

# Human Resources

## Status of the Pension Systems

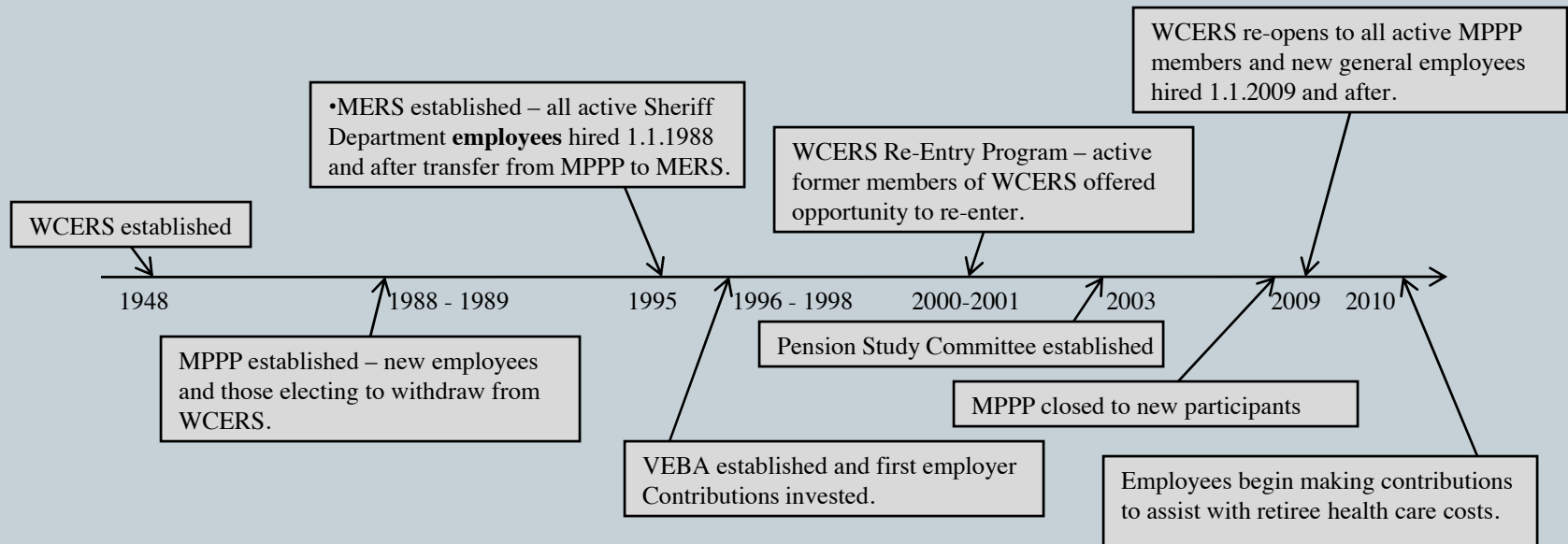


**Board of Commissioner Working  
Session**

**September 8, 2011**

# Retirement Program History

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**Washtenaw County Employees Retirement System (WCERS) – Defined Benefit**

**Money Purchase Pension Plan (MPPP) – Defined Contribution (Closed)**

**Municipal Employees' Retirement System (MERS) - Defined Benefit**

**Voluntary Employees Beneficiary Association (VEBA) – Health Funding Trust**

# Current Retirement Benefit Structures

A **Defined Benefit Plan** is a qualified retirement account from which a pension benefit is based on a specific formula indicating the exact benefit that one can expect upon retiring. The benefit formula, specified within the plan document, is based on salary history, the duration of employment and a percentage (multiplier). Investment risk and portfolio management are under the control of the plan administrator, and as such investment gains or losses do not affect the benefit payable to the individual member. Contributions may be made by the employee, the employer, or both.

- WCERS
- MERS

A **Deferred Compensation Program** is an arrangement in which a portion of an employee's income is paid out at a date after which that income is actually earned. The primary benefit of most deferred compensation is the deferral of tax to the date(s) at which the employee actually receives the income and/or investment earnings.

- 457 – Deferred Compensation

# Current Retirement Benefit Structures

**Other Post Employment Benefits (OPEB)** – Post-employment benefits that an employee will receive at the start of retirement. This type of benefit does not include pension benefits, but rather benefits such as healthcare, life insurance, etc.

- VEBA

Washtenaw County in an attempt to secure and pre-fund the liabilities associated with retiree healthcare, established a Voluntary Employees' Beneficiary Association (VEBA) on December 27, 1996. The members of this VEBA shall be all employees of the County and all former employees of the County eligible for retiree health care benefits under the Plan. Trustees will exercise discretionary authority or control in the investment of the Trust Fund, and shall hold, administer, invest, reinvest, and disburse the Trust Fund in accordance with the Plan Document and applicable federal and state law.

# Plan Provisions

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- **WCERS**

- 2.0% Multiplier
- FAC – 3
- Vesting – 8 years
- Eligibility
  - ✦ Age 60 and vested
  - ✦ Rule of 75 – sum of age and service total 75 or greater.
    - Minimum age 50 – hired prior to 1.1.2009
    - Minimum age 55 – hired 1.1.2009 or after
  - ✦ Position Elimination – minimum age 45 with at least 8 years of service credit.

- **MERS**

- 2.75% Multiplier
- FAC – 5
- Vesting – 10 years
- Eligibility
  - ✦ Age 60 and vested
  - ✦ Age 50 with 25 or more years of service

- **VEBA**

- VEBA provides funding for healthcare benefits members' receive in accordance with retirement eligibility provisions.

# Plan Demographics

2010 - Valuation

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- **WCERS**

- Active Members – 1010
- Deferred Members – 22
- Retirees / Beneficiaries – 740
  
- Market Value of Assets: \$205,235,006
  
- Employee Contribution:
  - ✦ 2010            7.50%
  - ✦ 2011            7.50%
  - ✦ 2012            TBD
  
- Employer Contribution:
  - ✦ 2010            8.70%
  - ✦ 2011            8.67%
  - ✦ 2012            10.00%

- **MERS**

- Active Members – 286
- Deferred Members – 22
- Retirees / Beneficiaries – 21
  
- Market Value of Assets: \$38,244,111
  
- Employee Contribution:
  - ✦ 2010            8.00%    POAM / COAM
  - ✦ 2011            8.00%    POAM / COAM
  - ✦ 2012            8.00%    POAM / COAM
  
- Employer Contribution:
  - ✦ 2010            9.09% POAM    11.21% COAM
  - ✦ 2011            7.48% POAM    8.89% COAM
  - ✦ 2012            8.06% POAM    10.75% COAM

# Plan Demographics

2010 - Valuation

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- **VEBA**

- Active Members – 1303

- Retirees / Beneficiaries – 726

- Market Value of Assets: \$63,078,224

- Employee Contribution (assets deposited with respective retirement program):

✦ 2010	General – 0.50%	Sheriff - 0.50%
✦ 2011	General – 0.00%	Sheriff – 1.00%
✦ 2012	General – TBD	Sheriff – 1.00%

- Employer Contribution:

✦ 2010	15.58%
✦ 2011	15.81%
✦ 2012	16.99%

# Funding Sources

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Income used to fund pension programs generally comes from three sources:

- Member Contributions
- Employer Contributions
- Investment Returns

The 2011 NCPERS Public Fund Study found that on average, investment returns are the most significant funding source (66%), and have funded more than two-thirds of public retirement benefits over the past 25 years.

Further the NCPERS Study found that despite weak short-term investment experience in 2008 and 2009, the long-term investment discipline of fund managers has produced an average 1-year return of 13.5 percent based on most recently reported data.



# Investment Returns

Annual Investment Performance Reports as of December 31 (WCERS and VEBA)  
Comprehensive Annual Financial Report (MERS)

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WCERS	Performance	2010	2009	2008	2007
	Fund	14.00%	16.90%	-22.50	8.10%
	Policy Index	14.30%	17.60%	-23.00	6.00%

MERS	Performance	2010	2009	2008	2007
	Fund	14.43%	17.30%	-24.79	8.57%
	Policy Index	13.24%	23.30%	-26.17	6.43%

VEBA	Performance	2010	2009	2008	2007
	Fund	12.92%	18.79%	-23.55%	8.59%
	Policy Index	11.65%	22.38%	-26.67%	5.97%

# Relative Performance

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- Each plan has a diversified portfolio of various asset classes, including domestic equities, international equities, fixed income, real estate, and alternative investments. When reviewing the performance it is important to evaluate the performance relative to the **benchmark** – a similarly structured portfolio that is closely aligned to the true holdings.
- When reviewing performance, it's important to compare the correct metrics (i.e. asset class vs. combined portfolio). It can be confusing and frustrating to hear the S&P 500 is up 10%, and the respective plan is only up 8%. It's important to realize the plan is comprised of multiple asset classes, not just the S&P 500.

- Comparing Apples to Apples:

S & P 500 (Large Cap Index)	-1.77%
MSCI EAFE (International Index)	-6.02%
BC Aggregate Index (Fixed Income Index)	5.88%
Combined Account	1.25%
50% SP 500 / 10% EAFE / 40% BC Agg	0.87%

# Evaluating Health of System

- An actuarial valuation is a type of appraisal which requires making economic and demographic assumptions in order to estimate future liabilities. The assumptions are typically based on a mix of statistical studies and experienced judgment. Since assumptions are often derived from long-term data, unusual short-term conditions or unanticipated trends can occasionally cause problems. First, assumptions must be made to determine the total value of pension payouts that must be made in the future. Second, assumptions must also be made as to the expected growth of the fund's assets which will allow it to meet those obligations.

Valuation are completed annually and establish future contributions rates. Data provided here within are from the respective 2010 valuations, and determine contributions rates for calendar year 2012.

# Actuarial Accrued Liabilities

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Valuation Date	Valuation Assets	Accrued Liabilities	Unfunded Accrued Liability	Funded Ratio
12.31.2007	210,445,657	265,463,304	55,016,647	79.30
12.31.2008	209,556,482	270,299,282	60,742,800	77.50
12.31.2009	201,112,644	271,514,028	70,401,384	74.10
12.31.2010	199,082,987	283,335,493	84,252,506	70.30

M  
E  
R  
S

Valuation Date	Valuation Assets	Accrued Liabilities	Unfunded Accrued Liability	Funded Ratio
12.31.2007	28,502,361	39,234,595	10,732,234	73.00
12.31.2008	32,923,716	45,653,463	12,729,747	72.00
12.31.2009	38,243,998	43,001,103	4,757,105	89.00
12.31.2010	44,474,881	49,354,128	4,879,247	90.10

# Actuarial Accrued Liabilities

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Valuation Date	Valuation Assets	Accrued Liabilities	Unfunded Accrued Liability	Funded Ratio
12.31.2007	44,747,254	164,107,793	119,360,539	27.30
12.31.2008	49,980,535	194,580,255	145,599,720	25.20
12.31.2009	52,375,567	192,041,852	139,666,285	27.30
12.31.2010	60,423,474	210,172,475	149,749,001	28.70

- The funded ratio is a measure used to evaluate the asset and liability levels. While the investment return in 2009 exceeded that of the assumed rate of return for both WCERS and VEBA, the return in 2008 posed a drag on the funded ratio. Note that a funded ratio is only a snapshot in a long-term continual process.
- A 2009 Wilshire survey of 125 public fund systems found that 57 funds had reported an average funded ratio of 58%. This same survey performed for 2008 had found that the average funded ratio of 107 public fund systems had a funded ratio of 79%.

# Different Assets, Liabilities & Assumptions

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A note of caution when attempting to compare WCERS, MERS, VEBA – or other retirement plans. Each system is designed and administered under a different set of assets, liabilities, and assumptions.

## ○ Smoothing

- ✦ WCERS and VEBA – utilize five year smoothing periods.
- ✦ MERS – utilizes a ten year smoothing period.

## ○ Membership

- ✦ WCERS – part of the liabilities reflected in the valuation represent a liability for prior Sheriff members that is being accounted for over a 10 year period. The 2012 contribution of \$3,077,457 will be the third of the ten payment periods.
- ✦ Retiree Expenses – As a relatively young plan, MERS has a much small proportion of retirees, and thus is able to invest significantly more of incoming contributions than WCERS or VEBA where their monthly expenses almost equate to the monthly revenues.

## ○ Investment Opportunities

- ✦ Based on the size of the investment pool, each plan has different investment opportunities and challenges. For example MERS total portfolio as of December 2010 exceeded \$6.6 billion in assets allows for additional investment opportunities not available to plans such as VEBA with assets under \$65 million.

## ○ Investment Return Assumptions

- ✦ WCERS Assumed Rate of Return 7.75%
- ✦ MERS Assumed Rate of Return 8.00%
- ✦ VEBA Assumed Rate of Return 7.50%

# Retirement Commission

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- The **Washtenaw County Employees Retirement System (WCERS)** was established to provide pension benefit to the personnel of the County and their beneficiaries, under the authority of Section 12a of Act No. 156, Public Acts of 1851, as amended (“County Pension Plan Act”). The Washtenaw County Retirement Ordinance, together with the applicable collective bargaining agreement and applicable federal and state law, control and govern the rights and benefits under the Retirement System.
- The **Voluntary Employees’ Beneficiary Association (VEBA)** was established to provide a secure trust account to pre-fund the liabilities associated with the retiree healthcare benefits provided for by Washtenaw County.
- Trustees on each Board are:
  - Vested only with the authority to grant those benefits which are authorized by the provisions of the Retirement System Ordinance or VEBA Plan Document, as amended by collective bargaining agreements, and the Trustees do not have the discretion to change the terms of the Ordinance or Plan Document.
  - Responsible for the prudent and proper investment of the assets in accordance with:
    - ✦ Investment Policy Statement
    - ✦ Public Employee Retirement System Investment Act (Act 314)

# Agenda Items

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- **WCERS**

- Investment Consultant

- ✦ Hired new in Investment Consultant
  - Investment Policy Update
  - Asset Allocation Update
    - Alternative Asset Classes

- Report of the Actuary

- ✦ Experience Study

- Asset Allocation

August 2011

- |                          |                  | <u>Prior</u> |
|--------------------------|------------------|--------------|
| ✦ Domestic Equities      |                  | 50.0%        |
|                          | 30.0%            |              |
| ✦ International Equities |                  | 10.0%        |
|                          | 16.0%            |              |
| ✦ Fixed Income           | 30.0%            | 29.0%        |
| ✦ Alternative            | 10.0%            | 25.0%        |
|                          | ○ Real Estate    |              |
|                          | ○ Hedge Funds    |              |
|                          | ○ Private Equity |              |

- **VEBA**

- Investment Consultant

- ✦ Asset Allocation Update
  - Commodities
  - Hedge Funds
  - Alternative Asset Classes – Phase II

- Report of the Actuary

- ✦ Experience Study

- Asset Allocation

- |                          |                  |
|--------------------------|------------------|
| ✦ Domestic Equities      | 35.0%            |
| ✦ International Equities | 12.5%            |
| ✦ Fixed Income           | 25.0%            |
| ✦ Alternative            | 20.00%           |
|                          | ○ Real Estate    |
|                          | ○ Hedge Funds    |
|                          | ○ Private Equity |



# Investment Philosophy

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- **Upside Capture / Downside Protection:** a portfolio structure that participates in some of the markets' upside potential, while providing a degree of protection against downside risk.
  - If losses are contained to 50% of the market drop, it takes only 64% of the gains to achieve market returns.
- **Minimize Volatility**

											Arithmetic Average Return	Compound Average Return
YEAR	1	2	3	4	5	6	7	8	9	10		
<b>Volatile</b>	30%	-10%	30%	-10%	30%	-10%	30%	-10%	30%	-10%	<b>10%</b>	<b>8.2%</b>
<b>Moderate</b>	20%	0%	20%	0%	20%	0%	20%	0%	20%	0%	<b>10%</b>	<b>9.5%</b>
<b>Stable</b>	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	<b>10%</b>	<b>10.0%</b>

Despite all three portfolios having an identical average annual return, the combination of the negative returns and added volatility resulted in lower compounded returns.

# Managing DB Plan Risks

NCPERS Research Series

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- Examine portfolio allocations in light of downside risks.
- Avoid benefit increases based on “excess assets”.
- Consistently contribute the amounts necessary to fund the plan.
- Determine the long-term costs of new benefits before awarding them.

# Responsible Management and Design Practices

(GFOA Advisory)

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- GFOA recommends that state and local plan sponsors use great caution with regard to the following:
  - **Spiking of final pensionable compensation** – may lead to inequitable benefits and hidden costs.
  - **Sustainable full retirement ages** – review in light of increased life expectancy, may help ensure sustainability.
  - **Retroactive benefit increases** – may undermine plan funding.
  - **Deferred retirement option plans (DROPs)** – poor design or unrealistically high investment returns could unexpectedly higher costs.
  - **Ad hoc cost of living allowances (COLAs)** – ad hoc COLAs based on temporary surpluses will likely impair funding.
  - **Realistic investment assumptions**
  - **Non-contributory plans** – requiring employee contributions will help ensure employees bear a proportionate share of benefits/enhancements.
  - **Subsidized service credits purchases** – ensuring that service credits are purchased at full actuarial cost will keep service purchases viable.



# Questions