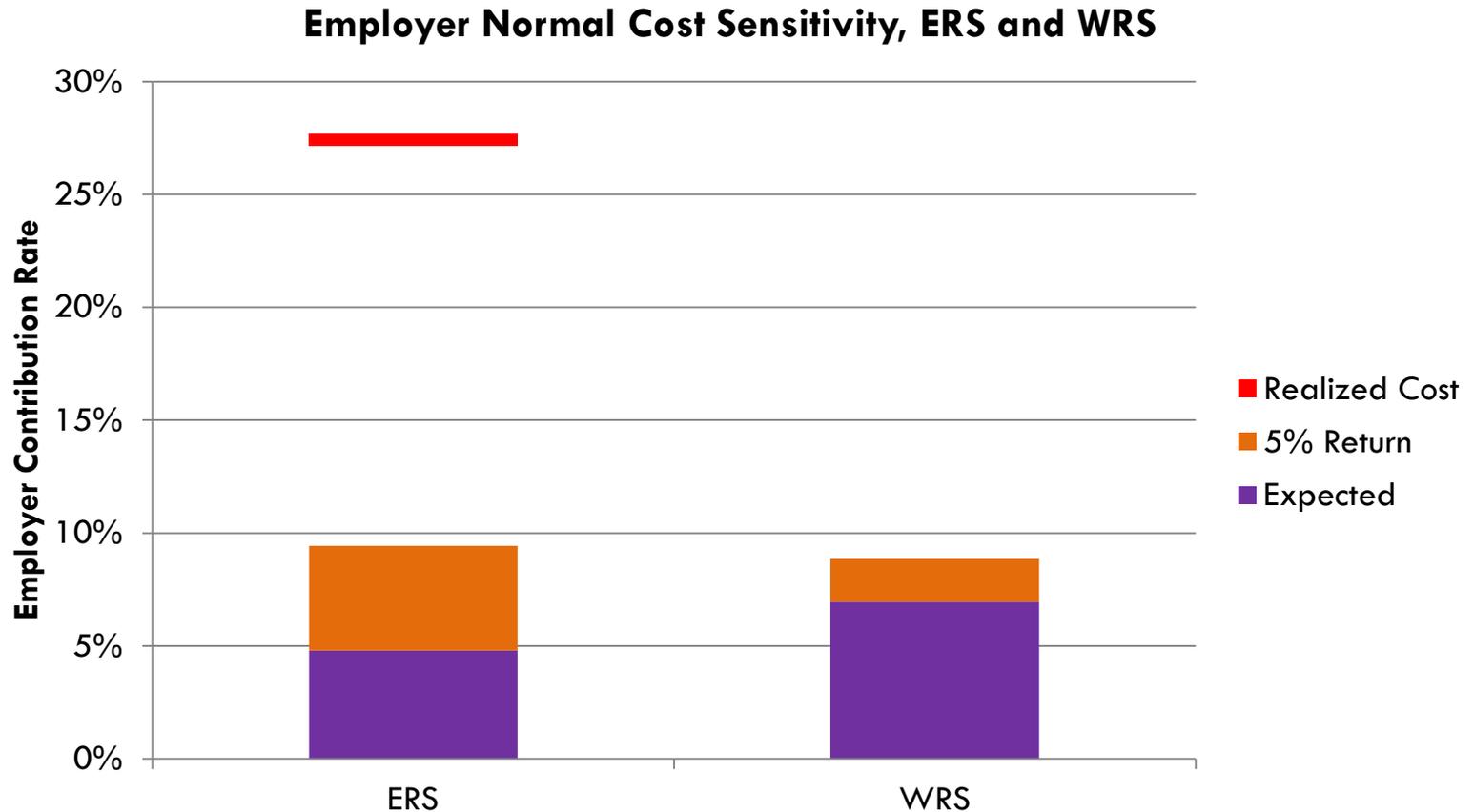


Notes:
 Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions and WRS plan assumptions. Updated using additional data from Segal.

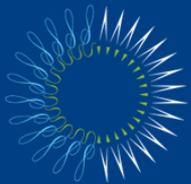
Breaking Down the Increased Cost from a New Employee Transition to WRS

- We estimate that switching new hires to WRS will increase total employer costs over the period of 2017 through 2046 by \$201 million, or about 2% of payroll.
- About \$160 million of that difference can be explained by three causes:
 - Higher level of benefits in WRS: \$118 million
 - Lower return assumption in WRS: \$30 million
 - Reduction in employee risk share contributions in ERS: \$13 million
- WRS benefits have a higher expected cost than ERS benefits but have substantial risk mitigation built into the plan design and a track record of being well-funded.

Normal Cost Sensitivity



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.



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Considerations for Transitioning Current Employees to WRS

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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Considerations for Transitioning Current Employees to WRS

- We considered different approaches for a partial freeze.

- Benefit provisions that can be carried over:
 - Salary growth
 - Retirement eligibility
 - Vesting

- Our modeling assumed retirement eligibility and vesting are based on combined years of service.

- We model both no salary increases after transition in calculating ERS benefits as well as including all increases in salary after transition.
 - Our understanding of current reciprocity is that salary after transition is credited with inflation but not total wage growth.
 - We assumed no employee contributions to ERS.



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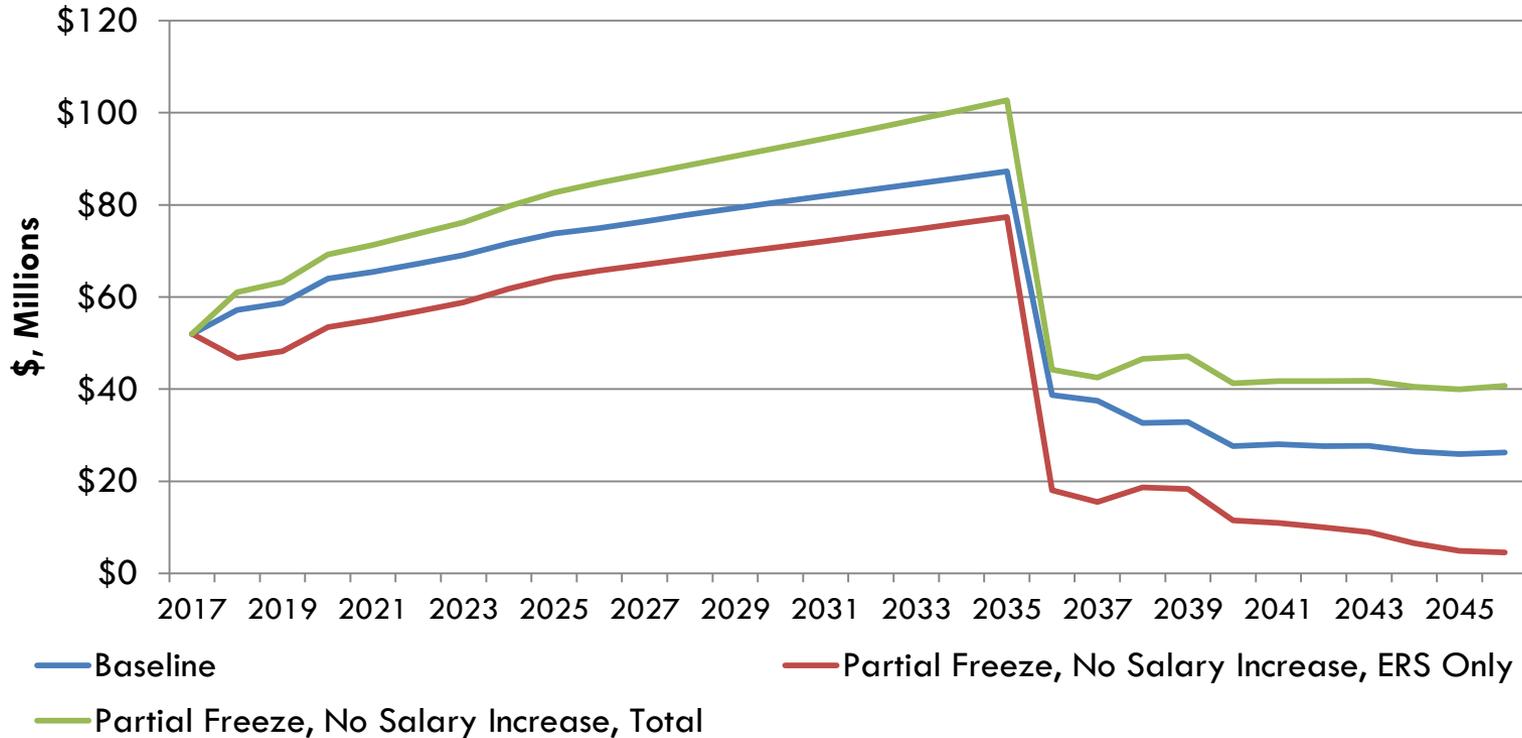
Fiscal Metrics

Fiscal Results of Transitioning Current Employees to WRS

- A partial freeze that transitions current employees to WRS is projected to cost \$100 to \$180 million more than the soft freeze.
- This estimate is based on no further employee contributions towards ERS and current employees instead contributing towards WRS.
- The elimination of employee contributions to ERS drives this result—total contributions to ERS go down by \$300 to \$370 million but \$312 million of that is foregone employee contributions.

Expected Employer Costs Under Partial Freeze

Projected Employer Contributions, Partial Freeze, No Salary Increase

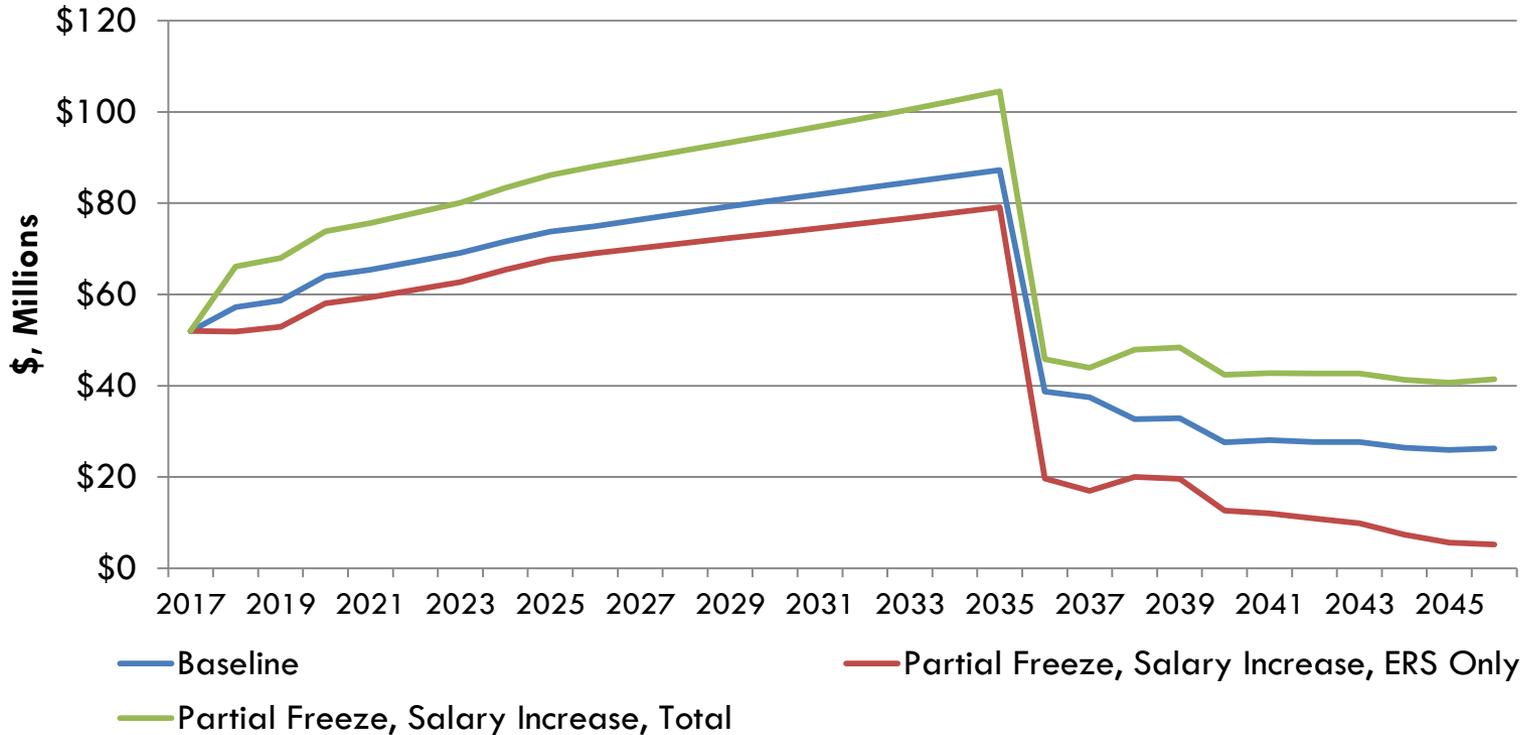


Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

Expected Employer Costs Under Partial Freeze

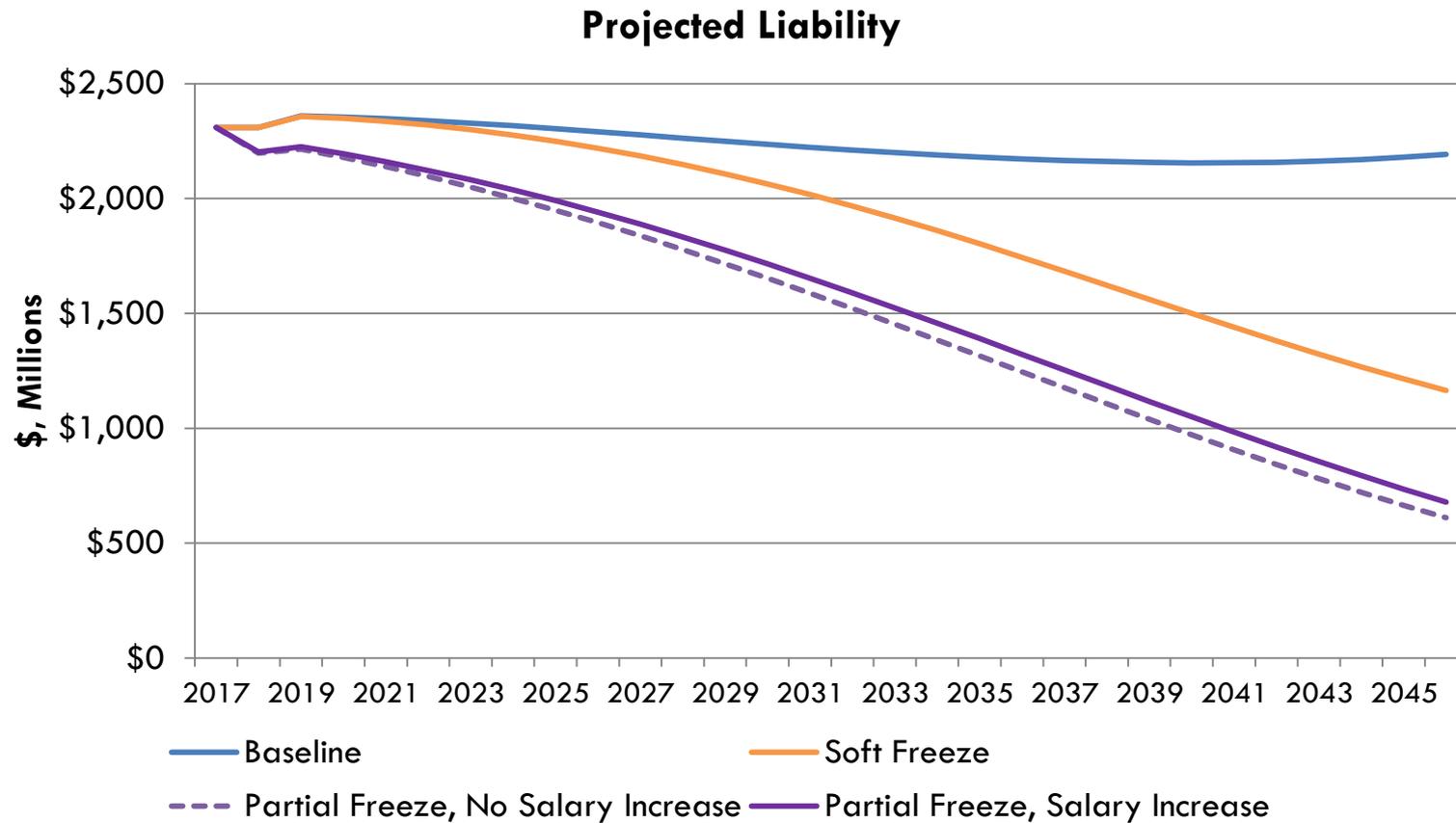
**Projected Employer Contributions,
Partial Freeze, Salary Increase**



Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

Liability will Decline Under Soft or Partial Freeze



Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

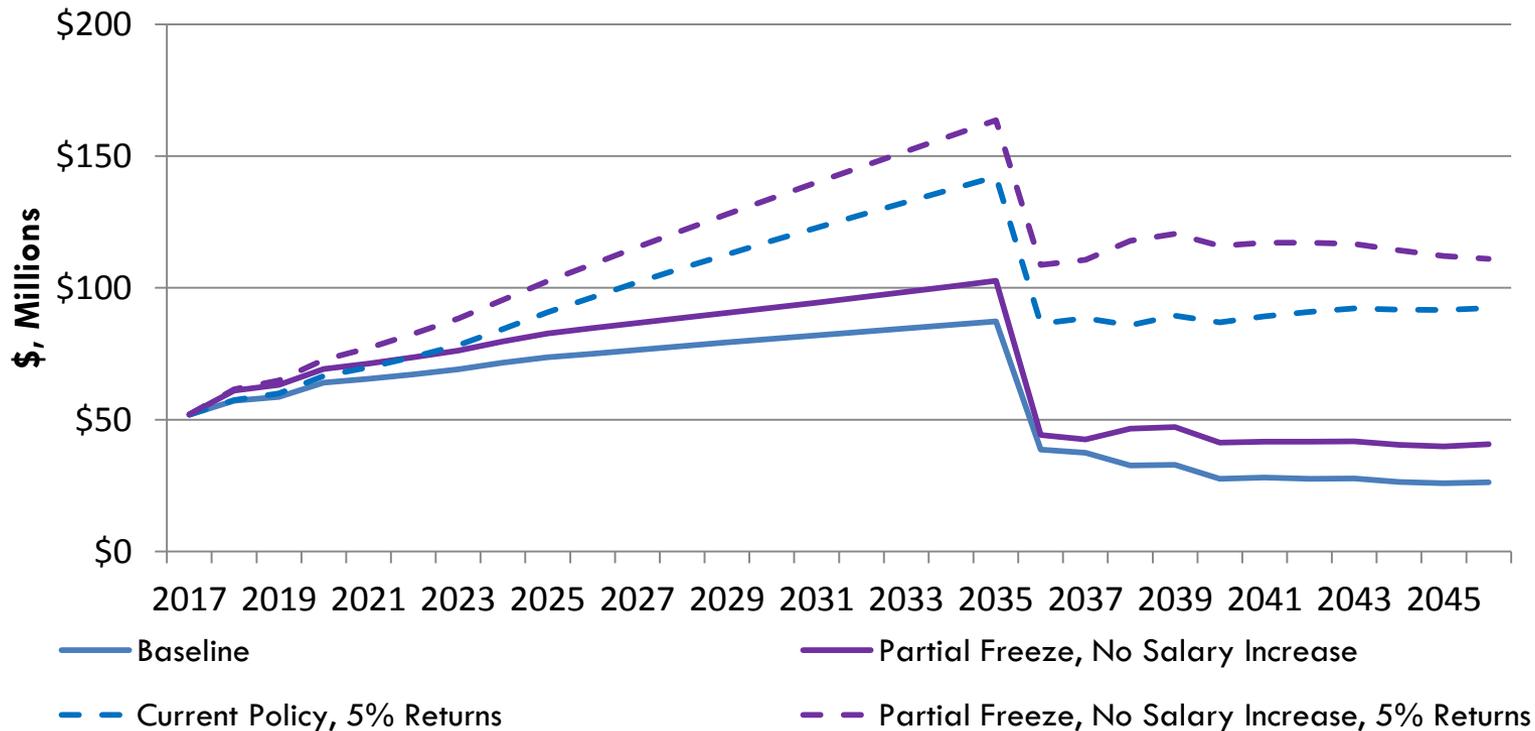
Long-term Impact of Transition to WRS is Risk Reduction

- Projected ERS employer costs increase by 60% under current policy in a low-return scenario; for members transitioned to WRS there is a 30% increase in employer costs in a low return scenario.
- The overall impact in the short-term is reduced by two factors:
 - The reduction (in a soft freeze) or cessation (in a partial freeze) of employee risk share contributions adds to employer costs in the short-term.
 - WRS risk-mitigation in retirement will take time to take effect.

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

Expected Employer Costs for ERS after Partial Freeze, Low Returns and No Salary Increases

Projected Employer Contributions,
Partial Freeze, No Salary Increase

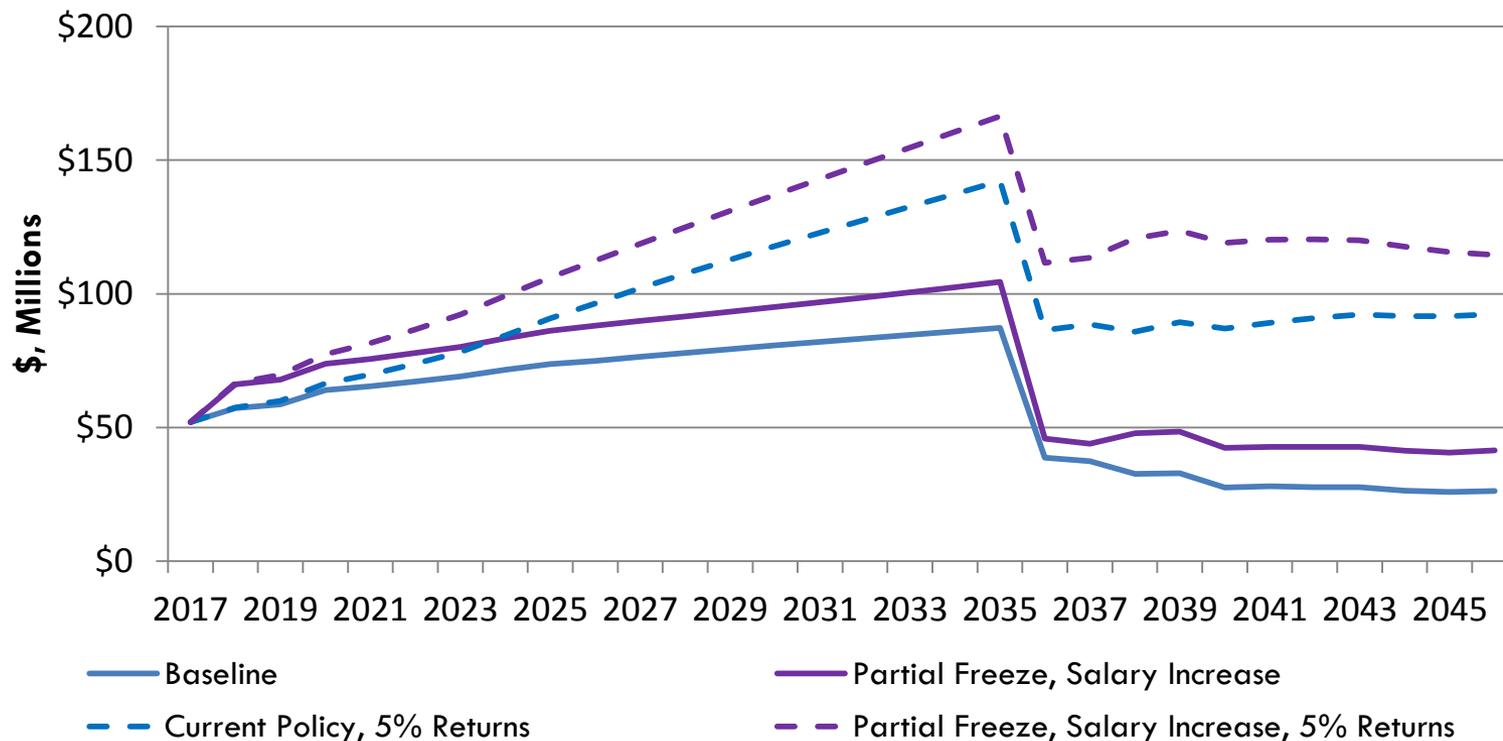


Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

Expected Employer Costs for ERS after Partial Freeze, Low Returns and Full Salary Increases

**Projected Employer Contributions,
Partial Freeze, Salary Increase**

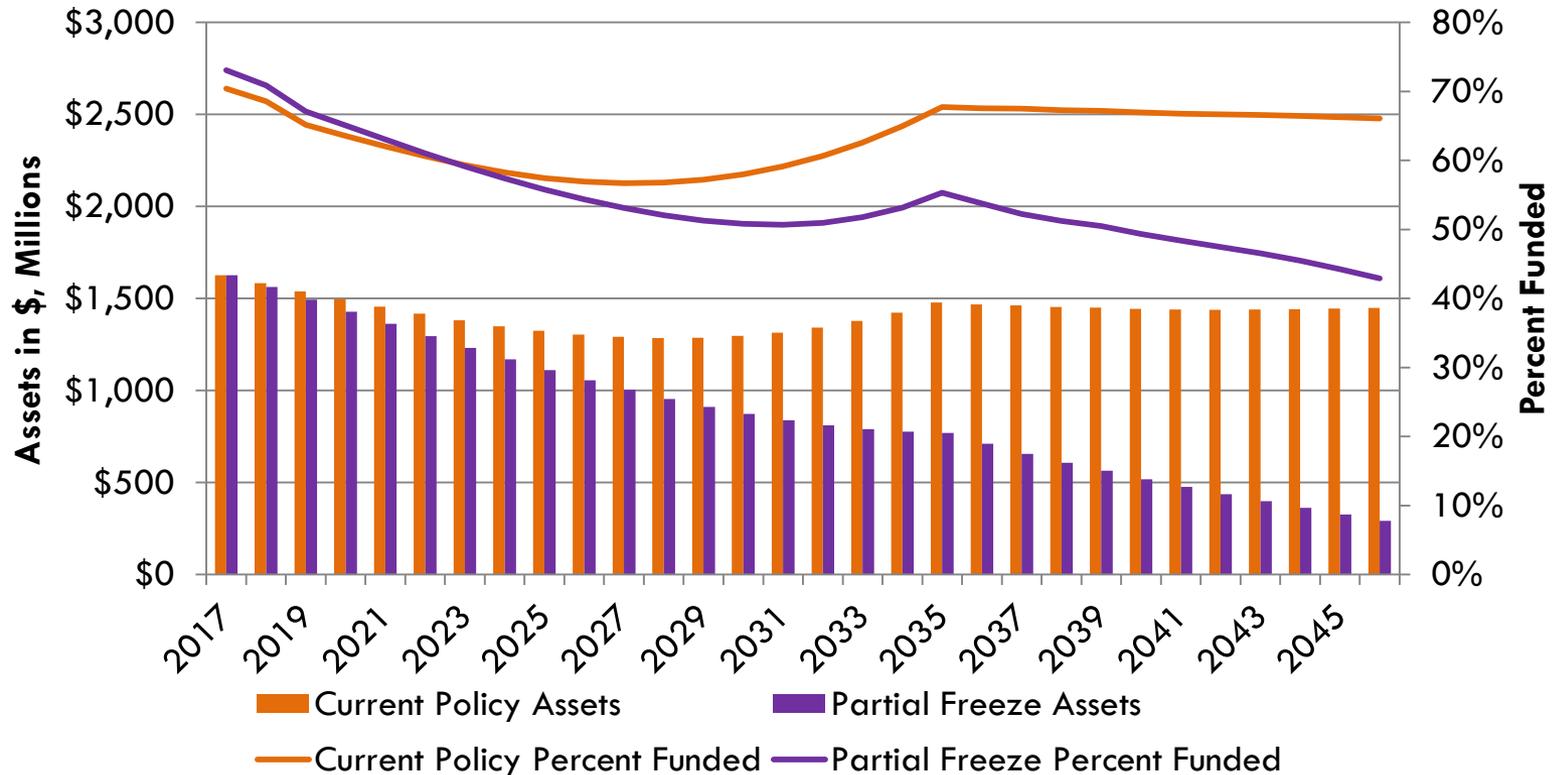


Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

Assets and Funding Levels in a 5% Return Scenario for a Partial Freeze with Salary Increases

Assets and Percent Funded in a 5% Return Scenario

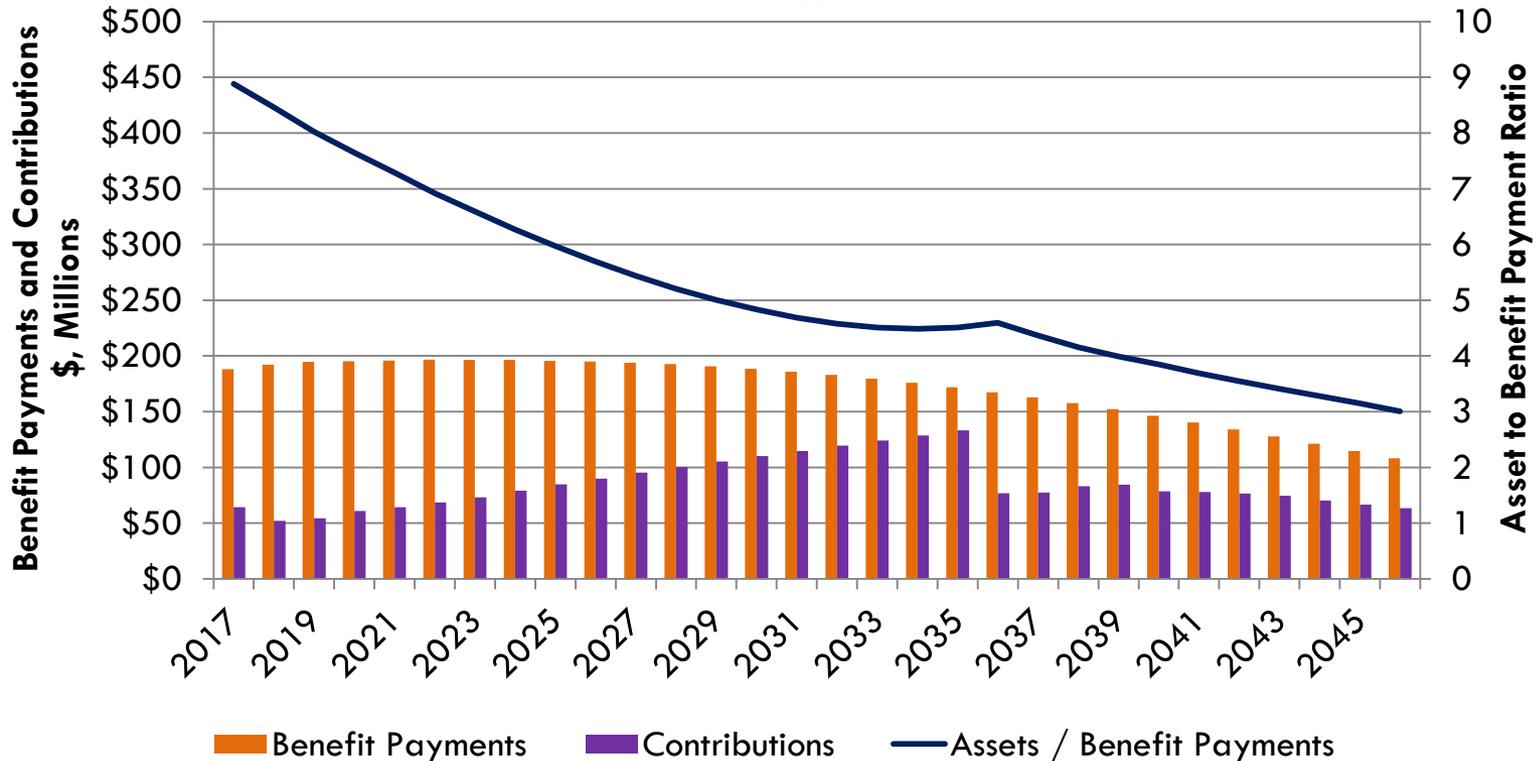


Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

Assets and Funding Levels in a 5% Return Scenario for a Partial Freeze with Salary Increases

Benefit Payments and Contributions in a Partial Freeze, 5% Return Scenario



Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

Findings from Fiscal Metrics

- A partial freeze would increase total employer costs over the projection period compared to both current policy and a soft freeze.
- Key driver is cessation of employee contributions to ERS.
 - Unclear if there is a feasible way to maintain some level of employee contributions to ERS in a partial freeze.
- Long-term impact of shift to WRS, either under soft or partial freeze, is more stable costs and lower risk of ongoing underfunding.
- 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.



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Retirement Security Metrics

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.

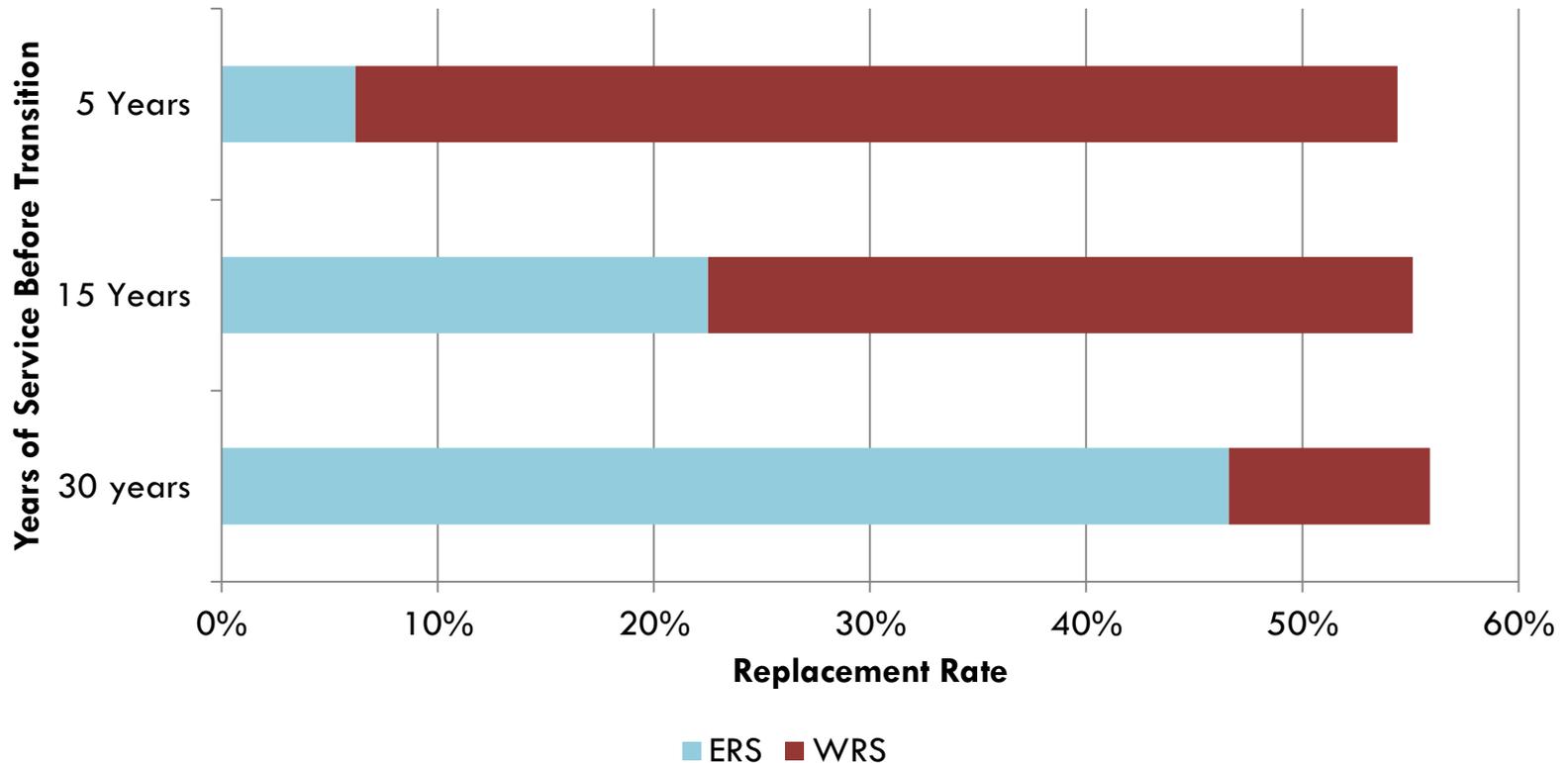
***Some firefighters under protective occupation hired/rehired after March 31, 1986 do not participate in social security.

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?

Replacement Income for Workers with Different Years of Service Prior to Transition, Salary Inflation Indexed

Replacement Income By Source, Salary Indexed by Inflation

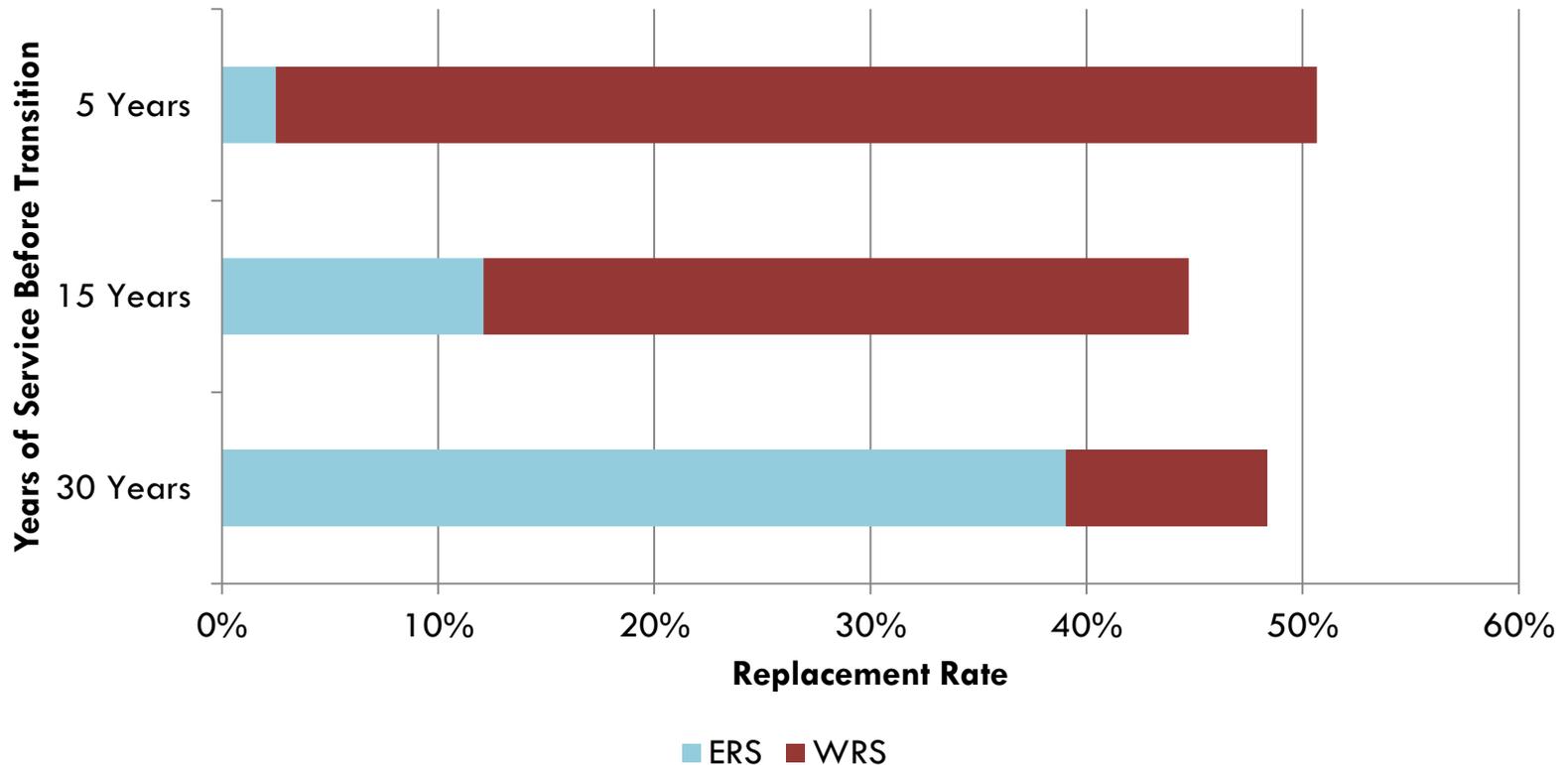


Notes:

Pew analysis using ERS actuarial assumptions for salary growth and inflation.

Replacement Income for Workers with Different Years of Service Prior to Transition, No Salary Indexing

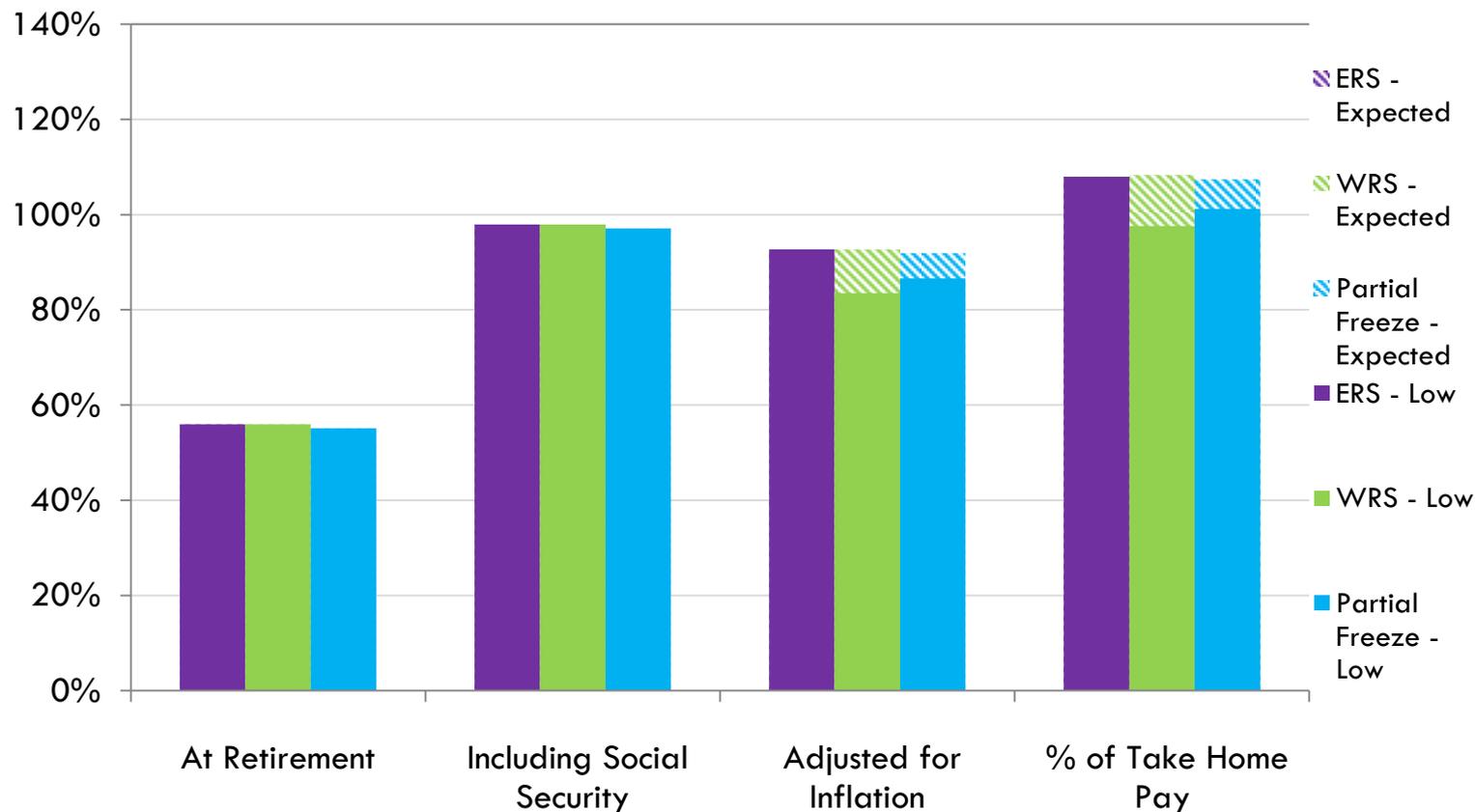
Replacement Income By Source, Salary Not Indexed



Notes:

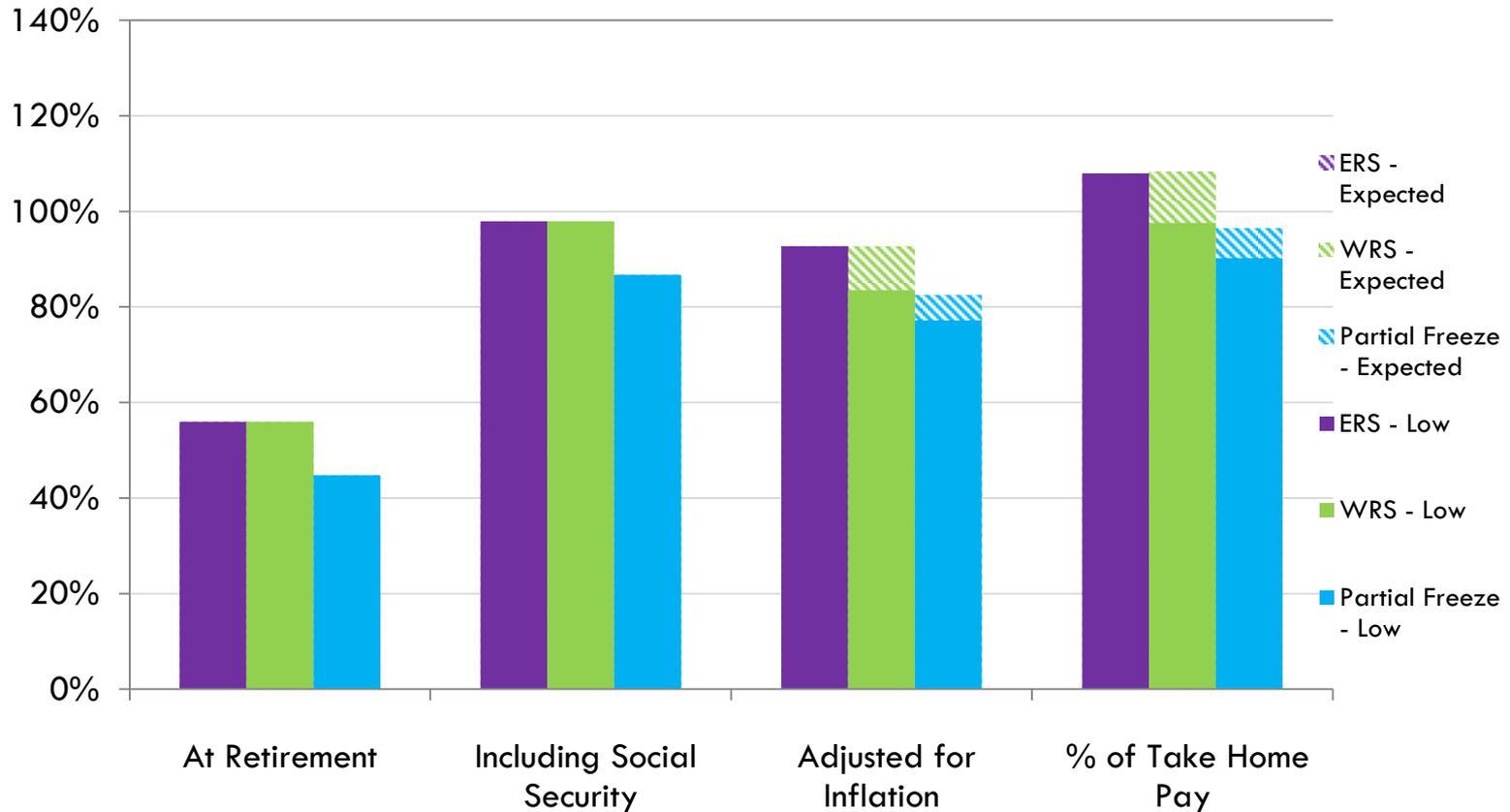
Pew analysis using ERS actuarial assumptions for salary growth and inflation.

Replacement Income—Partial Freeze Salary Indexed



Notes:
 Pew analysis using ERS actuarial assumptions for salary growth and inflation. Partial freeze example participant has 15 years of service with ERS before transition and salary after transition indexed by inflation.

Replacement Income—Partial Freeze Salary Not Indexed

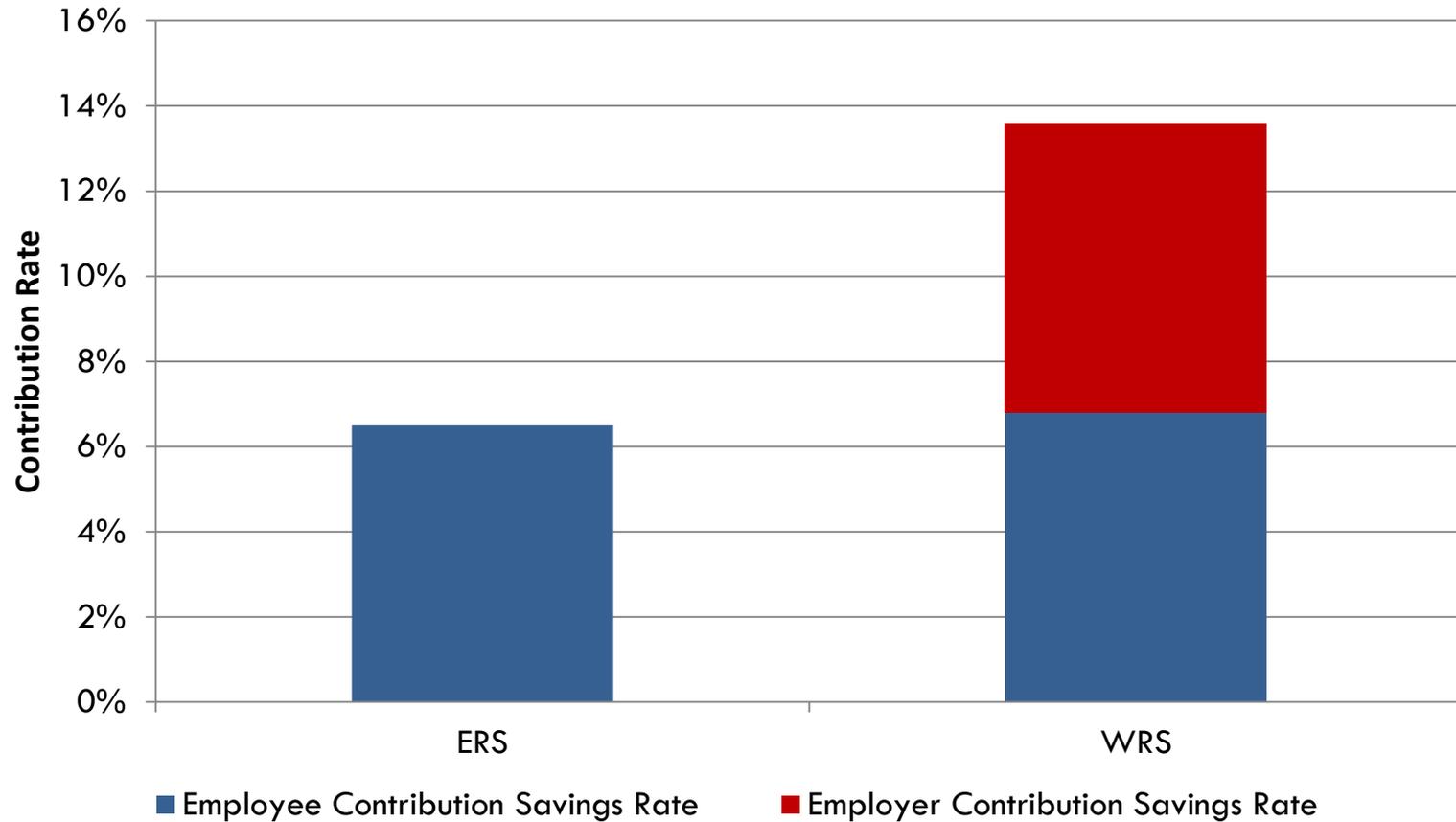


Notes:
Pew analysis using ERS actuarial assumptions for salary growth and inflation. Partial freeze example participant has 15 years of service with ERS before transition and salary after transition not indexed.

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 partial-freeze of the ERS and a transition of current employees to WRS will increase employer costs through 2046 compared to both baseline policy and a soft-freeze.
- **Identifying how benefits should carryover between ERS and WRS.**
- **A partial-freeze does not appear to cause solvency risk within the projection period.** Funding levels drop in a low return scenario as does the ratio of assets to benefit payments. However, the plan does not achieve insolvency or near-insolvency over the projection period and annual benefit payments decline rapidly.
- **A partial-freeze would eliminate employee contributions going towards ERS.**

Assumptions for Partial Freeze Analysis

- **How to manage reciprocity between plans?** We assume that vesting and retirement eligibility have full reciprocity for modeling purposes and examine different approaches of indexing salary at transition in calculating ERS benefits.
- **How to manage employee contributions in a partial freeze?** We assume that no employee contributions go towards ERS after transition.
- **Both assumptions can potentially be changed if that is the policy direction Milwaukee County is interested in.**

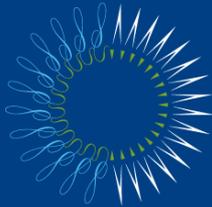


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Conclusion

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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 current 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 partial freeze increases costs compared to a soft freeze, largely due to the cessation of employee contributions to ERS. Career employees that already have 10 to 20 years of service could get a substantial benefit cut in a partial freeze.
- New plan design will not eliminate the need to have a credible plan to pay for existing promises.



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