



City of Rockville
MEMORANDUM

November 19, 2010

TO: Retirement Board

FROM: Gavin Cohen, Executive Secretary

SUBJECT: Pension Plan (Plan) Design Changes

Recommendation

Staff recommends that the Board approve changes to the Defined Benefit Plan for new participants into the Plan effective January 1, 2011 or as soon as feasible thereafter if approved by the Mayor and Council as follows:

1. Establishing the Normal Retirement Age to be 65 with 10 years of service.
2. Establishing the Early Retirement Age to be 58 with 10 years of service.
3. Increasing the early reduction penalty for early withdrawal to 3/8 of 1% for each month the benefit commences prior to the normal retirement date.
4. Changing the vesting period for those entering the DB Plan to 10 years for all participants.

Due to the cost, staff is not recommending implementing a “rule of 85” benefit enhancement.

These changes only impact the Union and Administrative employees. They do not impact the Police Plan. Staff is not recommending changes to the Police Plan other than what the Board has already approved by including the Police in the Supplemental Contribution formula when needed.

Changes can be implemented retroactively or prospectively. Due to the impact on incumbents, Staff recommends that changes be implemented prospectively.

Background and Discussion

At the Board meeting held on January 22nd, 2010, staff reviewed with the Board a proposal commissioned by staff from the Plan actuary that reviewed potential design element changes to the Defined Benefit Pension Plan and Thrift Plan.

At the Board meeting held on August 27th, 2010, the Board heard the results from the study presented by Mike Clark the Plan actuary. The Board deferred any recommendations pending receiving similar studies for the Union Group of employees and the Police group of employees.

These additional studies will be presented at the Board meeting and are not attached to this report.

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A summary of the design elements for the Administrative and Union plans studied is listed below.

- Increasing the Normal Retirement Age
- Increasing the Early Retirement Age
- Adding a minimum 10 year vesting period
- Increasing the actuarial penalty for early withdrawal
- Adding a provision for an early out without actuarial reduction for a “rule of 85”

A summary of the design elements for the Police plan studied is listed below.

- Increasing the Normal Retirement Age
- Increasing the Early Retirement from 25 years to 30 Years

Retirement Ages

One of the biggest cost factor in any DB retirement plan is the age when participants can qualify for normal retirement. A participant’s age impacts the cost of the benefit in two express ways. The first is that the retiree is no longer contributing into the system, and the second is it’s the age that the retiree can draw lifetime benefits.

One of the paradoxes of pension policy is the trend toward earlier retirement, notwithstanding the fact that individuals are living longer and longer. Implicit within this paradox is that the more years an individual spends in retirement, the fewer years they’re spending in the workforce. The economic consequence of this is that we spend fewer years earning income, and by extension fewer years accumulating assets for retirement. Stated slightly differently, employees are contributing fewer dollars from a shorter working career, and a shorter time for investing those dollars, into the retirement system, yet are expecting a longer pension payout period. Clearly over time this would lead to a retirement system that cannot be sustained without a significant encumbrance on the taxpayer.

The federal social security system has recognized this problem and has over time been increasing the social security age from 65 to 67, and congress may soon be discussing age 70 for younger Americans, while allowing for early retirement withdrawals at a reduced rate from age 62. This change recognized that people are living longer than when social security was started, and indeed since the City of Rockville began offering a DB retirement Plan.

This is the first time since Rockville has offered retirement Plans that staff is recommending increasing both the Normal Retirement Age and the Early Retirement Age.

Staff is also recommending that retirees who want to take advantage of drawing retirement funds early, have to pay larger penalty, i.e. reduction of benefits than is currently being paid. The rationale is similar to that mentioned above, namely that funds drawn out as benefits are no longer earning money, and the payout period for paying benefits is longer. The penalty would increase from 3% a year to 4.5% a year and from drawing ten years early to drawing seven years early. Social Security currently allows for an age 67 retiree a five-year early withdrawal with a 6.67% and 5% annual penalty.

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Vesting

Staff is recommending removing the language that allows a participant to vest immediately upon attainment of age 60. This change means that any participant regardless of age in the Plan would have to work for ten years to vest at 100%. (The ten years can be reduced to seven if the maximum buyback provision of the Plan is utilized.)

“Rule of 85”

The “rule of 85” benefit enhancement is too expensive for the Plan to consider costing \$1.7mill under the Age 62 alternative and \$4.6Mill under the age 65 alternative. Staff is not recommending that this be implemented.

Staff believes that it’s important to start addressing the sustainability of the Defined Benefit Plan as soon as possible, and without these recommended changes to the Plan the cost to the City taxpayer will become prohibitive.

Mike Clark, the Plan actuary, will present a summary of the three studies. These studies if approved by the Mayor and Council will set up a tiered system of retirement benefits with new participants entering the Plan after the effective date of the change having different retirement benefits than the current incumbent participants.

Police Plan

The Police plan, like public safety plans around the country, tend to have more generous retirement benefit formulas and earlier retirement ages than those of other public sector employees. The Police do not participate in the City’s Thrift Plan. For years of service prior to 4/1/04, Police earn a multiplier of 2.0% and after 4/1/2004 2.25% with a maximum benefit of 67.5% of average earnings. For this Benefit, they contribute 8.5% of earnings. The Police vesting schedule is 50% after five years of service with an additional 10% a year through 100% after ten years of service.

Other Options:

The Board can also study the following impacts to the Plan:

Increasing Employee Contributions

Reducing Multipliers

Attachment: Plan Design Study Proposal – City of Rockville Defined Benefit Pension Plan