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Mr. Thomas Taneyhill
Executive Director
Baltimore City Fire and Police Employees' Retirement System
7 E. Redwood Street
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Baltimore, MD 21202

July 19, 2010

Subject: Cost Impact of Proposed Changes to the City of Baltimore Fire & Police Employees' Retirement System under Council Bill 10-0571

Dear Tom:

As requested, we have estimated the City and State contribution impact of the potential changes in plan provisions in City Council Bill 10-0571.

The "baseline" scenario is from the June 18, 2010 letter which provided contribution calculations for Council Bill 10-0519, which became Ordinance 10-306.

Benefit Changes

As requested by the Fire & Police Board of Trustees, we analyzed the cost impact of the following changes. The changes would be effective July 1, 2010:

- Change the requirement for grandfathering of retirement eligibility from 15 or more years of continuous service as a contributing member of the System to 15 or more years of service.
- Increase the interest rate for accumulating DROP2 accounts from 3.0% to 5.5% for grandfathered members.
- Allow service purchases by December 31, 2010 to count for purposes of determining grandfathered status under Ordinance 10-306.
- Remove the continuous service requirement for all retirement eligibility.

Basis for the Cost/Savings Calculations

A summary of the results for the DROP2 interest credits proposed change is shown in the attached Exhibit 1. Note that this cost was already included in the contribution estimates that we provided to Kramon and Graham on June 18, 2010. In other words, the change does have a cost, but that cost was already included in the figures provided when Council Bill 10-0519 was being considered.

Similarly, the cost for more generous grandfathering (15 years of service instead of 15 years of continuous service as a contributing member) was already included in the calculations for

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Council Bill 10-0519 because we have no data to distinguish continuous service. We also have no way to estimate how many members may purchase service by December 31, 2010 to qualify for grandfathering. To provide an idea of the cost of extending grandfathering (either through the more generous definition or allowing service purchases to count), we calculated the additional Normal Cost and amortization payment for two sample members, one with 15 years on July 1, 2010 and one with almost 20 years.

Per Member Contribution Increases for Additional Grandfathering

Increase in City Contribution with Grandfathering vs. without				
Total Service at July 1, 2010	Pay at June 30, 2009	Normal Cost*	Amortization Payment**	First Year Total
15 years	\$65,000	\$2,400	\$3,200	\$5,600
20 years	\$65,000	\$3,500	\$6,400	\$9,900

* Increases by more than 8 %/year between now and retirement age. Ends at retirement/termination/disability
** Continues for 20 years

These contribution figures would increase proportionally for members with high pay or decrease proportionally for members with lower pay.

Because we have no data on continuous service, we cannot estimate the impact of removing the continuous service requirement for all retirement eligibility. We believe the number of members affected is relatively small. If so, the cost should be modest and will hit the city's budget as higher future amortization payments as the actuarial gains that might have come from this source do not appear.

Our estimates use the data used for June 30, 2009 actuarial valuation, and except as noted below, the actuarial assumptions and methods are the same as those used in that valuation. Actual costs or savings will depend on the experience of the plan.

We have assumed the benefit changes would be reflected as an update to the June 30, 2009 valuation. Therefore, if the changes were adopted, the FY 2011 City contribution would be the first contribution to change.

The initial cost/savings equals the change in Normal Cost and a 20-year amortization of any changes in Unfunded Actuarial Liability, as required by Article 22 of the City Code.

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In the interest of time, the estimates shown in this letter only show the effect on the City's and State's contribution in the first year. Over the long term, the contribution requirement will change from the FY 2011 amount, perhaps significantly, based on the demographics of plan members, economic conditions and plan experience. However, regardless of whether the benefit changes described in this letter occur, in the absence of significant actuarial gains, we expect contributions will increase dramatically over the short term. This is because the actuarial value of assets, which is used to determine the annual contribution, was approximately \$812 million more than the market value of assets as of June 30, 2009. The most significant contributors to this difference are:

- 80% of the investment losses which occurred during FY2009, as well as about 64% of the investment loss which occurred during FY 2008, remain deferred as of June 30, 2009 due to the 5-year asset smoothing method,
- As of June 30, 2009, about \$199 million of the negative balances of the BIF & ERF remain to be recognized over the next 5 years.

If these items were recognized immediately (and with no other changes,) the City's contribution requirement would increase by approximately \$80 to \$85 million. Interested parties may wish to consider this potential upcoming increase when reviewing the estimated impact of Council Bill 10-0571 as well as when analyzing the System's near and long term funded status. A comprehensive solution to the System's current funded status might include a plan for dealing with the likely contribution increases; perhaps by accelerating recognition of past losses, either now or when the City's budget pressure begins to ease. Actuarial gains (e.g. lower-than-assumed pay increases) could ameliorate or actuarial losses (e.g., lower turnover) could exacerbate the projected trend of rapidly increasing contribution requirements. We have previously furnished illustrations of the pattern of these increases based on the pre-Ordinance 10-306 benefit provisions to the Trustees. We are available to prepare comparable projections for these proposed changes if requested.

Assumption Changes

Benefit liabilities under the proposed plan changes in this letter were calculated using an 8.00% investment return assumption for both pre-retirement and post-retirement, per Ordinance 10-306

Because retirement eligibility is delayed by Ordinance 10-306, retirement / employment patterns would be affected. Timing of retirement can significantly affect plan costs and we have no way to determine the actual rates of retirement under the proposed changes until

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we can observe experience with the provisions in place. Actual experience could be later or earlier (and therefore, everything else being equal, more or less costly) than that expected under any given set of assumed rates. This letter shows the results for one set of retirement assumptions, reflecting later retirement than the current assumptions. The age-based COLA and limited subsidy of early retirement under Ordinance 10-306 could make early retirements less expensive than under many public safety plans. The retirement assumption was not changed for grandfathered members. We anticipate using the assumptions shown herein for the FY2011 contribution if the proposed changes are incorporated.

The retirement rates used in this analysis for the non-grandfathered members are shown in the attached Exhibits 2B, 2C, 3 and 4. The effect on expected retirement ages for non-grandfathered members is shown below:

Weighted average anticipated retirement ages

Scenario*	Current Provisions (DROP eligible)		Current Provisions (DROP2 eligible)		Proposed Changes(non-grandfathered)	
	Fire	Police	Fire	Police	Fire	Police
Average assumed service retirement age	52.5	52.5	52.6	52.0	54.2	52.6

* For "grandfathered" members, or members who are eligible for service retirement benefits at the effective date of the change, the retirement assumption is the same as baseline. Therefore, the expected retirement age for these members is the same as the baseline assumptions.

The later retirement eligibility under the proposed provisions could also cause an increase in the disability claims, which could have a significant impact on contribution requirements. This letter shows results with no change in the rate of disability retirements. In a similar analysis we recently prepared for the City, we found that doubling the rate of disability assumption in the period from five years preceding the current eligibility for Normal Retirement to the new eligibility for Normal Retirement could increase annual contributions by \$4 to \$5 million. That calculation was only meant to demonstrate one possible scenario. The rate of disability could more than double or it could change less. That calculation was for Normal Retirement only at age 55 with 15 years of service. Adding Normal Retirement at 25 years regardless of age should reduce the potential additional cost for higher rates of disability.

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Exhibits 2A, 2B, and 2C show the retirement assumptions for unreduced retirement benefits (for members reaching the earlier of 1) age 55 with 15+ years of service, or 2) 25 years of service, regardless of age) with separate rates for firefighters and police. Exhibits 3 and 4 show the retirement assumptions for the reduced benefits for early retirement, with separate tables for firefighters and police.

We assumed that the number of active members on the date of the plan change would be the same as at July 1, 2009. We did not reflect any change to administrative costs as a result of the proposed changes.

Other Issues

As noted above, pension changes are likely to affect the timing of members' retirement. Changes in retirement timing typically also affect the cost of retiree medical benefits. Estimating that change in cost is beyond the scope of this letter.

Less generous retirement benefits, due to either later eligibility for retirement benefits or lower City-funded benefit amounts at retirement, could cause additional turnover or could result in members working longer than anticipated to reach the same level of benefits. We did not attempt to quantify the impact on savings caused by any changes in turnover.

On June 16, 2010, the Governmental Accounting Standards Board (GASB) issued preliminary views on pension accounting and financial reporting. While the final requirements and effective date are uncertain, we believe changes in the current GASB 27 requirements are likely. Based on the preliminary views, those changes are likely to increase (perhaps substantially) the amount the City will have to report as its Annual Required Contribution (ARC). While GASB has no authority to actually require higher contributions, only to make jurisdictions report what GASB believes is a fair representation of the annual cost of the plan, bond rating agencies could well pay attention to any gap between the ARC and the actual contribution. We will be happy to provide further information about the GASB preliminary views and their possible impact on the City's ARC and its reporting of pension obligations.

Any increase/decrease in Actuarial Accrued Liability worsens/improves the System's funded status. As you're aware, the funded status has been drawing attention. These proposed changes have only a small impact on the funded ratio.

This letter has been prepared for the Trustees to provide cost estimates for proposed changes in benefits. This letter may not be used or relied upon by any party other than the

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City and the Trustees or for any other purpose; Mercer is not responsible for the consequences of any such unauthorized use.

This letter includes or is derived from projections of future funding and/or accounting costs and/or benefit related results. To prepare these projections or results, various actuarial assumptions and methods, as described in this letter and in the 2009 actuarial valuation report, were used to project a limited number of scenarios from a range of possibilities. However, the future is uncertain, and the plan's actual experience will likely differ from the assumptions utilized and the scenarios presented; these differences may be significant or material. In addition, different assumptions or scenarios may also be within the reasonable range and results based on those assumptions would be different. This letter has been created for a limited purpose, is presented at a particular point in time and should not be viewed as a prediction of the plan's future financial condition.

This letter is based on participant data supplied by the Fire and Police Employees' Retirement System (this data customarily would not be verified by a plan's actuary) and on the plan documents, including amendments, supplied by the Fire and Police Employees' Retirement System. Mercer is not responsible for the validity, accuracy and comprehensiveness of this information; the results can be expected to differ and may need to be revised if the underlying data or the plan provisions supplied to us are incomplete or inaccurate.

The information contained in this document (including any attachments) is not intended by Mercer to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code that may be imposed on the taxpayer.

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Please let me know if you have any questions or need any further information. I can be reached at 410 347 2806. I am a member of the American Academy of Actuaries and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

Sincerely,

A handwritten signature in cursive script that reads "Douglas L. Rowe".

Douglas L. Rowe, FSA, MAAA, EA
Principal

Copy:
James Baughman, Mercer

Enclosure

Fire and Police Employees' Retirement System of the City of Baltimore
- Exhibit 1 for July 19, 2010 letter (CC 10-0571)
 Contribution Impact of Proposed Changes

Impact on FY2011 contributions

Results in \$millions	Proposed Change to DROP2 interest credits for grandfathered members
Plan Provisions Investment Return Assumption Grandfathering Criteria*	July 20, 2010 letter 8.00% 15 Years of Service
Normal Cost increase	\$ 0.3
Amortization of Unfunded Liability increase	\$ 0.4
Reduction due to CRF Transfer	\$ -
FY2011 City/State contribution increase	\$ 0.7
Funded Status (Actuarial Value of Assets basis) decrease	0.1%
Funded Status (Market Value of Assets basis)	0.1%

* Also includes members currently eligible for service retirement benefits due to age (age 50 and hired before 1/1/03)

Please note that the normal cost and amortization amounts shown include a year of interest to 7/1/2010.
 The State contribution shown would normally be contributed prior to FY2011.

This exhibit may only be used in conjunction with Mercer's July 20, 2010 letter.

Service Retirement Rates for Proposed Changes
-- Exhibit 2A for July 19, 2010 letter

Retirement rates for members & future members not participating in DROP or DROP2 (also grandfathered members under proposed changes)

Baseline

If 20 or more years of service, regardless of age

After age 50, if less than 20 years of service and retirement eligible

Years of Service	Rate*	After Reflecting DROP %**	Age	Rate*	After Reflecting DROP %**
20	60.00%	6.00%	50	6.40%	0.64%
21	22.50%	2.25%	51	4.60%	0.46%
22	22.50%	2.25%	52	4.60%	0.46%
23	29.30%	2.93%	53	4.70%	0.47%
24	33.80%	3.38%	54	5.90%	0.59%
25	33.80%	3.38%	55	7.30%	0.73%
26	33.80%	3.38%	56	6.90%	0.69%
27	33.80%	3.38%	57	6.90%	0.69%
28	33.80%	3.38%	58	6.90%	0.69%
29	33.80%	3.38%	59	13.90%	1.39%
30	33.80%	3.38%	60	21.20%	2.12%
31	33.80%	3.38%	61	17.20%	1.72%
32	33.80%	3.38%	62	25.50%	2.55%
33	33.80%	3.38%	63	25.50%	2.55%
34+	33.80%	3.38%	64	32.30%	3.23%
			65+	100.00%	100.00%

* before applying DROP/DROP2 participation assumption

** retirement rate after reflecting DROP/DROP2 participation assumption

Note:

Baseline rates also apply to grandfathered members under the proposed changes.

Service Retirement Rates for Proposed Changes

-- Exhibit 2B for July 19, 2010 letter

Service retirement rates for non-grandfathered members at the effective date of the change
 -- Service retirement eligibility would be postponed from age 50 or 20 years of service
 to the earlier of a) age 55 and 15 years of service, and b) 25 years of service regardless of age

The following rates have not been adjusted by DROP2 participation
 The following rates only apply to members with 25 or more years of service at retirement.

Firefighters

age	<u>at first eligibility*</u>		<u>after first eligibility*</u>	
	rate**	after reflecting DROP2%***	rate**	after reflecting DROP2%***
<55	60.00%	9.00%	50.00%	7.50%
55	60.00%	9.00%	50.00%	7.50%
56	60.00%	9.00%	50.00%	7.50%
57	60.00%	9.00%	50.00%	7.50%
58	60.00%	9.00%	50.00%	7.50%
59	60.00%	9.00%	50.00%	7.50%
60	60.00%	9.00%	50.00%	7.50%
61	60.00%	9.00%	50.00%	7.50%
62	60.00%	9.00%	50.00%	7.50%
63	60.00%	9.00%	50.00%	7.50%
64	60.00%	9.00%	50.00%	7.50%
65+	100.00%	100.00%	100.00%	100.00%

Police

age	<u>at first eligibility*</u>		<u>after first eligibility*</u>	
	rate**	after reflecting DROP2%***	rate**	after reflecting DROP2%***
<55	70.00%	17.50%	60.00%	15.00%
55	70.00%	17.50%	60.00%	15.00%
56	70.00%	17.50%	60.00%	15.00%
57	70.00%	17.50%	60.00%	15.00%
58	70.00%	17.50%	60.00%	15.00%
59	70.00%	17.50%	60.00%	15.00%
60	70.00%	17.50%	60.00%	15.00%
61	70.00%	17.50%	60.00%	15.00%
62	70.00%	17.50%	60.00%	15.00%
63	70.00%	17.50%	60.00%	15.00%
64	70.00%	17.50%	60.00%	15.00%
65+	100.00%	100.00%	100.00%	100.00%

* Eligibility for unreduced benefits

** Service retirement eligibility would be age 55 with 15 or more years of service, or 25 years of service regardless of age

*** Retirement rate after reflecting DROP/DROP2 participation assumption

Note:

Members reaching the "age/service" eligibility (age 55 with 15 or more years of service) but with less than 25 years of service are assumed to retire at the following rates:

Firefighters - 14%, Police - 16%

DROP2 Retirement Rates for Proposed Changes

-- Exhibit 2C for July 19, 2010 letter

*DROP2 participation assumption for non-grandfathered members (assumption for grandfathered members is unchanged from Baseline)
 -- DROP2 eligibility for non-grandfathered members would be postponed from 20 years of service to 25 years of service*

Participation %	Baseline		Proposed Changes	
	Fire	Police	Fire	Police
	90%	90%	85%	75%

Retirement rates for non-grandfathered participating in DROP2 (assumption for grandfathered members is unchanged from Baseline)

-- before applying the DROP2 participation assumption noted above

Years after eligibility/ election	Baseline		Proposed Changes	
	Fire	Police	Fire	Police
0	0.00%	0.00%	0.00%	0.00%
1	3.25%	4.75%	4.00%	6.00%
2	4.25%	5.75%	5.00%	7.00%
3	11.25%	12.75%	14.00%	16.00%
4	10.25%	11.75%	13.00%	15.00%
5	10.25%	11.75%	15.00%	18.00%
6	7.25%	9.00%	12.00%	14.00%
7	7.25%	26.00%	12.00%	36.00%
8	24.00%	26.00%	34.00%	36.00%
9	24.00%	26.00%	34.00%	36.00%
10	23.50%	26.50%	33.50%	36.50%
11	23.50%	26.50%	33.50%	36.50%
12	23.50%	26.50%	33.50%	36.50%
13	23.50%	26.50%	33.50%	36.50%
14+	23.00%	27.00%	33.00%	37.00%

-- after applying the DROP2 participation assumption noted above

Years after eligibility/ election	Baseline		Proposed Changes	
	Fire	Police	Fire	Police
0	0.00%	0.00%	0.00%	0.00%
1	2.93%	4.28%	3.40%	4.50%
2	3.83%	5.18%	4.25%	5.25%
3	10.13%	11.48%	11.90%	12.00%
4	9.23%	10.58%	11.05%	11.25%
5	9.23%	10.58%	12.75%	13.50%
6	6.53%	8.10%	10.20%	10.50%
7	6.53%	23.40%	10.20%	27.00%
8	21.60%	23.40%	28.90%	27.00%
9	21.60%	23.40%	28.90%	27.00%
10	21.15%	23.85%	28.48%	27.38%
11	21.15%	23.85%	28.48%	27.38%
12	21.15%	23.85%	28.48%	27.38%
13	21.15%	23.85%	28.48%	27.38%
14+	20.70%	24.30%	28.05%	27.75%

Notes:

Baseline rates also apply to grandfathered members under proposed changes

Early Retirement Rates for Proposed Changes
-- Exhibit 3 for July 19, 2010 letter

Early retirement rates for non-grandfathered members at the effective date of the change
 -- Firefighters

Age	Service													
	<10*	10	11	12	13	14	15	1	2	3	4	21-24	25+	
<45	<div style="border: 1px dashed black; padding: 5px; text-align: center;"> Members not yet eligible for early retirement </div>											3.00%	2.00%	
45												3.00%	3.00%	
46												3.00%	3.00%	
47												3.00%	3.00%	
48												3.00%	3.00%	
49	4.00%	4.00%												
50	3.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	
51	3.00%	6.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	
52	3.00%	6.00%	8.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	
53	3.00%	6.00%	8.00%	10.00%	12.00%	12.00%	12.00%	12.00%	12.00%	12.00%	12.00%	12.00%	12.00%	
54	3.00%	6.00%	8.00%	10.00%	12.00%	14.00%	14.00%	14.00%	14.00%	14.00%	14.00%	14.00%	14.00%	
55	4.50%	7.00%	9.50%	12.00%	14.50%	17.00%	<div style="border: 1px dashed black; padding: 5px; text-align: center;"> Members eligible for unreduced benefits </div>						6.00%	6.00%
56	5.00%	8.00%	11.00%	14.00%	17.00%	20.00%							6.00%	6.00%
57	5.00%	8.00%	11.00%	15.00%	19.00%	23.00%							8.00%	8.00%
58	5.00%	8.00%	14.00%	18.00%	22.00%	26.00%							10.00%	10.00%
59	5.00%	8.00%	15.00%	20.00%	25.00%	30.00%							12.00%	12.00%
60	5.00%	15.00%	20.00%	25.00%	30.00%	35.00%							14.00%	14.00%
61	10.00%	20.00%	25.00%	30.00%	35.00%	40.00%							14.00%	14.00%
62	15.00%	20.00%	25.00%	30.00%	35.00%	40.00%							14.00%	14.00%
63	15.00%	20.00%	25.00%	30.00%	35.00%	40.00%							14.00%	14.00%
64	15.00%	20.00%	25.00%	30.00%	35.00%	40.00%							14.00%	14.00%
65	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%						

* For members hired before January 1, 2003. Members hired on or after January 1, 2003 would need 10 or more years of service to retire

Early Retirement Rates for Proposed Changes
-- Exhibit 4 for July 19, 2010 letter

Early retirement rates for non-grandfathered members at the effective date of the change
 -- Police

Age	Service													
	<10*	10	11	12	13	14	15	1	2	3	4	21-24	25+	
<45	<div style="border: 1px dashed black; padding: 5px; text-align: center;"> Members not yet eligible for early retirement </div>											5.00%	4.00%	
45												5.00%	5.00%	
46												5.00%	5.00%	
47												5.00%	5.00%	
48												5.00%	5.00%	
49	6.00%	6.00%												
50	5.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	
51	5.00%	8.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	
52	5.00%	8.00%	10.00%	12.00%	12.00%	12.00%	12.00%	12.00%	12.00%	12.00%	12.00%	12.00%	12.00%	
53	5.00%	8.00%	10.00%	12.00%	14.00%	14.00%	14.00%	14.00%	14.00%	14.00%	14.00%	14.00%	14.00%	
54	5.00%	8.00%	10.00%	12.00%	14.00%	16.00%	16.00%	16.00%	16.00%	16.00%	16.00%	16.00%	16.00%	
55	5.00%	8.00%	11.00%	14.00%	17.00%	20.00%	<div style="border: 1px dashed black; padding: 5px; text-align: center;"> Members eligible for unreduced benefits </div>						8.00%	8.00%
56	7.00%	11.00%	15.00%	19.00%	23.00%	27.00%							8.00%	8.00%
57	10.00%	15.00%	20.00%	25.00%	30.00%	35.00%							10.00%	10.00%
58	15.00%	20.00%	25.00%	30.00%	35.00%	40.00%							12.00%	12.00%
59	20.00%	25.00%	30.00%	35.00%	40.00%	45.00%							14.00%	14.00%
60	25.00%	30.00%	35.00%	40.00%	45.00%	50.00%							16.00%	16.00%
61	30.00%	35.00%	40.00%	45.00%	50.00%	55.00%							18.00%	18.00%
62	35.00%	40.00%	45.00%	50.00%	55.00%	60.00%							20.00%	20.00%
63	35.00%	40.00%	45.00%	50.00%	55.00%	60.00%							22.00%	22.00%
64	35.00%	40.00%	45.00%	50.00%	55.00%	60.00%							24.00%	24.00%
65	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	26.00%	26.00%						

* For members hired before January 1, 2003. Members hired on or after January 1, 2003 would need 10 or more years of service to retire