TASK FORCE ON SUSTAINABLE FUNDING OF BALTIMORE CITY'S FIRE AND POLICE PENSION SYSTEM

By THE GREATER BALTIMORE COMMITTEE

TABLE OF CONTENTS

The City of Baltimore is facing a serious fiscal challenge. Current contributions to fund the City's Fire & Police Employees' Retirement System, (referred to elsewhere in this report as the F&P Pension plan or system) are inadequate to fully cover the existing and anticipated liabilities required under the pension system. The most recent Comprehensive Annual Financial Report[1] states, "negative investment performance of 21.9%, the recognition of additional accumulated losses from the separate reserves used in previous years to provide benefit improvements to members and retirees, contribution reductions by the City, and costly post-retirement benefit increase provisions, will drive the employer contribution requirements to unsustainable new highs." Meanwhile, the City's unfunded liability continues to grow. Currently, the actuarial funded ratio of the F&P system is 84.8%, while the funded ratio according to market value stands at only 58.2%. The problem threatens the city's fiscal stability and could result in a reduction in City services, increased taxes, and a decline of the City's bond rating – a combination of adverse circumstances that would result in immediate and long term financial burdens on the City and its citizens.

The Task Force quickly recognized that Baltimore City is not alone in its predicament and that state, city, and municipal pension plans across the country have similar underfunding problems. The Pew Center on the States recently released a survey of state-administered pension plans, retiree health care and other post-employment benefits, which found that as of 2008 states had $2.4 trillion to meet $3.4 trillion in promised benefits.[2] The report identifies a number of reasons why the pension systems are in trouble which include, but are not limited to, expanding benefits, overly optimistic assumptions about investment returns and failing to sufficiently fund the programs.

In approaching the complex issues related to the retirement system for public safety employees, the Task Force members conclude that in addition to recommending steps to conserve financial resources of the system and to ensure its long-term fiscal stability, it is absolutely essential to also provide a retirement benefits plan that is fair, equitable and competitive for the public safety employees of Baltimore City.

EXECUTIVE SUMMARY

The Retirement System for Baltimore's public safety employees is a defined benefit retirement plan. A defined benefit plan offers lifetime pension benefits and disability benefits -- as well as benefits for surviving spouses and dependents. The benefits offered

[1] Comprehensive Annual Financial Report, A Component Unit of the City of Baltimore, Maryland; Thomas P. Taneyhill and David A. Randall, June 30, 2009.
[2] Pew Center on the States, The Trillion Dollar Gap: Underfunded State Retirement Systems and the Road to Reform, February 2010.

in Baltimore's F&P pension plan are part of a comprehensive employee compensation package comprised of salary, personal leave, health care and retirement benefits that public safety personnel earn by reason of their dedicated service to protect the lives and property of City residents and business owners. Unlike other public sector employees, police and fire employees are not included in the social security system. Thus, a sustainable pension system is a critically important benefit for these public servants.

In fiscal year 2009, the F&P Pension Plan paid out retirement, disability and death benefits totaling $184,178,112 to 5,929 fire and police department retirees and their beneficiaries. Included in the total benefits were $143,864,108 to retirees and beneficiaries based upon age and service, $7,102,447 for line of duty and non-duty death benefits, and $33,211,557 for disability benefits. The retirement benefits cited for 2009, include $10,379,493 in payments under the F&P system's Deferred Retirement Option Plan (DROP), an incentive plan intended to retain experienced and well trained personnel within the ranks of Baltimore's fire and police departments.

The GBC Task Force embarked upon its assessment of Baltimore's underfunded pension system with a firm understanding that swift and meaningful action must be taken if the plan is to remain viable over the long term. From the outset, the Task Force has been committed to a search for solutions rather than engaging in an exercise in fixing blame for a problem of serious proportions. Our discussions have been -- and remain – sharply focused on finding fair, equitable and creative solutions that fully address the growing unfunded liabilities of the City's retirement system. We saw our mission as four fold:

1. To research and understand the funding issues of the Retirement System, the source and scope of the problems and the level of urgency required to resolve them.

2. To consider and analyze a variety of steps that will result in a long-term plan to restore and maintain the financial stability of the City's pension plan for public safety employees.

3. To meet with stakeholders and solicit their input and consider their perspectives in devising solutions that restore the pension plan's fiscal integrity and ensure a continuing capacity to recruit and retain an experienced, well trained corps of police officers and fire fighters.

4. And finally, to develop a report providing "fiscally sustainable" recommendations – both short and long term – that truly address the underfunding of the City's police and fire fighters pension liabilities.

There is a general consensus among Task Force members that unless all stakeholders agree to reforms of the Retirement System, the current underfunding will continue and will further impair the City's ability to provide basic public services, attract new businesses and ultimately threaten the ability of the F&P pension plan to fulfill the commitments that have been made to retirees. Absent mutual assent or a negotiated resolution, the savings estimated in this report may not be fully realized. The City contribution may change based on demographics of plan members, economic conditions and plan experience in relation to the recommendations below. Also, legally negotiated employment agreements may prevent the application of some of these principles retroactively thus affecting the level of savings realized. Nevertheless, failing to act decisively will make it difficult to maintain the quality of life the citizens of Baltimore expect and deserve. In addition, it may increase the cost of borrowing – a consequence that could result in higher taxes or further budgetary pressures on the City.

In its search for solutions, the members of the Task Force ultimately narrowed its focus and distilled from numerous options and potential remedies those options that offer the best hope of a fair and effective approach to the problem presented. In particular, the Task Force recommendations fall into three broad categories:

1) PLAN MANAGEMENT,

2) FUTURE BENEFIT STRUCTURE and

3) RETIREMENT SYSTEM GOVERNANCE

PLAN MANAGEMENT

1. **A realignment of the plan's asset management structure** by the marshalling of pension plan assets into a single, tightly managed fund, eliminating the 6-part asset allocation currently used. The Task Force believes this recommendation will ultimately lead to better overall asset returns and lower plan administration costs with limited, if any, increase in risk to retiree benefits.

2. **Require the City to make the required actuarial contribution each year from its General Fund and not use money already in the trust to mitigate their contribution obligation**. In the past, the City has used the System's unallocated earnings to meet its contribution[3] as determined by the plan's actuary. The Task

[3] The System's unallocated earnings have also been used to enact reductions for active employee contributions and retiree increases.

Force believes it is important to the long-term sustainability of the Plan for the City to refrain from satisfying its obligation to the plan by using plan excess earnings.

FUTURE BENFIT STRUCTURE

3. **Replacing the current "variable benefit"** for retired members of the plan with an annual increase based upon a cost-of-living with an annual cap. This would allow the Plan's actuary and the City Finance Director to more closely project future expenditures for cost of living increases and provide a more stable increase for retirees. This would further conserve pension fund assets by allowing positive earnings on plan assets to fund current benefits. A simple acceptable approach would be a cost of living tied to the annual increase of social security. Any imposed cap should not exceed 3% per annum. Due to the challenging economic times there is no cost of living allocation afforded under the social security index.

4. **A lengthening of the age and service requirements** for determining eligibility for pension benefits. Currently, pension system members can retire at age 50 if they have at least 10 years of service or at any age if they have completed 20 years of service. The Task Force believes consideration should be given to increase the age and/or service requirement so that the combination of the two equates to at least 75 in order to receive full benefits. A number of plan options exist to implement the Rule of 75. For example, the Rule of 75 could require a member to reach a minimum age of 55 years, earn a minimum of 25 years of service or simply attain the sum of age and service totaling at least 75 with no age or service year minimum.

5. **Terminating the provisions of the Deferred Retirement Option Plan (DROP2) for those members who have not yet achieved 15 years of service.** The plan as currently structured allows experienced fire fighters and police officers with 20 years of service to suspend their participation in the F&P pension plan for three years during which they remain on the job, but earn no service credits toward their pension. During the three-year DROP period, participants can channel the contributions they would have made to the F&P pension plan into a personal retirement account that earns guaranteed interest at the rate of 5.5% until the member's last day of covered City employment as well as their frozen annual retirement benefit. The recommendation to eliminate the Deferred Retirement Option Plan would apply to all employees with less than 15 years of service.

6. **Revision of the calculation method for the average final compensation** (AFC) by increasing the service period used in the calculation. The AFC is currently based on compensation earned during the last 18 months of service. The Task Force

believes by increasing the number of months used in calculating final average compensation, the plan will achieve a more equitable retirement benefit among all beneficiaries entering retirement while better aligning retirement benefits with earnings during an employee's period of service. The Task Force recommends increasing the service period used in the calculation to a minimum of 36 months and a maximum of 60 months.

7. **Increase the employee contributions supporting the F&P pension system** from the current 6% to no more than 10%. Union representatives who appeared before the Task Force indicated a willingness on the part of their memberships to explore increases in the mandatory employee contributions. The Task Force believes that higher employee contributions are warranted by the retirement benefit amount earned coupled with the period over which such benefit will be paid when compared with other public plans.

8. **Consideration of a Defined Contribution Plan for future hires.** The Task Force believes serious consideration should be given to converting from a defined benefit plan to a defined contribution plan for future fire and police officers. This form of system is under consideration in many other jurisdictions and is consistent with private sector plans. In reaching this policy decision it is imperative to consider both the cost, the ability to attract and retain high quality fire fighters and police officers, and the competitiveness of the total employee compensation package offered to the City's public safety officers.

RETIREMENT SYSTEM GOVERNANCE

9. **A re-structuring of the F&P Pension system governance**. The ultimate solutions to the problem now confronting the system depend on experienced, effective, long-term, decision making about the benefit structure and about the marshalling of assets to support it. The members of the Task Force are in general agreement that the governance of the Fire & Police pension system could greatly benefit by expanding the membership of the Board of Trustees to include individuals with broad experience in finance and budgeting. It is recommended that the citizen representation on the board must have a background in one or more of the following: accounting, actuarial, auditing, investment management, investment consulting and financial law. The Task Force recommends expanding the Board to include the Director of Finance and the Budget Director or their designees, as well as, an additional citizen member. In addition, it was considered of utmost importance that the communication between the Board of Trustees and the City of

Baltimore increase through at least semiannual hearings before the appropriate City Council committee.

The focus of this report is limited primarily to retirement benefits for Baltimore's fire fighters and police officers. The Task Force recognizes that there are other major provisions of the F&P pension system concerning the process for receiving death and disability benefits, the purchase of service credits for previous employment and military service, and the retiree health coverage plan. Although an important part of the overall benefit structure of the F&P pension plan, these additional benefits are each costly to the plan and should be reviewed further by the Mayor and City Council to assess their relevance and quantify their cost benefit. For that reason the Task Force has elected to save for future study any assessment of those benefits not directly related to retirement.

The Greater Baltimore Committee is grateful to the City for the opportunity to participate in this effort to assist in resolving one of Baltimore's more pressing challenges.

The Report

The Big Picture

Baltimore is a city with a population of 637,000 and nearly 260,000 individual households. The median household income in 2007 was estimated at about $37,000. With nearly 20% of the population living in poverty, Baltimore City has one of the lowest capacities to raise revenue but maintains one of the highest efforts in the State.[1] Baltimore City's assessable property tax base will not yield comparable revenues compared to jurisdictions of its size.[2] As a result of the limited revenue raising capability, the City has fewer resources in tight budgetary times to handle the necessary functions of government-including the public service of the fire and police departments.

Baltimore's individual citizens, their homes and the commercial businesses that serve them, are protected by the City's fire and police departments. The City of Baltimore has invested significant resources to expand the ranks of public safety personnel to meet current needs. Between 1994 and 2002, more than 330 police officer positions were added. Then, in 2005, the Police department lost 338 sworn officers, due largely to the implementation of new policies that restricted the number of officers holding administrative positions due to limited duty status. Although attrition continued to rise over the next two years – 267 in 2006 and 273 in 2007 – recruitment of new officers was also up. The police force added 227 new officers in 2006 and 266 in 2007. Not surprisingly, attrition declined for both 2008 and 2009 with numbers at its lowest in half a decade. Last year, 172 police left the force, while 175 were hired to join Baltimore's finest.

The ranks of City fire fighters tend to be significantly more stable in terms of both recruitment and retirement. Over the past five years (2004 thru 2009) an average of only 56 fire fighters have retired each year and new recruits have been readily available. The data from recent years suggest that Baltimore can and does attract new recruits to its police and fire departments at rates that keep pace with resignations and retirements.

The combined departments comprise a public safety force of 4,690 active fire fighters and police officers as of June 30, 2009.[3] It has been widely accepted that public safety employees engage in occupations that are somewhat more dangerous than most others.

The current pension system is considered an important employment incentive that allows the City to attract and retain highly motivated individuals willing to serve in demanding and sometimes life threatening job situations. The Baltimore Fire and Police Employees' Retirement System (FPERS) is a local government defined benefit pension plan. It provides a number of employment benefits including those related to lifetime retirement benefits, line-of-duty disability, line-of-duty death, and ordinary death and disability while employed.

Federal law allows local state and municipal governments to exempt public safety employees from the Social Security system provided they are covered under local systems that meet certain approved standards. In the 1950s, Baltimore's fire and police unions elected not to enroll in the Social Security system. Because police and fire employees are not eligible for and do not receive Social Security retirement benefits, the long term financial viability of the City's pension fund for public safety employees is of critical importance to those who anticipate drawing benefits from the plan.

That the City's public safety employees are not eligible for and do not receive Social Security benefits is an aspect of the fire and police departments' pension system that is seldom brought to the attention of the general public. For that reason there tends to be limited public understanding and often unjust criticism of the level of retirement benefits offered to public safety employees.

Evolution of the Pension Plan

When the Baltimore Fire & Police Pension Plan was established in July 1, 1962, as defined in Article 22 of the Baltimore City Code, membership in the plan was made a condition of employment. Initially the defined benefit plan simply provided retirement benefits to members of the fire and police departments who reached age 50 with at least 25 years of service. Retirement was mandatory for fire fighters and police officers who reached age 55, and for fire lieutenants, police sergeants, and other higher ranking officers, at age 65. In 1985, all mandatory age requirements were set aside for all members of the Plan regardless of department and rank.

There have been many modifications made to the Plan since its inception. For example, credit for service done outside of the police and fire departments was originally only for prior employment with the City. Ordinance 81-552 allowed service credit for up to 3 years of pre-employment military service for members age 50 with 10 years of service or members with 25 years of service regardless of age. The requirements for service credit continued to expand to include employment with the federal, state and local government, military leave of absence, Maryland Police Corps training and more.

In 1983 the Plan's actuary, Mercer Inc., wrote to the Boards of Trustees of the Fire and Police system as well as the Employees' Retirement System (ERS) of their concern "because of surprise when [recent] bills were found to increase City cost by $2 million each year into the future." (See Appendix for a copy of the letter).

Another Plan provision that has evolved over the years is the calculation for the average final compensation (AFC), which is used to calculate retirement benefits. Originally when the Plan was established the AFC calculation was for five consecutive years of service during which the member's earnable compensation was the highest. Currently, retirement benefits are calculated on the basis of years of credited service and AFC over an 18-month period of highest pay.[4]

As unions and the City continued negotiations for earlier retirement and additional benefits, new legislation was introduced attempting to encourage retention through greater benefits to retire earlier- both at increased cost to the City. For a brief summary of City ordinances related to the retention of fire and police members please see "Legislation affecting Fire and Police Member Retention" in the Appendix.

Structure of the Pension Plan/ Plan Benefit Structure

Membership in the Retirement System remains mandatory for all of the City's sworn and uniformed fire and police employees as a condition of employment[5]. As of June 30, 2009, the City police force had 3,010 active police officers and the fire department had 1,660 active fire fighters. Another 20 or so public safety employees work as school crossing guards or at BWI Airport. Active members of Baltimore's fire and police departments currently contribute to their retirement system at the rate of 6% of regular compensation. The current average salary of all active members of the Baltimore City Fire and Police Departments is $60,005 and the average age of city employed fire fighters and police officers is almost exactly 39 years. The current average length of service, again combining all city fire fighters and police, is about 12.45 years.[6]

The Baltimore F&P Retirement System is funded from three sources:

(a) the mandatory contributions of its employee members,

(b) the annual budgetary contributions by the City, and

(c) the earnings accrued from the system's substantial investments.

The City's Pension Fund asset funding structure for the F&P pension system is currently somewhat fragmented – divided among several distinct funding sources/ employee groups, as follows:

The Annuity Savings Fund (ASF)	holds contributions from active members
The Annuity Reserve Fund (ARF)	holds retired members contributions
The Pension Accumulation Fund (PAF)	holds the City's contributions for active members

The Pension Reserve Fund (PRF)	holds City contributions for retired members; adjusted yearly by transfer to/from the PAF so the Annuity Reserve Fund (ARF) and the Pension Reserve Fund (PRF) equal the actuarial present value of retiree benefits.
The Paid Up Benefit Fund (PuBF)	holds the assets to pay for the increases in the variable benefit already granted.
The Contingency Reserve Fund (CRF)	a safety net for the Paid Up Benefit Fund

Retirement benefits are based on a member's years of service, pay level and rate of benefits earned. Benefits are earned at the rate of 2.5% of full salary each year for the first 20 years of service and at 2% per year for each year thereafter. The retirement benefit is calculated by multiplying the total rate of benefits earned times the employee's average final compensation and other factors such as age and length of service at time of retirement.

Under the current system, members who reach age 50 and have at least 10 years of service are eligible for retirement benefits provided they have been contributing union members for at least 10 years. Members with 20 years of service and at least 10 years of union membership may retire at any age. For example: consider a F&P pension plan member with 25 years of service:

Assumed average final compensation	=	$61,000
First 20 years of service benefit calculation is 20 x 2.5%	=	50
Over 20 years of service benefit calculation is 5 x 2.0%	=	10%
Total percentage of final salary	=	60%
Maximum Retirement Allowance Due (60% x $61,000)	=	$36,600

The Variable Benefit

As noted, police officers and fire fighters in Baltimore do not participate in Social Security. One immediate consequence is the absence of an annual "cost-of-living" increase in retirement benefits. To address this circumstance, the City Council approved legislation that provides for a "variable benefit", an increase in benefits to retirees and beneficiaries whenever the investment performance exceeds 7.5% on fund assets. Due to market losses on invested funds in 2008 and 2009, no variable benefit increases were paid in the last two years and will not be paid in 2010.[7]

The Deferred Retirement Option Plan (DROP)

In 1996, the City's public safety employees' union lobbied for a Deferred Retirement Option Plan (DROP) which was granted by the City so that trained and experienced personnel would be encouraged to remain in service longer. To be eligible to participate, a plan member must have at least 20 years of service if employed prior to June 30, 2003, or for those entering the pension system after July 1, 2003, 20 or more years of service and at least 10 years as a contributing member of the pension system, regardless of age.[8]

Eligible pension plan members who elect to participate in DROP can do so for up to three years. While in the plan, participants are credited in a DROP Account with an amount equal to the annual retirement benefit they would have received had they taken retirement. The member deposits their normal contribution into the DROP account, which earns 8.25% interest until the member leaves fire and police covered City employment.

Retirement benefits calculated at the start of a member's participation are "frozen" and retirement credits are not earned for service while participating in DROP. If employment subsequent to participation in DROP extends for 18 months or more, plan members can earn back full service retirement benefits excluding the member's time while participating in DROP. Thus, for those who participate in DROP and remain employed by the Police or Fire departments afterwards, service credits can be fully "refreshed" within four years of completing a three-year DROP.

In 2009, a total of 893 members of the Fire & Police Employees Retirement System were active participants in the Deferred Retirement Option Plan – about 20% of all active fire fighters and police officers. Over time, about 90% percent of public safety personnel eligible to participate in the DROP have elected to do so. The total amount paid out to the DROP participants during 2009 was in excess of ten million dollars ($10,000,000). Over the past 10 years, the DROP payouts have ranged from a low of $7,545,984 in 2002, to a high of $25,901,332 in 1999 (the last year of the first three-year start-up of DROP).[9]

In 2004, the DROP test failed its review and the City was allowed to modify DROP. A bill was introduced in City Council to save the City contribution costs; however, the bill was eventually withdrawn after several amendments. In April 2005, Mercer evaluated the financial impact of the Deferred Retirement Option Plan's on annual costs. It was determined that to discontinue DROP would result "in no material savings." However, over the last five years, the decline in pension fund asset values and the City's inability to adequately recover the value of those assets suggests that costs related to DROP may be due for reconsideration.

In 2009, the Baltimore City Council considered a revised Deferred Retirement Option plan that came to be known as DROP2. The new plan was designed to reduce the City's pension costs by primarily reducing the 8.25% interest earned on DROP accounts. Under DROP 2, interest is earned at the rate of 5.5% and is terminated altogether after 36 months of an employee's participation in DROP2 or upon retirement.

Although similar deferred retirement incentives have been introduced in other jurisdictions in Maryland and elsewhere, the Baltimore City plan is considerably more generous than most. The primary reason the city's DROP plan is more generous is that it allows workers to continue building (i.e. - refresh) their pension accounts after DROP participation and eventually retire with considerably more liberal benefits. Other jurisdictions routinely freeze employee benefits once they enroll in a DROP and thus conserve the financial resources required to balance the costs incurred under their deferred retirement plans.[10]

Market Effects on the Plan

The pension system is supported by dedicated reserve investments primarily through the contributions of pension plan members, employer contributions provided annually by the City, and the earned interest on these invested funds. In the 2009 fiscal year, the market value of all the pension fund's supporting assets declined $1.67 billion to $1.21 billion. The rate of return of invested assets dropped 21.9% in FY-2009, which followed a 7% decline in the market value of plan assets in the prior year.

The consequence of these asset value erosions was neatly summed up in the annual report of Thomas P. Taneyhill, CPA, Executive Director of the Fire and Police Employees' Retirement System:

> "In fiscal years 2008 and 2009, investment performance has negatively impacted the assets needed to pay regular retirement benefits. Increases were not provided to retirees following fiscal years 2008 and 2009. In fiscal year 2010, if the year-to-date investment performance continues for the remainder of the year, and if post-retirement benefits are not amended, a substantial amount of assets will have to be allocated…to pay the basic retirement benefits…"

The negative investment performance for the City's fiscal year ending June 30, 2009, amounted to $509.2 million. The work of The Greater Baltimore Committee Task Force has been focused largely on finding ways to conserve funds within the current system so that these accumulated losses can be recovered through systematic savings in coming years.

Currently, the City's contribution to the F&P pension system as a percentage of payroll costs exceeds established benchmarks for similar public retirement plans.[11] The National Association of State Retirement Administrators' Public Fund Survey published in October 2009 reported that for non-social security eligible workers, the employer contribution to the retirement plan in fiscal year 2008 was on average 11.8% of payroll costs; however, in Baltimore City it was 27%. In fiscal year 2010, the percentage of payroll for the F&P pension plan grew to 30.5%. By comparison, the City's contribution to Social Security eligible workers (the Employee Retirement System) was 13.2%.[12]

Overall Costs

In addition to the market erosion of assets backing its pension system are a number of factors making it challenging for the City to meet its yearly pension contribution obligations:

- The benefit structure under the City pension system – developed and expanded over the years – is generous and continues to expand. The benefit structure does not reflect private sector benefit plans or trends among public sectors.

- In 2008, the City's contribution as a percentage of its payroll for the F&P plan was more than twice as much than its Social Security eligible employees.

- A significant number of the City's police officers and fire fighters participate in the Deferred Retirement Option Plan (DROP), the retirement benefit enhancement designed to retain experienced personnel. Allowing plan members with 20 or more years of service to collect retirement benefits in a "savings account' for a period of three years while also collecting their regular pay, has proven an expensive incentive to retain experienced personnel. Although no service credits are earned during participation in DROP, participants earn 8.5% interest on their DROP account balances even after eventual retirement.

'**Spiking'… A Source of Hidden Costs**

The Task Force also examined the "spiking" of pension benefits in the final months of service and what impact the practice may be having on the costs related to the City's pension plan for public safety employees. The practice of seeking out higher paid assignments in order to boost regular annual earnable compensation is difficult in many instances to distinguish from simple ambition and the desire to "do better" financially. Data sheets for those public safety employees who retired in fiscal year 2009 showed that not a single retiree that year received less than a 5% pay increase in the 18 months before they retired. The highest pay increase within the final 12 months of employment was over 30%.

The problem of pension "spiking" is troublesome because it allows an employee covered by a pension system to artificially enhance his or her pension benefit by accepting duty assignments during the final months of service to increase ("spike") pensionable earnings. Under the City's current retirement system, pensions benefits are calculated on the basis of highest sustained earnings extending over 18 months of continuous active service. However, it would be harder to make such distinctions if the period of service included in calculating final average pay was more protracted.

When pension spiking occurs, the employee receives a pension benefit – a boost in monthly pension benefits *for life* – that were neither anticipated nor paid for over the course of his or her working years.   Neither the employee nor the employer contributed to the pension reserve fund to cover the cost of spiked pension benefits. The result is a greater drain on pension resources than was actuarially anticipated. The extent of abuse is difficult to measure, although it should be noted that some officers receive as many as five or six salary increases in their final 18 months of duty.

The issues related to pension "spiking" are not new and a number of government administered pension plans have devised "anti-spiking" measures to guard against abuse of their pension systems. Generally, increasing the period for determining the average final compensation versus a shorter period helps "smooth out" sharp pay increases right before retirement, providing a more reasonable representation of the employee's final average pay before retirement. The 18-month period currently used to determine final average pay for Baltimore's police and fire fighters stands out among surrounding jurisdictions as particularly short. Nationwide, other jurisdictions now use 3 to 5 years in determining a retiree's final average pay.

Proposed Remedies

Clearly, bold and meaningful reforms are needed to preserve the pension system for Baltimore's public safety employees. Baltimore is not alone in facing a pension system financial crisis. Gravely underfunded public employee retirement systems can be found in city and state governments elsewhere in Maryland and throughout the United States. In seeking solutions to the underfunding of Baltimore's pension system, the Task Force considered the solutions developed in other locales, drew upon the collective wisdom and experience of other city leaders and elected officials, examined actuarial studies in

Baltimore and in other municipalities, and sought guidance from public safety union employees in Baltimore and elsewhere.

Among the various options explored, including some that are suggested for immediate change, were:

- Consideration of a “defined contribution” system for new fire fighters and police officers who will have longer tenure to earn future pension benefits.
- Adjustments to minimum age and service requirements for plan participants.
- Providing an actuarially reduced benefit for retirement prior to new eligibility requirements.
- Eliminating the separate fund asset allocation structure.
- Timely, consistent and legally required contributions by both the City and by plan members to eliminate current unfunded liabilities and maintain future plan assets at a level to fully support future actuarial projections.
- Legislation to trim some of the most expensive benefits provided under the defined benefit retirement plan including but not limited to the purchase of service credits, health coverage, and revising the process for eligibility and management as it relates to death and disability.
- Further study of the enrollment of new hires in the federal social security system.
- Increased payroll contributions by fire and police members.
- Increase the number of months used in calculating final average pay.

Regardless of the source of particular proposals, there is an across the board consensus that any potential remedy or remedies should lead to development of a long-term solution of the present problem. Nonetheless, all members of the Task Force recognize that some short-term fixes may be necessary to smooth the transition to a more financially viable system.

There is no silver bullet than can easily solve this policy challenge.

The situation is urgent. Failure to act could ultimately jeopardize the City’s credit standing and make it increasingly difficult to hire and retain personnel to serve as fire fighters and police officers. As noted earlier, what is ultimately at stake here is the financial credibility of the City and its ability to attract and retain qualified public safety personnel. Any solution must be an inclusive process that avoids the usual political, labor union, management/employee tensions that too frequently cause needless delay in the adoption of a plan of action.

Union Proposal for Funding Reform

Recognizing the undesirable consequences of delay in addressing the issues related to funding of the pension system, fire and police union leaders in Baltimore presented a well considered six-part proposal for reforming the Retirement System.

Provisions in that plan include:

- Replacing the existing variable benefit with a fixed 2% cost-of-living benefit with provisions to increase it in future years based on the adequacy of pension plan funds.
- Increasing the mandatory employee contribution incrementally – by .5% per year from 6% to 9%— over a six year period.
- Increasing in the City's annual contribution to the pension plan and the adoption of financial penalties imposed for failure to follow established funding guidelines.

The union proposal, presented by the City's active fire fighters and police officers, represents a commendable effort demonstrating cooperation in seeking measures to correct the funding problems of the Retirement System. The Task Force received written copies of the proposal and participated in an extensive presentation by union leaders and their actuary, Tom Lowman, of Bolton Partners, Inc.[13] Task Force members vetted and discussed the proposal and found that although the proposals offered some changes to the system that most of the recommendations would likely increase costs to the City without addressing the driving costs of the plan. (See Appendix for the Union Proposal for Funding Reform).

The first of the six part plan, replaces the existing variable benefit with an annual 2% increase with a 2.5% enhancement when the funded ratio exceeds 75% or January 1, 2031, whichever is earlier. Active members of the plan expressed a willingness to increase their bi-weekly contributions. However, the offer is contingent on the City funding the plan according to two options:

a) Requiring the City to contribute an amount equal to the lesser of:

1) the full cost requested by the Board of Trustees or

2) an amount (as a percentage of its payroll) equal to 4% of pay more than the prior year's percentage.

They further state in their proposal that the City shall also contribute at least $82 million in fiscal year 2010. It is interesting to note that the City has already budgeted at least $101 million for FY 2010 and is facing an additional $63.9 million increase in their contribution.[14]

The union proposal also recommends a penalty for not adhering to their proposed City contribution that further increases costs to the City by raising the COLA, increasing post retirement survivor benefits, and reducing their member contributions. The fifth proposal creates a penalty for extending the amortization period beyond 20 years. If the amortization period is extended by the Board of Trustees then the 2.5% COLA increase would start five years earlier. The final proposal also relates to the actions of the Board of Trustees by requiring the City contribution to not be below the Annual Required Contribution (ARC).

Members of the Baltimore Retired Police Benevolent Association, Inc. also presented their ideas, frustrations and recommendations to the Task Force. They identified a number of contributing factors to the present dilemma, including instituting DROP, the lowering of retirement requirements and failing to increase contributions to reflect the added benefits. Retired members made it clear that their main concern was reform that impacted post retirement benefits, but they were still very apprehensive about the overall health and long term viability of the Plan. Some of their recommendations included increasing contributions to 9%, increase the retirement age for new hires, eliminate the DROP, and increasing the transparency of the Board of Trustees.

RECOMMENDATIONS

There are several inter-acting components that make up the existing benefit plan for Baltimore's fire fighters and police officers. These include:

- The current structure of funds management
- The post-retirement "variable benefit"
- The minimum age for eligibility for benefits
- The Deferred Retirement Option Plan (DROP and DROP2)
- The calculation of final average earnings
- The percentage of employee contribution to the plan
- Governance of the pension system.

To integrate the impact of changing any one -- or any combination -- of these components, the Task Force developed a set of 13 scenarios each with an actuarial determination as to what level of savings could be achieved from the plan adjustment. The result is a systematic breakdown of cost and potential savings for each of the 13 scenarios. Each alternate option was then measured against "Scenario 0" – the baseline scenario that reflects two basic assumptions:

1) That the current fund structure that places pension fund assets under six different management headings, be combined into one fund earning a projected 7.75% rate of return.
2) That the existing "variable benefit" allowance be terminated and replaced by an annual cost-of-living increase based upon the Social Security Administration annual cost-of-living calculation, but capped at 2%. (The cost of living benefit was set at 2% for the sole purpose of determining estimated contribution impact in the conducted analyses.)

All of the other scenarios considered by the Task Force combine Scenario 0 and a change to one or more of the other components of the current retirement system such as minimum age/service at retirement, the Deferred Retirement Option Plan, the number of months used in calculating final compensation and various percentage increases in the employee contributions to the plan.

For each scenario, the impact on the fund – indicated as a cost increase or a savings – has been calculated for current plan members. The estimates are based on the June 30, 2009, actuarial valuation data presented by MERCER. The actual costs or savings reflected in the Task Force's recommendations will depend on the plan experience in coming years based on such external factors as demographics, economic conditions and fund performance in relation to the assumptions.

The Task Force considered numerous alternatives, always with awareness of how the burdens of recovery would fall. A matrix of plan designs were developed and various combinations for increasing the resources available to fund the retirement system were considered. Eventually we defined the components of a solution as a set of eight principles – eight scenarios that seek to address the issues in different ways that are fair to all parties most directly affected and, over time, if followed with discipline and careful management, will restore the pension system to full financial health.

The plan design principles that were distilled from the discussions and presentations that informed the Task Force during its meetings since last July include the following:

I. Combining the Six Pension Plan Funds into a Single Fund

First and foremost, serious consideration must be given to combining the six sources of funding that currently supports the City's benefit plans for public safety workers. The structure of the system now in place divides the pension systems financial resources among six distinct "pots" identified as:

(1) **Annuity Savings Fund** (ASF) current employee contributions.
(2) **Annuity Reserve Fund** (ARF) retired member contributions.
(3) **Pension Accumulation Fund** (PAF) City contributions for active employees.
(4) **Pension Reserve Fund** (PRF) City contributions for retired members.
(5) **Paid Up Benefit Fund** (PuBF) assets to pay variable benefit increases.
(6) **Contingency Reserve Fund** (CRF) funds to back up PuBF.

A realignment of the funding structure that supports the City's pension system is seen by the Task Force as a high priority if the invested assets are to produce at optimum level. For that reason it is included as one of two major components included in the recommended "Baseline Scenario". Combining the funds will also remove the possibility of diverting assets from one fund to another, simplify accountability and allow for a direct connection between the assets in hand and the money needed to fund the entire retirement system.

The Baseline Scenario includes two essential first steps:

1. Re-grouping of all remaining assets to be invested and managed as a single fund.

2. Elimination of the current "variable benefit" structure and replacing it with an annual cost of living adjustment under Social Security, up to 2% a year for all benefit recipients starting July 1, 2010.

Why we looked at this issue:

The current funding structure is unwieldy and expensive. Moreover, the shifting of funds from one "pot" to another sometimes clouds the true financial condition of the retirement system. The transparency of the retirement system and the City's management of monies earmarked for current and future benefits will contribute to broader public and member understanding of the system.

Why this recommendation is good for the fund:

Combining the funds that support the City's pension plans, will lead to greater annual accountability and create a direct relationship between resources available and current and future liabilities for total benefits in the Plan. In addition to the recommendation that the pension resources be combined in a single fund, the Task Force also suggests that legislation be adopted requiring an annual report on the status of funds available and all liabilities, both covered and anticipated to the City Council.

II. Elimination of the "variable benefit" and introduction of an annual cost-of-living benefit equal to that paid to Social Security beneficiaries and capped at a specified annual percentage.

The ultimate option in dealing with the City's pension costs related to the variable benefit would be to terminate the benefit. Doing so would generate a savings of $66.1 million in the City's 2011 fiscal year that could be applied to offset under-funded pension reserves. However, the rationale for maintaining some post-retirement cost-of-living adjustment far outweighs the potential savings.

Why we looked at this issue:

The variable benefit was made part of the City's public safety employee pension plan largely because plan members were not enrolled in the federal social security system and therefore did not receive a yearly cost-of-living allowance (COLA). The ordinance providing this benefit gives an increase to retirees and beneficiaries whenever the investment performance of the City's Fire and Police Employees' Retirement assets exceed 7.5%.   The term "Variable Benefit" suggests payouts will vary depending on the investment performance of those specified City pension fund assets. However, the benefit is only "variable" in the amount of increases provided – poor investment results do not affect increases already granted and over time the City is required to make up any decline or shortfall in investment income to cover prior "variable" benefit payouts. The structure of the Variable Benefit further reduces the earning capacity of the pension fund by allocating positive returns to benefit improvements as opposed to increasing the funding level of the plan. The maintenance of this arrangement is a continuing financial burden on the City in those years when market experience turns adverse.

The Task Force recommends removing the "variable benefit" from the overall benefit structure and replacing it with an annual cost-of-living benefit tied to the annual Social Security COLA, capped at a specified percentage not to exceed 3% per annum. This straight forward and more easily managed benefit would allow for more accurate annual projections of pension plan costs and carries the potential over time of a considerable reduction in pension plan costs.

Why this recommendation is good for the fund:

Mayor and former Governor of Maryland, William Donald Schaefer, warned in 1983 of the long term financial consequences of enacting legislation to include a variable benefit as part of the pension plan. In a letter to then President of the City Council Clarence H. "Du" Burns, Mayor Schaefer said:

> "It has been stated that this benefit will be provided at no cost to the City. It is unreasonable and wishful thinking to believe that large sums of money can be set aside for the variable benefit without increasing the cost of the pension system to the City."

Schaefer went on to say that the allocation of approximately $60,000,000 to set up the variable benefit was money that "…would have been used to reduce the City pension cost by approximately $500,000 in FY 84 and significantly more in future years.[15]"

Recent experience has demonstrated the fundamental flaw in the current "variable benefit" payout. Market returns are unpredictable over the long run. Not only does the current arrangement burden the city with pension costs that are uncertain in the extreme, but also fixes those costs as a continuing expense even when the anticipated income to cover them does not materialize. Adopting this recommendation will allow the City to better project the money needed to fulfill its obligation to retirees and will consistently match real cost-of-living increases with cost-of-living benefits.

II. Increase in Employee Contributions

Each member of the public safety employees' pension plan currently contributes 6% of "regular compensation" annually to support the pension plan. Three possible contribution rate increases – to 8%, 9% or 10% -- in the employee pension plan contribution were discussed. In a presentation to the Task Force on Sept. 1, 2009, the leadership of the police and fire fighters unions suggested that union members would be willing to accept a mandatory incremental increase in employee contributions of .5% annually moving the contribution rate from 6% to 9% over six years. However, the Task Force recommends that any increased contribution rate adopted should take effect immediately. The impact on the City's annual benefit costs for each proposed rate of employee contribution is as follows:

	8%	9%	10%
o Cost Savings (millions)	$5.4	$8.1	$10.8
o Percentage of Payroll	1.93%	2.89%	3.85%

Why we looked at this issue:

Research shows that most police and fire pension plans require members to contribute significantly more than members enrolled in the Baltimore City plan. In recent years, other state and city pension plan administrators have successfully secured increases in the contributions of plan members. For example, the contribution by members of the Ohio Police and Fire Pension Fund went from 10% to 12% in August 2009. In Springfield, Missouri, public safety employees hired before July 1, 2006 currently contribute 11.35% of compensation.[16] Similar increases were proposed and/or imposed in Philadelphia, Pennsylvania, Omaha, Nebraska, and the State of Massachusetts. Regionally, the Baltimore City F&P pension plan is on the low end of the spectrum. Police officers in Howard County contribute 11.60%, while Baltimore County hires after July 2007 contribute 7%.

Why this recommendation is good for the fund:

By increasing the member contributions to the pension fund reserves, the long-term compound effect will help ensure a reliable engine for asset growth to sustain future benefits.

III. Require and Consistently Deliver Annual City Contributions

The Task Force recommends that the City commit to making the Annual Recommended Contribution (ARC) calculated by the plan's actuary each year. The ARC is based on the plan's assumptions and funding methods and allocates the plans unfunded liability and expected future benefit accruals over future service years.

In the past, the City has on occasion used the System's unallocated earnings to meet its contribution[17] as determined by the plan's actuary. The Task Force believes it is important to the long-term sustainability of the Plan for the City to refrain from satisfying its obligation to the plan by using plan excess earnings.

Why we looked at this issue:

Annual City contributions to sustain and grow pension fund assets should be required, consistently delivered and fully adequate to cover current and future liabilities. Recent experience clearly demonstrates the financial pitfalls of depending on market gains or the transfer of investment gains from one fund to another as a strategy to offset contributions to the pension fund.

Why this recommendation is good for the fund:

The future of Baltimore's public safety employee retirement benefits rests on creating a reliable structure to grow the assets that ultimately will pay for benefits as promised by the City. The successful implementation of this recommendation is critically important to the future solvency of the Fund. Legislatively granting pension contribution holidays must be a practice of the past.

IV. Revision of Age and Service Requirements.

Under the existing retirement plan, members are eligible for full retirement when they reach age 50 with at least 10 years of credited service, or at any age when they have at least 20 years of service. The Task Force developed and considered a number of scenarios that included revisions in the age and service requirements for retirement. One such scenario calls for adoption of what the Task Force refers to as “the Rule of 75”. The rule allows for full retirement when any combination of age and years of service total 75.

Three versions of the rule were considered:

1) Establishing eligibility for retirement at a minimum age of 55
2) Establishing eligibility based upon a minimum of 25 years of service, provided the sum of age and service totaled at least 75.
3) Establishing eligibility based upon a required sum of age and service totaling at least 75 with no minimum age or years of service requirement being established.

Recognizing the interest that some members of the pension system already have in the current retirement plan, the Task Force searched for some combination of eligibility requirements within the existing benefit structure that would be both fair and flexible under the Task Force’s suggested “Rule of 75.”

The Task Force recommends a revision of age and service provisions of the current plan based on “the Rule of 75” with the minimum age of eligibility for full retirement set at 55 years or 25 years of service. The potential savings associated with this reform could be as high as $40 million.

Why we looked at this issue:

The Rule of 75 actually repositions the pension plan closer to its original roots. The plan started with a normal service retirement at age 50 with 25 years of service. Starting in the late 1980s the plan underwent a number of changes to allow for earlier age and lower service requirements at higher accrual rates. By the turn of the century, members of the plan urged for several transfer-in and purchase provisions to bring in service from other jurisdictions which meant that their service on the force in the City was not as long as previous members. (See Appendix for a summary of the evolution of the Plan retirement requirements).

Why this recommendation is good for the fund:

However, as pointed out earlier, in the actuarial assessment of how this proposal would impact pension plan costs, just how much the City can save by adjusting age and service requirements is heavily dependent on the actual retirement patterns of the plan members, which cannot be known until the plan provisions are in place. The expectation is that the proposed changes in the age and service requirements will have an impact over time on when police officers and fire fighters decide to retire. Actuarial analysis suggests that the average age of retirement for police officers will move from the current 52.6 years to 54 years under the third version of the Rule of 75, and that the average age of retiring fire fighters will increase slightly less than six months – from the current 52 years to 52.4 years.

V. Elimination of the Deferred Retirement Option Plan (DROP-2)

The plan benefit structure offers a compensation enhancement option aimed at retaining experienced personnel with the option of a lifetime benefit for a surviving spouse or other designated beneficiary.

Over a ten year period starting in 1999, the median annual cost of DROP benefits was $16,723,658, ranging from a high of nearly $26 million in 1999 (the third year after the deferred retirement option was first offered and the initial "class" of DROP enrollees were first eligible to draw full benefits), to a low of $7.5 million in 2002. Currently, about 90% of those plan members eligible to enroll in the deferred retirement plan do so. In 2009, the cost of DROP was $10,379,493.

The potential savings for removing DROP 2 for members with less than 15 years of service could be as high as $3.8 million.

Why we looked at this issue:

In 2009, the Baltimore City Council considered a revised Deferred Retirement Option Plan that came to be known as DROP 2. The new plan was intended to reduce the City's pension costs by cutting the interest earned on DROP accounts from 8.25% to 5.5% and terminating the interest credited to DROP 2 accounts after 36 months of participation or upon retirement. The recent action by the Baltimore City Council to adjust the interest paid on DROP accounts and other changes are commendable. However, it is not seen as a remedy that will adequately address the long-term problems of cost and relevance that the Task Force has identified with this particular pension benefit.

The stated purpose of the Deferred Retirement Option Plan is the retention of experienced personnel as they approach 20 years of service with the City's Fire or Police departments. In reviewing retirement trends over the past 20 years, it was found that the majority of fire fighters retired with 30-34 years of experience pre and post DROP.[18] Similarly members of the police force retired at similar trends pre and post DROP. There were more police officers who retired with more than thirty years post DROP but there were also more officers who retired with less than 20 years as compared with the ten years prior to the creation of DROP.

Police Retirement Trends

		20-24 Years		**25-29 Years**		**30-34 Years**	
	TOTAL	Number	Percent	Number	Percent	Number	Percent
Police Retirements before DROP (1987-1996)	1,165	417	**36%**	357	**31%**	208	**18%**
Police Retirements after DROP (1997- 2006)	1,176	322	**27%**	278	**24%**	219	**19%**

Fire Retirement Trends

		20-24 Years		**25-29 Years**		**30-34 Years**	
	TOTAL	Number	Percent	Number	Percent	Number	Percent
Fire Retirements before DROP (1987-1996)	717	136	**19%**	188	**26%**	223	**31%**
Fire Retirements after DROP (1997- 2006)	660	63	**10%**	163	**25%**	223	**34%**

Why this recommendation is good for the fund:

New and less costly strategies for attracting recruits and retaining experienced police officers and fire fighters must be developed. Moreover, the DROP as a tool for recruiting may be less effective in today's job market. Young recruits tend to be less interested in retirement benefits than in more immediately tangible benefits such as starting salary and job advancement possibilities, health care benefits and work environment.

Recent actuarial projections suggest that the impact of removing the DROP benefit from the public safety employees retirement plan would not at this time cause a serious surge in retirements and resignations by police officers or fire fighters with the possible exception of those who recently completed 20 or 25 years of service. A mitigating factor here could be that public safety personnel may be motivated to remain in service due to the "Rule of 75" discussed earlier in this report and their desire to ultimately gain full retirement benefits.

VI. Increase the span of months in calculating the average final compensation.

The Task Force examined the impact of changing the time component from 18 consecutive months to 36 or 60 months in calculating final average pay. The assumption underlying the use of an extended period of service in calculating an individual's final average pay is that it gives a clearer picture of the actual "value" of the service performed while a member of the City's Police or Fire departments. Relying on only 18 months in what, for most retirees, is a 20-year career provides a very limited view of actual service and earnings. Expanding the period in calculating highest pay period to three or five years presents a much more realistic picture of an employee's job contribution and just compensation in retirement. In addition, the expanded time frame for determining final average pay would make it more difficult to "spike" pension benefits and offers a fair, reasonable and more equitable time basis.

Why we looked at this issue:

As stated earlier in the report, the AFC calculation was originally the five consecutive years of service during which the member's earnable compensation was the highest. Subsequent changes over the years reduced the years of service used in the calculation to its current 18 months. However, compared to its regional counterparts 18 months is one of the lowest calculations. For example, Howard County Fire and Police as well as the Maryland's State Police use three years in calculating average final pay. A number of other states and municipalities have recently revised their methods of calculating final average salary in an effort to conserve pension plan resources. The Ohio Police & Fire Pension Fund recently dropped a three-year pay period. Massachusetts' Special Commission to Study the Massachusetts Contributory Retirement System proposed increasing the period for average highest earnings from three years to five.

Why this recommendation is good for the fund:

Updating the components applied in calculating final average pay period would reduce the risk of spiking and serve as a more realistic view of the member's final pay. It is estimated that the total cost savings (normal cost plus the amortization of the unfunded liability) could be about $4.8 million by dropping the current 18-month final average pay period in favor of a 36-month period. Similarly, the City's contribution could be reduced by roughly $12 million if final average compensation was calculated over 60 months.

VII. Enroll New Hires in a Defined Contribution Plan and Social Security

The Task Force believes serious consideration should be given to converting from a defined benefit plan to a defined contribution plan for future fire and police officers. This form of system is under consideration in many other jurisdictions and is consistent with private sector plans. In reaching this policy decision it is imperative to consider both the cost, the ability to attract and retain high quality fire fighters and police officers, and the competitiveness of the total employee compensation package offered to the City's public safety officers.

Although defined benefit retirement plans remain a common benefit format for many local government workers, such plans have been largely replaced in the private sector by "defined contribution" plans.[19] A defined contribution retirement plan is jointly funded by tax-free contributions made by both employees and their employer. The combined contributions are gathered in a company sponsored retirement plan – usually a 401(k) plan -- and typically form a core holding to help fund an employee's retirement. Assets that accrue in a 401(k) plan, as well as the dividends and interest they earn are held tax free until withdrawn.

There are advantages and disadvantages to both defined contribution and defined benefit plans. Defined contribution plans do not provide for significant death or disability benefits for participants in their early years of participation or for a cost of living adjustment in future years of retirement. Retirees who participate in defined contribution plans are more vulnerable to market performance -– which may be to their advantage when investments are rising in value, but can sharply decrease anticipated retirement income when market values drop.

Changing from a defined *benefit* to a defined *contribution* retirement plan usually involves a long phase-in period and should not be seen as a “quick fix” for depressed employer retirement plan reserves.[20]

For these and other reasons the Task Force recommends that the Board of Trustees of the Fire and Police Employees’ Retirement System give serious consideration to establishing a defined contribution plan for newly hired personnel that integrates participation in Social Security.

Why we looked at this issue:

The cost of sustaining a defined benefit program is proving increasingly difficult for governments dependent on tax revenues. The recent decline in the market value of City assets supporting the F&P pension plan and the resulting unfunded liabilities now confronting the City illustrates the challenge.

Why this recommendation is good for the fund:

The Task Force recommendation regarding the introduction of a defined contribution retirement plan for newly hired public safety employees suggests only that this option deserves more study and evaluation. A defined contribution plan holds out the possibility of conserving pension fund assets and of expanding the advantages of cost sharing between employer and employee. Introducing a defined contribution plan in combination with social security may be a viable path to follow.

Governance – Essential for Change

Currently the Board of Trustees of the Fire and Police Employees’ is composed of individuals who are experienced and dedicated public servants who serve without compensation. If meaningful change is to occur in the management and financial stability of the pension system, strong leadership will be required as we go forward. At times the board will consider, and must be able to objectively act upon, issues that may run contrary to their personal financial interests as leaders of Baltimore’s public safety employees. Such decision making is difficult under any circumstances, but even more so when it directly impacts your family, your friends and your personal interests.

Although the main focus of the Task Force's discussions and deliberations centered on the financial resources and benefits structure of the Fire & Police Retirement System, some consideration of the management and decision- making related to the system is unavoidable. The challenging circumstances now faced by the City and by the Board of Trustees regarding the mounting unfunded liability of the pension system should not be borne solely by those who struggled to manage a system clearly in need of repair.

The Task Force considered this in light of the complexity of pension fund management in today's uncertain financial environment. We offer the following new governance structure as a way to increase accountability, achieve greater transparency and preserve the board's independence. The recommendations for the composition of the Board of Trustees are as follows:

- Three voting ex-officio City members:
  -- The Director of Finance
  -- The Comptroller
  -- The Budget Director
- Six plan participants:
  -- 2 Police representatives
  -- 2 Fire representatives
  -- 2 Retiree representatives
- Three citizen representatives with financial expertise in one or more of the following areas: accounting, actuarial, auditing, investment management, investment consulting and financial law.

It is further recommended that the Board prepare a mandatory annual report for a public hearing convened by the appropriate City Council subcommittee. The report should provide timely updates on the health and financial stability of the plan, proposed changes by the actuary, and any recommendations adopted by the Board.

This proposed restructuring of the Board of Trustees and the required increased public disclosure is intended to capitalize on the strengths of a more diverse board, allow necessary oversight and monitoring, and ensure the proper alignment of interests that intersect in the continued financial stability of the City's pension plan for its public safety employees.

Conclusion: Baltimore is not alone in confronting this problem

The Greater Baltimore Committee is pleased to have had a role in the search for an effective solution, or combination of solutions, to the challenging issues surrounding the financial management of the Fire and Police Employee Retirement System. As the GBC Task Force examined these issues, it became obvious that Baltimore must intensify its search for more effective and less costly ways to recognize and reward the special role that public safety employees have in protecting and preserving our quality of life. Other cities throughout the United States – Atlanta, Cincinnati, Philadelphia, Pittsburgh and Omaha, among them -- have faced similar challenges in recent months. A report prepared by the task force charged with finding solutions to the under funding of the pension system in Omaha noted in its final report: "The extent of the decline in value of public pension plans throughout the country serves as a sobering wake-up call that swift and meaningful action must be taken to address the underfunding of public pension plans if they are to remain viable over the long-term."

The situation is urgent. Failure to act could ultimately jeopardize the City's credit standing and make it increasingly difficult to hire and retain personnel to serve as fire fighters and police officers. Any solution must be an inclusive process that avoids the usual political, labor union, management/employee tensions that too frequently cause needless delay in the adoption of a plan of action.

Endnotes

[1] See Appendix.
[2] See Appendix.
[3] CAFR ending June 30, 2009, pg. 29.
[4] See the Appendix, for further information on the evolution of the AFC.
[5] For further information on the details of the Plan refer to the Fire and Police Employee Retirement Policy Manual.
[6] Mercer Report, "The Fire and Police Employees Retirement System of the City of Baltimore, Actuarial Valuation Report for June 30, 2009, pg.22.
[7] *Id*. at pg.1.
[8] CAFR ending June 30, 2009, pg. 74.
[9] CAFR ending June 30, 2009, pgs.89-90.
[10] See Appendix for a comparison of regional retirement plans.
[11] Presentation to GBC F&P Task Force by Edward J. Gallagher, Director of Finance, City of Baltimore, Nov. 9, 2009, pg.21.
[12] *Id.* The NASRA reports the national average of surveyed plans covering Social Security eligible worker to be at 8.7% of payroll costs.
[13] Tom Lowman is currently the Chief Actuary at Bolton Partners Inc., and was formerly at Mercer where he was the lead actuary on the F&P account.
[14] As it stands, there are two post-retirement investment return assumptions- 6.8% under the City Code and 5.0% as recommended by Mercer and adopted by the Board of Trustees- which yields the two different recommended contributions. The proposed 5.0% assumption increases the total by $63.9 million.
[15] Mayor William Donald Schaefer, Letter to The Honorable Clarence H. "Du" Burns, President, and Members of the City Council of Baltimore, May 31, 1983.
[16] Ivey, Diane. "Communities demand solution for pension burden." Illinois Times. 11 Mar. 2010. Web. "According to Mayor Tim Davlin, almost 100 percent of property taxes collected in Springfield go to police and fire pensions. In accordance with state law, the city's public safety employees receive retirement funds, which can total up to 75 percent of their final pay rate if they retire at age 50 and have held the job for a minimum of 30 years."
[17] The System's unallocated earnings have also been used to enact reductions for active employee contributions and retiree increases.
[18] When examining years of service in intervals of five (i.e. 0-4 years; 5-9 years; 10-14 years…)
[19] Only about 20% of private sector workers have traditional defined benefit pensions.
[20] California recently evaluated the costs of converting the state's teacher retirement fund from a defined benefit to a defined contribution plan. Consulting actuaries projected that the older plan would have to be maintained for 75 years to serve all those with vested interests. Moreover, they estimated that the costs related to making the change in 2006 would not be fully recovered until 2028.

APPENDIX

The Greater Baltimore Committee Fire and Police Pension Task Force

Background

The Greater Baltimore Committee Task Force was formed in response to a request in early April, 2009, from Baltimore City Council President Stephanie Rawlings-Blake expressing her “deep concern” regarding Baltimore City’s Fire & Police Employee Retirement System. Her letter, co-signed by William H. Cole IV, Acting Chairman of the Council’s Committee on Taxation, Finance & Economic Development, noted that the pension system for the City’s public safety employees is “in grave danger” of bankruptcy. The letter said that the City Council’s efforts to reform the pension system early in 2009 were “inadequate.”

The City Council President further noted that the Greater Baltimore Committee (GBC) had assisted the City on a number of prior occasions to help make City government more efficient, cost effective and sustainable. She recommended that the GBC take the lead and perform an independent analysis of liabilities and develop fiscally-sustainable recommendations that will fully address the crisis both in the short and long terms.

In response to the Council President’s request, the Task Force was formed under the Chairmanship of Donald C. Fry, President and Chief Executive Officer of the GBC with Kisha A. Brown, GBC Director of Government Relations serving as Project Manager.

The initial meeting of GBC Baltimore City Fire & Police Pension Task Force was held on July, 15, 2009, at GBC’s offices. Subsequent meetings, including smaller work groups, were held on:

August 18, 2009	*November 9, 2009*
September 1, 2009	*November 19, 2009*
September 15, 2009	*November 24, 2009*
September 21, 2009	*December 3, 2009*
October 19, 2009	*December 11, 2009*
October 30, 2009	*December 17, 2009*

Task Force members contributed a significant amount of time outside of formal meetings, researching the causes of the City's unfunded liabilities, identifying potential solutions and discussing the problems with stakeholders including union representatives for the police and fire fighters, retirees, independent actuarial and pension consultants, the City's Director of Finance, and the Executive Director of the City's Fire & Police Retirement System. The comments and presentations of all those who provided information to the Task Force were thoughtfully prepared and skillfully presented.

Members of the GBC Fire & Police Pension Task Force

Chair: Donald C. Fry
Staff: Kisha A. Brown

Andrew M. Bertamini
Regional President – Baltimore
Wachovia Bank

David S. Boomershine
Senior Consulting Actuary & President
Bommershine Consulting Group

Thomas F. Brady
Executive Vice President (Retired)
Constellation Energy

Martin P. Brunk
Managing Director
RSM McCladrey

James E. Dunn, Jr.
Vice President Compensation and Benefits
McCormick & Company, Inc.

Gary Geisel
Former President & CEO
Provident Bank

Christopher P. Giermek, C.P.A.
Partner
PricewaterhouseCoopers

Kevin M. Hall
Baltimore Office Managing partner
KPMG LLP

Charles E. "Ted" Herget, Jr.
Principal
Asset Strategy Consultants

Steven C. Huber
Fixed Income Department
T. Rowe Price

Stephon A. Jackson
Equity Division
T. Rowe Price

Alvin Katz
Chairman
Katz Abosch

Barbara A. Klein
Associate Vice President for Government Affairs
University of Maryland, Baltimore

M. Kent Krabbe
Executive Director
Maryland Automobile Insurance Fund

Karyl B. Leggio
Dean
Sellinger School of Business & Management
Loyola College in Maryland

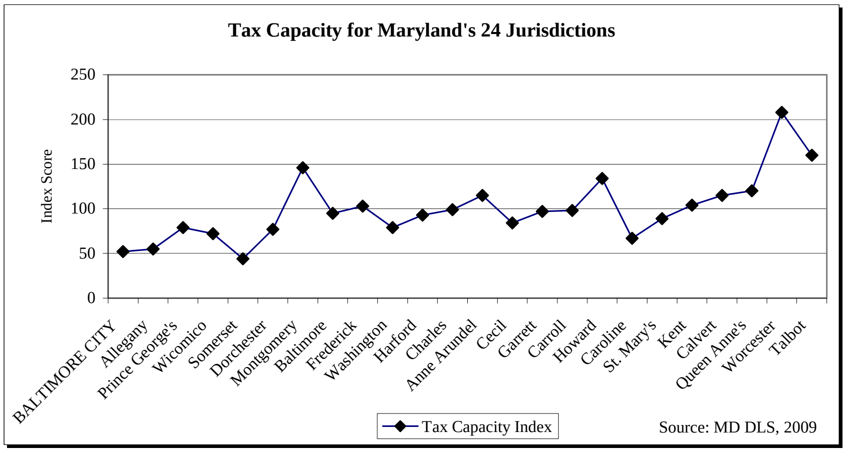
Terri Long
Vice President/Actuary
AON Consulting

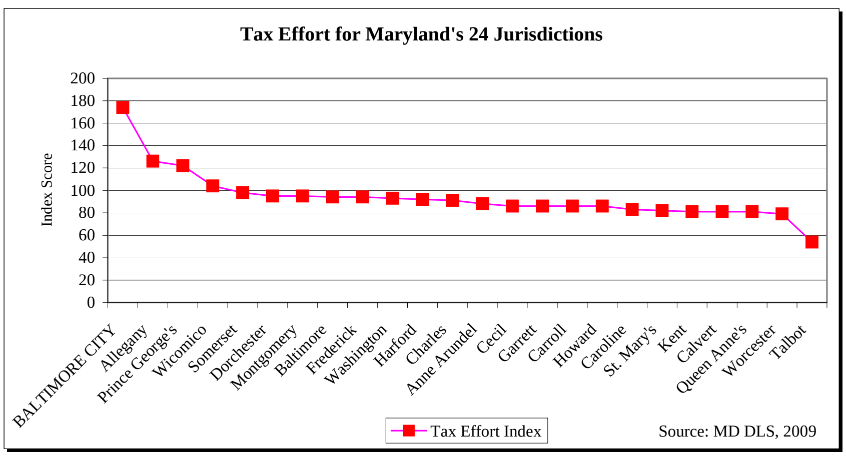
Frederick Puddester
Senior Associate Dean of Finance &
Administration
Johns Hopkins University
School of Arts & Science

Graylin E. Smith, C.P.A.
President
SB & Company, LLC

Kathleen Strukoff
Senior Vice President
AON Consulting

Tax Capacity vs. Tax Effort





Source: MD Department of Legislative Services, 2009

City and County Assessable Property Tax Base and Population

JURISDICTION	ASSESSABLE BASE ($ 000s)	POPULATION (July 2007 estimate)
BALTIMORE CITY	**$33,550,206**	**637,455**
Montgomery County	$186,958,792	930,813
Prince George's County	$88,580,752	828,770
Baltimore County	$81,731,405	788,994
Anne Arundel County	$81,956,083	512,154
Howard County	$47,665,838	273,669
Statewide	$728,037,172	5,618,344

Source: MD Department of Legislative Services, 2009

City and County Property Tax Yield and Tax Rates

JURISDICTION	ONE CENT YIELD IN REAL PROPERTY TAX RATE, FY09	FY09 REAL PROPERTY TAX RATE (per $100 AV)
Montgomery	$18,298,000	$0.916
Prince George's	$8,569,000	$1.319
Baltimore	$7,864,000	$1.100
Anne Arundel	$7,923,000	$0.891
Howard	$4,614,000	$1.150
BALTIMORE CITY	**$3,146,000**	**$2.268**

Source: MD Department of Legislative Services, 2009

Evolution of the Average Final Compensation Calculation

When established July 1, 1962, the F&P Average Final Compensation (AFC) calculation was for 5 consecutive years of service during which the member's earnable compensation was the highest.

On July 1, 1973, the AFC calculation was changed to 3 consecutive years of service during which the member's earnable compensation was the highest.

Beginning July 1, 1986, until June 30, 1988, the AFC calculation was for 2 consecutive years of service during which the member's earnable compensation was the highest.

Beginning July 1, 1988, the AFC calculation is for the 18 consecutive months of service during which the member's earnable compensation is the highest.

- If the member had less than the required years of service, then AFC was for the total years of service.

- If a member left F&P covered employment and later returned and became benefit eligible, i.e. service retirement, disability retirement, but, had less than the required years of <u>current</u> service for the AFC calculation, we would use compensation from the previous employment for the AFC calculation, if the years of previous service were purchased and were to be used in the benefit calculation.

BALTIMORE CITY LEGISLATION AFFECTING F&P MEMBER RETENTION*

Ord. 62-1285

Established the F&P, effective July 1, 1962, with service retirement available at age 50 or 25 years of service.

If a member retired after 25 years of service but before age 50, he could elect an early retirement benefit, equal to an actuarially-reduced age 50 benefit, or he could defer commencement until age 50 and receive an unreduced benefit. (The Baltimore City Code was later amended to allow a member to receive an unreduced benefit upon retirement after 25 years of service – regardless of the member's age upon retirement.)

Service retirement benefit was equal to 2.0% of average final compensation ("AFC") for first 25 years and 1.67% of AFC for subsequent years.

Required mandatory retirement for members at age 55, with an exception for Fire Lieutenant and Police Sergeant ranks, which had mandatory retirement at age 65.

Ord. 81-552

Allowed service credit for up to 3 years of pre-employment military service, for members age 50 with 10 years of service or members with 25 years of service (regardless of age).

Johnson v. Mayor and City Council of Baltimore (1985)

U.S. Supreme Court ruled that the F&P mandatory retirement provisions violated federal Age Discrimination in Employment Act; those provisions became null and void as a result of the Supreme Court decision.

Ord. 89-232

Shortened the 25-year service retirement to 20 years, for members retiring on or after July 1, 1989.

---

* Provisions encouraging retention are in bold font; provisions encouraging earlier retirement are underlined.

Changed the service retirement benefit, for members retiring on or after July 1, 1989, to 2.25% of average final compensation ("AFC") for first 20 years, 2.50% of AFC for next 2 years, and 1.67% of AFC for subsequent years.

Ord. 91- 786

Changed the service retirement benefit, for members retiring on or after July 1, 1991, to 2.5% of average final compensation ("AFC") for first 20 years and 1.8% of AFC for subsequent years.

Allowed for the repurchase of F&P service lost after separation from service if member returns within 60 months after separation.

Shortened the eligibility for pre-employment military service to age 50 with 10 years of service or 20 years of service (regardless of age).

Ord. 93-262

Changed the service retirement benefit, for members retiring on or after June 29, 1993, to 2.5% of average final compensation ("AFC") for first 20 years and 2.0% of AFC for subsequent years.

Ord. 96-42

Established DROP, effective July 1, 1996, to encourage police and fire officers with at least 20 years of service to remain employed. Maximum DROP benefit available only if member participated in DROP for 3 years and remained employed for at least 6 more years (total post- retirement-eligible retention of 9 years).

Opened a window between June 1, 1996 and August 31, 1996 for non-DROP members with 35 or more years of service to retire and receive additional service and enhanced average final compensation.

Ord. 98-290

Allowed for the purchase of prior service in ERS, State of Maryland system or system of a Maryland subdivision by members who joined before July 1, 1994 and by members who joined after June 30, 1994.

Opened a window to June 30, 1999 for the purchase of service by certain members who joined before July 1, 1994 but didn't qualify under new rules.

Ord. 00-49

Opened a window from July 1, 2000 to December 31, 2000 for the purchase of service from another system by members who joined before July 1, 2000.

Increased the multiplier for the Intermediate and Full DROP "recovery benefit" from 1.0% to 1.5%. Reduced the eligibility period for Full DROP benefit from 5 years to 18 months.

Maximum DROP benefit is available only if member participates in DROP for 3 years and remains employed for at least 4 more years (total post- retirement-eligible retention of 7 years).

Ord. 03-576

Amended the service retirement and DROP eligibility requirement for employees who became members on or after July 1, 2003 to require 10 years of F&P service in addition to attainment of age 50 or 20 years of total service.

Removed mandatory retirement provisions. (Age Discrimination in Employment Act has since been amended so as to allow the City to again impose mandatory retirement for members at age 55 or older.)

Provided for the receipt of service credit for in-service military leaves of absence in conformance with federal and state law.

Established new rules for repurchase of F&P service credit lost due to separation from service. No longer limited to members who return within 60 months of separation.

Opened a window from June 30, 2003 to December 31, 2004 for the purchase of service from another system by members who joined before July 1, 2003.

Established new rules for the purchase of service by members who joined after June 30, 2003. Opened up the purchase of service to members with prior service in federal or out-of-state governmental systems.

Allowed for the purchase of Maryland Police Corps training time as service credit.

Authorized the purchase of service credit through tax-free rollovers.

Ord. 04-889

Opened a window from January 3, 2005 to April 1, 2005 for members to apply or re-apply for line-of-duty disability benefits without regard to the five-year limitations period.

Ord. 07-610

Allowed for the purchase of HABC pension plan service for HABC police employment.

Ord. 09-209

Established DROP 2, effective January 1, 2010. DROP 2 is a variation of existing DROP. Employees who become members on or after effective date of DROP 2 must have 20 years of continuous F&P service to be eligible. For police, maximum DROP 2 benefit is available only if member participates in DROP 2 for 3 years and remains employed for at least 3 ½ more years (total post- retirement-eligible retention of 6 ½ years). For fire, maximum DROP 2 benefit is available only if member participates in DROP 2 for 3 years and remains employed for at least 5 more years (total post- retirement-eligible retention of 8 years).

DROP Comparison
Baltimore Fire and Police Plan vs. Surrounding Jurisdictions

	Baltimore City Fire & Police Plan	Anne Arundel County Fire & Police Plans	Baltimore County Fire & Police Plans	Howard County Fire & Police Plan
DROP				
DROP Type	DROP-In	DROP-Out	Back-DROP	DROP-Out
Voluntary/Mandatory	Voluntary	Voluntary	Voluntary, election made @ retirement	Voluntary
Eligibility Requirements	**Before 7/1/2003:** 20 years of service credit **After 6/30/2003:** 20 years of service credit and at least 10yrs. must be as a contributing member of the F&P	**Before 7/1/2002:** Age 50 on effective date of DROP participation and 20 years of Actual County Service. **On or after 7/1/2002:** 20 years of service, regardless of age	**Sworn Firefighters:** Before **7/1/2007** At least 32 years of qualifying service, including credit for unused sick leave, military service, and other jurisdictional servie outside Balto. County or transfer service within Balto. County for members who were in active service on or before 12/31/2003. For members who were not in active service on 12/31/2003, there is no credit for other jurisdiction service or service as general employee. **The DROP will not be available to members hired on or after 7/1/2007.**	All active members who have at least 25 years of creditable service.
			Sworn Police Officers: Before 7/1/2007 At least 27 years of qualifying service, including credit for unused sick leave, military service, and other jurisdictional service outside Balto. County or transfer service within Balto. County for members who were in active service on or before 12/31/2003. For members who were not in active service on 12/31/2003, there is no credit for other jurisdiction service or service as general employee. **The DROP will not be available to members hired on or after 7/1/2007.**	
Employment Status	Remains an active employee	Remains an active employee	Remains an active employee	Remains an active employee
Participation Period	3 years	Initial period is 3 years, but may be extended no more 2 one-year terms. Maximum of 5 years	**Fire Service** **Length of DROP** 32 years 3 years 33 years 3, 3 1/2, or 4 years 34 or more years 3, 3 1/2, 4, 4 1/2 or 5 years	3 or 4 years. Member makes an election for 3 or 4 years at DROP entry
			Police Service **Length of DROP** 27 years 3 years 28 years 3, 3 1/2, or 4 years 29 or more years 3, 3 1/2, 4, 4 1/2 or 5 years	
Interest Rate	8.25%	8%	The greater of: (1) The rate of return on the actuarial value of assets for the prior calendar year minus 50 basis points (admin. expenses); or (2) 5%, the regular rate of interest	No Interest on DROP
Member contributions rate	6.00%	No member contributions during DROP	Based on age at plan entry: 6.46% - 8.90%	Members contribute to the Retirement Plan not DROP

DROP Comparison
Baltimore Fire and Police Plan vs. Surrounding Jurisdictions

	Baltimore City Fire & Police Plan	Anne Arundel County Fire & Police Plans	Baltimore County Fire & Police Plans	Howard County Fire & Police Plan
			Qualifying Service = membership service, membership credit for acumulated unused sick leave, creditable military service, other jurisdictional service outside Balt. Co. for members who are in service on or before 12/31/03 and transfer service within Balt. Co. for members who are in active service on or before 12/31/03. Does not include other jurisdictional service outside Balt. Co. for members who begin service after 12/31/03 and transfere service within Balt. Co. for members who begin active service after 12/31/03.	
DROP Distribution	Lump sum, rollover, annuity	Lump sum, rollover, annuity	Single lump sum payment or rollover	Lump sum, rollover, annuity
DROP Account	DROP Benefits, Member Contributions, and Interest	Monthly retirement benefit if retired + COLAs would have received + Interest	Based on assumed member contributions, pension benefits + interest earned in the DROP period.	Monthly retirement benefit + COLAs would have received
Service credit earned during DROP	No	No	No, DROP service is sevice credit minus the length of the DROP period selected by the member.	No
Discontinuation of DROP Participation	Terminating service anytime during or at the end of DROP period automatically ends DROP; Can elect to discontinue DROP participation on 1st or 2nd anniversary of DROP start date Member resumes earning service credit Member keeps DROP account	Can revoke application up to 2wks prior to DROP effective date. If member leaves before end of 3-yr. DROP term, member doesn't receive DROP benefits. Can elect to discontinue DROP participation during the initial 3-yr DROP period, but may not rejoin	DROP benefits will not be paid to a member who elected a Termination benefit. If a member dies in active service, the surviving beneficiary will not be allowed to make a DROP election.	Can revoke DROP decision within two weeks of submitting application. The only ways to exit DROP earlier than the end of chosen period are: --Disability Retirement --Death --Voluntary retirement or disciplinary action that terminates employment

DROP Comparison
Baltimore Fire and Police Plan vs. Surrounding Jurisdictions

	Baltimore City Fire & Police Plan	Anne Arundel County Fire & Police Plans	Baltimore County Fire & Police Plans	Howard County Fire & Police Plan
DROP and Disability DROP and Death	If member becomes disabled due to line-of-duty or line-of-duty death, no DROP benefit allowed. If member becomes disabled due to non-line-of-duty or non-line-of duty death, DROP benefits are given.	If member becomes disabled during DROP, member would receive the benefit as if member retired on disability without electing DROP.	Not Applicable - Baltimore County has a Back-DROP calculated retroactively at time of retirement.	If a member becomes disabled during DROP, the member can elect one of two benefits: (1) The monthly disability retirement benefit you would have received if the member had not entered DROP and no DROP account, or (2) The member's DROP account plus the monthly benefit that, in combination with the DROP account, produces an actuarial value to the disability value equal to the disability benefit received if the member had not entered DROP. If DROP participant dies, whether in the line-of-duty or under other circumstances, then the following applies: --If beneficiary is eligible for a death benefit annuity, beneficiary will receive the balance in DROP account + the death benefit provided in the retirement plan (ordinary or line-of-duty) based on continuation of pay and creditable service from DROP entry date of death. --If beneficiary is not eligible for a death benefit annuity, beneficiary will receive the balance in DROP account + the lump sum general death benefit.
DROP and Post-Retirement Increases	Member who retires during or at the end of DROP participation period will have that DROP participation period counted toward the eligibility requirement for post-retirement benefit increases. Member who continues working at the end of a DROP participation period will not have that DROP participation period counted toward the eligibility requirement for post-retirement benefit increases. Post-retirement benefit increases for former DROP participants are applied prospectively.	DROP allowances credited to DROP account and paid on retirement are increased for COLAs as if member had retired at the beginning of the DROP period Annuity payments based on DROP account will not receive COLAs.	DROP allowances credited to the DROP account and paid on retirement are increased for COLAs as if member had retired at the beginning of the DROP period.	DROP allowances credited to the DROP account and paid on retirement are increased for COLAs as if member had retired at the beginning of the DROP period.
			Example: Fire - 74% of AFC for 29 years and 2% for each year over 29, plus DROP which consists of benefit payments, contributions and interest at higher of the actuarial rate of return less 50% basis points of 5%, whichever is greater.	
			Example: Police - 64% of AFC for 24 years and 2% for each year over 24, plus DROP which consists of benefit payments, contributions and interest at higher of the actuarial rate of return less 50% basis points.	

DROP Comparison
Baltimore Fire and Police Plan vs. Surrounding Jurisdictions

	Baltimore City Fire & Police Plan	Montgomery County Fire Plan	Prince George's County Fire & Police Plans	Maryland State Police Plan
DROP			**Police do not have a DROP	
DROP Type	DROP-In	DROP-Out		DROP-Out Member must retire at the end of DROP period
Voluntary/Mandatory	Voluntary	Voluntary		Voluntary
Eligibility Requirements	**Before 7/1/2003:** 20 years of service credit **After 6/30/2003:** 20 years of service credit and at least 10yrs. must be as a contributing member of the F&P	20 years of creditable service; no time limit to apply Sick leave may be used as credit towards eligibility to participate in DROP, up to the 2 year maximum.		Member must have at least 22 yrs., but less than 28 yrs. of creditable service and under age 60
Employment Status	Remains an active employee	Remains an active employee		Retired and continue to work
Participation Period	3 years	3 years		Limited to the lesser of: --4yrs. --Difference between 28 years and the member's creditable service upon election --Difference between age 60 and the member's age as of the date the member elects to participate in DROP --A term selected by the member (not to exceed 4yrs.).
Interest Rate	8.25%	8.25%		6.00%
Member contributions rate	6.00%	8.50%		None
DROP Distribution	Lump sum, rollover, or annuity	Lump sum, rollover, or annuity		Lump sum or rollover
DROP Account	DROP Benefits + Member Contributions + Interest	Monthly retirement benefit + Member Contributions + Interest		Monthly retirement benefit + Interest + COLAs
Service credit earned during DROP	No	No		No
Discontinuation of DROP Participation	Terminating service anytime during or at the end of DROP period automatically ends DROP; Can elect to discontinue DROP participation on 1st or 2nd anniversary of DROP start date Member resumes earning service credit Member keeps DROP account	Member may end participation in DROP and retire before the end of 3 years, but must give 60 days notice; Must retire after DROP period; Member may revoke decision during the 2-week period following submission of DROP application; If member leaves DROP early, DROP account will be smaller		Terminating service automatically ends DROP Revocation of DROP election is irrevocable

DROP Comparison
Baltimore Fire and Police Plan vs. Surrounding Jurisdictions

	Baltimore City Fire & Police Plan	Montgomery County Fire & Police Plans	Prince George's County Fire & Police Plans	Maryland State Police Plan
DROP and Disability **DROP and Death**	If member becomes disabled due to line-of-duty or line-of-duty death, no DROP benefit allowed. If member becomes disabled due to non-line-of-duty or non-line-of duty death, DROP benefits are given.	*For service-connected deaths* , beneficiary will receive the greater of (1) the balance in member's DROP account + the death benefit he or she would have received if the member had retired on the date DROP participation began OR (2) the service-connected death benefit that the beneficiary would have received if the member had never entered DROP, but not the DROP account balance. *For non-service-connected deaths,* beneficiary will receive the greater of (1) the balance in member's DROP account + the death benefit he or she would have received if the member had retired on the date DROP participation began. If elected a payment option for monthly retirement benefit in which no remaining benefit is payable to a beneficiary, only the DROP account will be payable.		DROP participants are not eligible to file for ordinary disability retirement; however, they can file for a special disability retirement. If approved for a special disability, the DROP participant will receive --A special disability retirement allowance, which is computed using the participant's AFC as of date of application of the special disability retirement AND receive payment of the DROP balance, or --Continue as a DROP participant with no change in retirement benefits.
DROP and Disability **DROP and Death**		For a non-serviceconnected disability, the member would receive the benefit as if he or she had not retired from DROP without disability + DROP account. For a service-connected disability, the member may elect to receive either (1) the benefit as if he or she had retired from DROP without disability, or (2) the service-connected benefit that he or she would have received if he or she had never entered DROP.		If a DROP participant dies while in DROP, the balance in his or her DROP account is paid to the surviving spouse. If not survived by a spouse, the amount is paid to the retiree's child(ren) under age 18. If the DROP participant is not survived by spouse or minor children, the balance in the account is paid to the participant's designated beneficiary. In addition, the spouse (or if no spouse, minor children) would start receiving a monthly retirement benefit equal to 50% of the participant's monthly retirement allowance. If the retiree had no spouse and childen, payment of the retirement account to the designated beneficiary would be based on the option selected by the participant at the time of retirement.
DROP and Post-Retirement Increases	Member who retires during or at the end of DROP participation period will have that DROP participation period counted toward the eligibility requirement for post-retirement benefit increases. Member who continues working at the end of a DROP participation period will not have that DROP participation period counted toward the eligibility requirement for post-retirement benefit increases. Post-retirement benefit increases for former DROP participants are applied prospectively.			DROP benefits deposited to the DROP account and paid on retirement are increased for COLAs as if member had retired at the beginning of DROP period.

DROP Comparison
Baltimore Fire and Police Plan vs. Surrounding Jurisdictions

	Baltimore City Fire & Police Plan	State of Maryland Law Enforcement Officers Pension System (LEOPS)		
DROP				
DROP Type	DROP-In	DROP-Out		
Voluntary/Mandatory	Voluntary	Voluntary		
Eligibility Requirements	**Before 7/1/2003:** 20 years of service credit **After 6/30/2003:** 20 years of service credit and at least 10yrs. must be as a contributing member of the F&P	Must have at least 25 years of service, but less than 30 years of creditable service Must indicate when he or she wants to retire and length of DROP participation period Must submit in the form of binding letter of resignation accepted by the Secretary of the member's employing department or a designee of the Secretary		
Employment Status	Remains an active employee	Retired and continue to work		
Participation Period	3 years	DROP participation period is limited to the lesser of: --5 years --Difference between 30yrs. of service and the member's creditable service upon election. --A term selected by the member (not to exceed 5 years)		
Interest Rate	8.25%	6.00%		
Member contributions rate	6.00%	No member contributions		

DROP Comparison
Baltimore Fire and Police Plan vs. Surrounding Jurisdictions

	Baltimore City Fire & Police Plan	State of Maryland Law Enforcement Officers Pension System (LEOPS)		
DROP Distribution	Lump sum, rollover, annuity	Lump sum or rollover		
DROP Account	DROP Benefits, Member Contributions, and Interest	Monthly retirement benefit + Interest + COLAs		
Service credit earned during DROP	No	No		
Discontinuation of DROP Participation	Terminating service anytime during or at the end of DROP period automatically ends DROP; Can elect to discontinue DROP participation on 1st or 2nd anniversary of DROP start date Member resumes earning service credit Member keeps DROP account	Election to participate in the DROP is irrevocable; DROP ends if the LEOPS employer terminates the participants employment, or if the participant elects to shorten the DROP participation period by terminating employment with his or her LEOPS employer prior to the termination date originally selected.		
DROP and Death	If member becomes disabled due to line-of-duty or line-of-duty death, no DROP benefit allowed. If member becomes disabled due to non-line-of-duty or non-line-of duty death, DROP benefits are given.	DROP participants are not eligible to file for ordinary disability retirement; however, they can file for an accidental disability retirement. If approved for an accidental disability, the DROP participant will receive --An accidental disability retirement allowance, which is computed using the participant's AFC as of date of application of the accidental disability retirement AND receive payment of the DROP balance, or --Continue as a DROP participant with no change in retirement benefits.		
DROP and Post-Retirement Increases	Member who retires during or at the end of DROP participation period will have that DROP participation period counted toward the eligibility requirement for post-retirement benefit increases. Member who continues working at the end of a DROP participation period will not have that DROP participation period counted toward the eligibility requirement for post-retirement benefit increases. Post-retirement benefit increases for former DROP participants are applied prospectively.	DROP benefits deposited to the DROP account and paid on retirement are increased for COLAs as if member had retired at the beginning of DROP period.		

WILLIAM M.
MERCER
INCORPORATED

March 8, 1983

The Boards of Trustees of:
The Fire and Police Employees' Retirement System of
the City of Baltimore; and
The Employees' Retirement System of the City of Baltimore
100 North Holliday Street — City Hall
Baltimore, Maryland 21202

Re: Increasing benefits in the course of payment

Honorable Members of the Boards of Trustees:

You have asked that we write a brief explanation of the operation and cost effects of the "Variable Benefit" Bills recently submitted by the Unions and the City.

We will try to represent these Bills as fairly and accurately as possible, but they are both complex. This complexity will force us to be less brief than may be your preference and prevents us from addressing the many ancillary issues which are important to the operations and cost of the Bills.

This is really the first time that you have requested our comment on a matter covered by a proposed Bill and we, therefore, feel required to express our views and clarify our position and opinions.

We are concerned because of the recent adoption by the City Council of Ordinances to provide credit for Military Service and give increases to retirees who retired prior to 1973. Our concern is based not on the adoption of these Bills but the expressions of surprise when these Bills were found to increase City cost by $2 million each year into the future.

City Council is now considering legislation which will, as it appears today, spend over $25 million in 1983. There is a reasonable expectation that these same Bills will spend several million dollars each year in the future.

We use the word "spend" advisedly because it avoids the use of the words "cost" and "contribution" which have taken on complicated meanings during the discussions. There is, however, no dispute that the Variable Benefit portion of Bill 1470 and Bills 1478 and 1479 will "spend" the money and this spending requires that someone accept the resultant cost.

Bill 1470 contains provisions for increases to retirees based on similar principles as 1478 and 1479 but is contained in a larger pension reform which would moderate the ultimate effect on City costs.

Again we reaffirm that we are not passing judgement on any of these Bills but are strongly recommending that Council be familiar with the financial consequences.

The term "Variable Benefit" was coined, we believe, to avoid the use of the phrase "Cost-of-Living Increase" and to emphasize that an increase would be contingent upon the Pension Fund Assets earning certain levels of investment income. The use of the word "Variable" can be misleading, however, because the benefit is only variable upwards. Poor investment results would not affect increases already given and the City would be required to make up any shortfall over time.

Bills 1470, 1478, 1479

Each of these Bills have provisions for increasing benefits to current and future retirees in each future year. These benefit increases are not one-time payments but, when given, would be paid over the remaining lifetime of the retiree and/or beneficiary. The assets necessary to support the initial pension and the benefit increases are guaranteed by the City.

Should investment return be favorable in a year, there would be a corresponding increase to retirees.

Should investment return be unfavorable in a year, there would be a corresponding increase in the required City contribution.

Each of the Bills (the Variable Benefit portion) are based on the same principle but differ in the mechanical application. This difference in mechanics can produce substantial difference in the amounts to be "spent" in any given year.

The principle upon which they are based follows this rationale:

1) The assets supporting benefits in the course of payment can be notionally segregated from the assets supporting benefits which will be payable to persons not yet retired.

2) City contributions are determined on the assumption that all assets and future contributions will generate investment income of 7½% per year (6% basic assumption plus 1½% Reserve for Book Value amortization payment).

3) Presently, if all other assumptions used in the valuation of the plan are exactly borne out by experience and if the pension assets earn in excess of this 7½%, the excess can be used to reduce City cost or improve benefits.

4) Each of these Bills anticipate that such investment income in excess of 7½% which is attributable to the assets held for retirees would, according to methods described in the Bills, be in part used to increase benefits to retirees and in part be used to reduce City contribution.

Operation and Financial Implications of the Bills

The assets held to support benefits payable to current retirees which we discussed above, we shall now refer to as the "Retiree Reserve."

The F&P Retiree Reserve is $190 million out of $316 million total assets (at June 30, 1982).

The ERS Retiree Reserve is $103 million out of $235 million total assets (at June 30, 1982).

Based on investment results to December 31, 1982 and assuming the assets earn 6% to June 30, 1983, the individual Bills would, in 1983, spend approximately the following:

	Bill 1470		Bill 1478	1479
	(ERS)	(F&P)	(ERS)	(F&P)
1983	$4,400,000	$7,200,000	$9,000,000	$17,000,000

(This anticipates some future cost reduction based on pension reform contained in the same Bill)

Each of the bills would require some amendment to accurately state the mechanical calculation and distribution of any amounts. Even small wording or mechanical changes can result in differences of millions of dollars over future years.

Bill 1470 contains greater protection for the City (tax rate) than do either 1478 or 1479. This protection is found in: the method used to calculate the amount to be spent; the amount allocated to retirees in any given year; the amount of reserve which could be used to prevent City contribution increases in years of poor investment performance; and the overall pension reform.

Bills 1478 and 1479 will spend more money more rapidly and a year of unfavorable experience will affect the City contribution rate more than under Bill 1470.

Comment and Recommendation

The desire to increase benefits to existing retirees is certainly an admirable goal and avoidance of an automatic Cost-of-Living escalator is commendable. The method under consideration seems supportable over the long term but it does not have the advantage of demonstrated success. This Variable Benefit concept is not a dominant technique and in fact lacks a history of success because it has not been widely used.

The method makes a great deal of sense but should still be approached cautiously until experience has been gained and confidence developed that it is appropriate and supportable in the Baltimore City context.

The integrity of the retirement systems should be paramount. The retirement systems of the State of Maryland and Social Security have both been damaged because of admittedly precipitous benefit improvements in various forms but largely because of Cost-of-Living related issues.

Bills 1478 and 1479 go beyond our comfort zone and we recommend strongly that you encourage caution and prudence when reviewing 1470, 1478 and 1479. Once adopted, it becomes very difficult to modify such legislation and the ability of the City to support what could be a major long term financial committment should shape the decision.

Sincerely,

James G. Delaney
Principal

Thomas Lowman, F.S.A.

JGD:TL/gg

WILLIAM DONALD SCHAEFER, Mayor
OFFICE OF THE MAYOR · CITY OF BALTIMORE
250 City Hall, Baltimore, Maryland 21202, (301) 396-3100

In reply refer to: MO-04

May 31, 1983

The Honorable Clarence H. "Du" Burns, President
and Members of the City Council of Baltimore

Dear Council Members:

There is no disagreement as to the desirability of increased pensions, particularly a "catch-up" for those who have been retired for many years. Everyone supports such increases and recognizes the need. I am pleased that these two bills contain such a "catch-up" provision by providing the first year benefit in accordance with a sliding scale that will give retirees who have been retired two years an 8% raise with additional increments added for each additional year of retirement up to 20 or more. Thus retirees with 20 or more years will receive a 27% increase. This is of course based on the current investment performance of retirement funds. Subsequent raises, under the plan, will provide an across-the-board increase to all eligible retirees at the same rate for all. For this reason and because of my concerns for our retired employees, I am pleased with these benefit provisions.

At the same time, I am very concerned with the cost that will be shifted to the City taxpayer as a result of the way these bills provide the funds for the new benefit. It has been stated that this benefit will be provided at no cost to the City. It is unreasonable and wishful thinking to believe that large sums of money can be set aside for the variable benefit, <u>without</u> increasing the cost of the pension system to the City.

The current projected investment performance will result in the allocation of approximately $60M for this benefit. Under the current plans, these funds would have been used to reduce the City pension cost by approximately $500,000 in FY 84 and <u>significantly</u> more in <u>future years</u>. This is a "cost to the City." This reduction in the City contribution could have been allocated to the Department of Education and other agencies to avoid service reductions and layoffs or to help fund the ever increasing cost of fringe benefits made available to City employees and retired employees. In addition, one of the more harmful provisions of the ordinances requires that the funds allocated for the variable benefit be segregated from the rest of the assets of the retirement system and provides that investment earnings on the variable benefit fund, in excess of 6%, inure only to the benefit of the variable benefit fund. They are not available to the total fund nor to the benefit of the City. Therefore, through the years, depending on the investment performance and the aggregate of the assets, the City will not get the benefit of good investment years but will incur the cost of bad years.

It has also been stated that the funds being set aside for the variable benefit are drawn from the employees' contributions. Therefore, it is argued that it is not City money being used but the employees' own money. This is, in fact, not true. The majority of the funds to be set aside for the variable benefit are from earnings on City contributions in the pension system. When an employee retires, his retirement allowance is paid from two funds. One of these funds represents the City's contribution to this annuity and the other fund represents the employees' contributions to the annuity. On June 30, 1982, the City contribution to these funds made up 85% of the total and employees' contributions represented 15% of the total in the case of the Fire and Police System, and 77% and 23% respectively in the case of the Employees Retirement System. Since the inception of the Plan C System, the City contribution is increasing and the employees' contribution is declining drastically and will continue to do so in the future. This is due to the fact that 70% of the members of the ERS system make no contribution to the pension system at all. The City bears the entire cost for these employees.

I am also concerned about the escalating cost of fringe benefits as well as those for retired personnel. Expenditures for non-pension fringe benefits have steadily escalated over the last ten years to a level of $67M. This is almost 1 1/2 times the pension contribution and is expected to continue to increase significantly. These fringe benefits are likewise applicable to our retired employees where the cost impact to the City for such things as health benefits are disproprotionately greater. In 1973, in the early days of my first administration, the cost of fringe benefits for retirees totaled $514,978. For FY 1984, eleven years later, the cost for fringe benefits for retirees, exclusive of pension contributions, will total $6,958,100. This represents a 1251% increase. This increase is due in great part to additional fringe benefits my administration has provided retirees. In 1973, retirees had only basic Blue Cross/Blue Shield coverage and if over age 65 received medicare supplemental coverage. During my administration, the Blue Cross/Blue Shield coverage has been increased at no cost to the retirees and Major Medical Insurance has been added which pays for health costs not covered by Blue Cross/Blue Shield. These added costs used to be paid for by the retiree. He is now relieved of this burden, and the City pays the entire cost of this program. In addition, retirees in 1973 did not have the prescription drug coverage, now made available to the retirees through my efforts. Thus, retirees do not have to pay for drugs but rather the City pays for them. These additional health benefits which are made available to retirees at no cost to them, are proving to be very costly to the City.

In fact, the value of the fringe benefits to retired employees often exceeds the pension allowance. When taken together, rising pension contributions and escalating fringe benefit costs place a heavy burden on future budgets without providing the full relief, in good investment years, that would be available if these two ordinances were not enacted.

However, despite all of the above concerns, I am aware of the plight of many of our retirees, and I am concerned for their well-being. Therefore, despite the cost and the burdens those bills will place on future budgets, I am signing both bills to give our many retirees a much needed increase.

Sincerely,

Mayor