City of Rockville

MEMORANDUM

February 19, 2010

TO: Retirement Board

FROM: Gavin Cohen, Executive Secretary

SUBJECT: Cost Sharing – Supplemental Employee Contributions

Recommendation

Staff recommends:

1) that the Retirement Board approve adding the Police into the supplemental employee contribution program,
2) that the Retirement Board approve the language change for implementation from "calendar" year to "fiscal" year,

These changes can only be implemented with the approval of the Mayor and Council.

Background

As the Board is aware, Staff is undertaking a review of all of the design elements of the City's retirement plans. One of those design elements for the Defined Benefit (DB) plan is cost sharing.

A DB plan can be funded from three sources, 1. the employer, 2. the employee, 3. earnings on Plan investments. Employees generally will contribute a percentage of their salaries based on a negotiated benefit formula. Employers will generally contribute an amount estimated by the Plan's actuary every year, an amount commonly known as the Annual Required Contribution (ARC). Finally, the Plan's assets are invested in accordance with the Board's investment policy, and the earnings are utilized to fund the Plan's benefits. The Plan's long-term earnings assumption is 7.75%.

The real advantage to employees in regards to having a DB plan, is that the benefit payout is guaranteed by formula, and all the risk of investment traditionally is borne by the employer. In other words when the Plan's investments perform well, less money is required to be contributed from the employer. When the Plan incurs losses on its investments, its only solution is to get higher contributions from the employer. When the Plan incurs extraordinary losses, its not uncommon for the employees and the employer to share in the increased contributions.

Discussion and Analysis
The language below is taken from Section 3.1 of the Retirement Plan (Plan) document. The Plan currently does include language for employees to share in the additional cost that accrues to the employer from adverse investment performance. Staff is recommending some modifications to the section of the Plan as highlighted below.

ARTICLE III – EMPLOYEE CONTRIBUTIONS 3.1, Page 12
(Underline would be additions; Strikethroughs represent deletions)

"As of any April 1, if the City contribution to the Defined Benefit Option of the Plan made on behalf of Administrative or Union Employees or Police Employees, exceeds 6.5% of the Earnings of the Administrative or Union Employees, or Police Employees who are participating under the Defined Benefit Option as of such April 1, the City, in its discretion, reserves the right to impose a "Supplemental Employee Contribution" for the following ~~calendar~~ fiscal year. This Supplemental Employee Contribution shall be no more than 50% of the excess of such City contribution over 6.5% of such Earnings and shall be treated as a contribution to the Defined Benefit Option."

Staff's recommendations are twofold.

1. The word "Police" should be included so that the Police employees can also share in the costs along with all of the other employees. This would help spread the increase in contributions over a larger pool of employees, and it is more equitable in times of stress that all employees participate. The Police have a much more generous retirement benefit than other employees that is more expensive for the City to fund.

2. Generally the City's annual valuation report for the April plan date gets finalized in August, and gets reviewed by the Retirement Board in late Fall. The Board recommendation would then need to go to the Mayor and Council, and after that if there were to be any change implemented in regards to employees compensation, the City would need to do outreach to all of the employee groups. It is therefore recommended that should the valuation report formula reflect that a supplementary employee contribution is required, after it is approved by the Mayor and Council that it be implemented the first full pay period of the following fiscal year, along with other fiscal changes that are implemented during the first full pay period of the fiscal year.

Though different employee groups have different benefit formulas and contribute at different rates, the supplemental employee contribution would apply to all employees in all groups utilizing the same calculation.

Please note that the Plan formula will generally only be activated when the Plan incurs substantial investment losses as it has during 2008 and 2009, through April 1, plan date. The actuarial valuation dated April 1, 2009 is the first time that staff asked the Plan actuary to include the calculation as part of the valuation report, and this will become a permanent part of the City's valuation report.

Table 1 below shows the calculation prepared by the Plan actuary and the impact on employees.

Table 1

Supplemental Employee Contribution Projections						
	FY 2010		FY 2011		FY 2012	
	Admin/Union	Police	Admin/Union	Police	Admin/Union	Police
ARC as a percentage of compensation	7.68%	9.64%	10.10%	12.70%	12.20%	15.30%
Excess over 6.5%	1.18%	3.14%	3.60%	6.20%	5.70%	8.80%
50% of excess	0.59%	1.57%	1.80%	3.10%	2.85%	4.40%
Maximum Supplemental employee contribution	$164,096	$61,159	$530,000	$130,000	$880,000	$190,000

Source: 4/1/2009 Actuarial Valuation Report, and supplemental Police Calculation.

Cost Implications:

Employee

Utilizing the proposed language amendments, effective first full pay in July 2010 (FY 2011), administrative and union employees would have an additional deduction from their paychecks of 1.80%. An employee earning $40,000 would have an additional pre-tax deduction of $27.69 a paycheck or $720 annually; one earning $100,000 would have an additional pre-tax deduction of $69.23 a paycheck or $1,800 annually.

The Police calculation is slightly different from the administrative and union employees due to the different costs structure and having a "separate plan." Effective first full pay in July 2010 (FY 2011), a police employee would have an additional deduction from their paychecks of 3.10%. An employee earning $40,000 would have an additional pre-tax deduction of $47.69 a paycheck or $1,240 annually; one earning $100,000 would have an additional pre-tax deduction of $119.23 a paycheck or $3,100 annually.

Employer

The additional contributions from employees will allow the Plan's assets to hopefully recover quicker and would enable the Plan's unfunded accrued actuarial liability to be reduced. There is no specific cost to the City to implement the two recommended changes. In the alternative the City could reduce its own contribution by the amount of the supplemental employee contribution.

Table 2

Employee Contribution Levels									
	FY 2010			FY 2011			FY 2012		
	Regular	Supp.	Total	Regular	Supp.	Total	Regular	Supp.	Total
Union	4.20%	0.59%	4.79%	4.20%	1.80%	6.00%	4.20%	2.85%	7.05%
Union - Thrift	0.00%	0.59%	0.59%	0.00%	1.80%	1.80%	0.00%	2.85%	2.85%
Admin	5.20%	0.59%	5.79%	5.20%	1.80%	7.00%	5.20%	2.85%	8.05%
Admin-Thrift	1.00%	0.59%	1.59%	1.00%	1.80%	2.80%	1.00%	2.85%	3.85%
Police	8.50%	1.57%	10.07%	8.50%	3.10%	11.60%	8.50%	4.40%	12.90%

Attachments: Annual Required Contribution Projections
Supplemental Employee Contribution Projections

Note: the attached projections were calculated by the Plan actuary as part of the April 1, 2009 Plan actuarial valuation report.