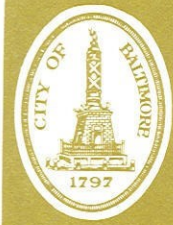


Thomas P. Taneyhill

FROM	NAME & TITLE	Thomas P. Taneyhill, Executive Director
	AGENCY NAME & ADDRESS	Fire and Police Employees' Retirement System 7 E. Redwood Street, 19 th Floor
	SUBJECT	City Council Bill 09-0348

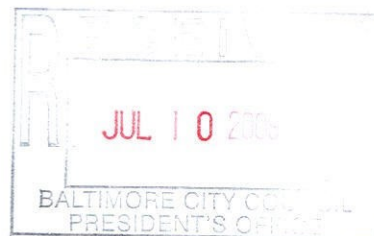
CITY of
BALTIMORE
MEMO



TO

DATE:
July 9, 2009

The Honorable President and Members
of the Baltimore City Council
Attn: Karen Randle, Executive Secretary
Room 409, City Hall
100 N. Holliday Street
Baltimore, Maryland 21202



Re: City Council Bill 09-0348 – Fire & Police Employees' Retirement System – Benefits – Post-Retirement Increases

Dear Madam President and City Council Members:

The purpose of City Council Bill 09-0348 is to amend provisions of the Fire and Police Employees' Retirement System (F&P) law by discontinuing the post-retirement increase provisions, eliminating a certain interest rate assumption, discontinuing certain accounting reserves related to the post-retirement increase provisions, guaranteeing already awarded post-retirement benefit increases, and providing for the examination of re-establishing post-retirement increase provisions for retired members and beneficiaries of the System.

At their meeting on Tuesday, June 16, 2009, the Board of Trustees of the Fire and Police Employees' Retirement System reviewed the proposed provisions of City Council Bill 09-0348. The Board approved that I advise the City Council that Bill 09-0348 is administratively workable.

Fiscal notes

Attached is the July 7, 2009 cost estimate for City Council Bill 09-0348 prepared by the System's actuary, Douglas L. Rowe of Mercer. Mr. Rowe estimates that due to the discontinuation of the current post-retirement increase provisions and the valuation of the current post-retirement benefit increase liabilities at a higher assumption rate, the City's contribution due to the F&P for fiscal year 2011 could be reduced by \$10.6 million.

Three important points must be mentioned regarding City Council Bill 09-0348 and the actuary's estimated contribution reduction:

- 1) The F&P is under-funded due to the dramatic downturn in economic conditions and the related financial markets over the past year and from

F/A

the “tech-bubble” meltdown in 2001. The F&P Board of Trustees will probably not want the City to reduce its contribution to the System. The Board may request additional contributions to improve the funded status of the System.

- 2) The Administration has expressed intent via Section 2 of City Council Bill 09-0348 to examine the feasibility of reestablishing a form of post-retirement benefit increases for retired members and beneficiaries of the F&P once the System attains and maintains an 85% funded ratio. If the contribution reduction is employed by the City and subsequently post-retirement increase provisions are reestablished that will make the contribution increase requirement to pay for new post-retirement increases seem all the more dramatic.
- 3) If City Council Bill 09-0348 is not passed and therefore the current post-retirement benefit increase provisions remain in effect, the F&P Board of Trustees will have no choice but to request an amendment to lower the System's post-retirement earnings assumption which will result in a \$61.5 million increase in the City's required contribution to the F&P. This cost increase is described in my attached March 18, 2009 report to the Council concerning City Council Bill 08-0220 (withdrawn from Council consideration) regarding F&P post-retirement increases.

The F&P Board of Trustees did not have the opportunity to examine the actuary's financial analysis at the same time that they reviewed this Council Bill for comment. After their review of the actuary's analysis at their July 21, 2009 meeting, the Board may have additional comments regarding this bill.

What City Council Bill 09-0348 proposes

City Council Bill 09-0348 proposes the following:

- Elimination of the regular interest credits to the Annuity Reserve and Pension Reserve. At the end of each fiscal year, the System credits “assumed” earnings of 7% to these two reserves utilized to account for retiree assets and liabilities. This function can be eliminated because when the actuary prepares the year end plan valuation report the two retiree reserves are rebalanced so that the reserves reflect estimated liabilities. The interest credit entry therefore is not required because of the actuarial rebalancing.
- Discontinuation of the existing post-retirement benefit increase provisions which are known as the “variable benefit increases.” The variable benefit provisions were summarized in my attached March 18, 2009 report to the Council on CC Bill 08-0220.

- Transfer of the assets accounted for in the two “variable benefit” reserves, the Paid-Up-Benefit Reserve and the Contingency Reserve, to the general asset account. According to the plan provisions, the variable benefit assets are accumulated and invested separately from the general plan assets. This was done because the variable benefit increases are not guaranteed by the City as are all other benefits earned by the members. Because the variable benefit increases are not guaranteed by the City, the F&P Board adopted a conservative investment policy by only investing the variable benefit assets in high quality fixed income securities. Transfer of the variable benefit assets to the general asset account will provide the potential for greater earnings as the Board may reallocate those variable benefit assets to invest in classes that have traditionally out-performed the fixed income markets. Keep in mind that even conservative fixed income securities are subject to the various risks of the investment markets.
- Transfer of the variable benefit liabilities in the Paid-Up-Benefit Reserve to the Pension Reserve, the general post-retirement liability account. It is appropriate to transfer the variable benefit liabilities to this reserve once the variable benefit increase liabilities are guaranteed by the City. See below.
- Discontinuation of the variable benefit reserves, the Paid-Up-Benefit Reserve and the Contingency Reserve. With the transfer of the variable benefit assets and liabilities to the general asset and liability accounts, the accounting reserves established for the variable benefit provisions will no longer be needed or utilized and can be eliminated.
- Guarantee of the already awarded variable benefit increases. The plan provisions provide that the benefits earned with the exception of the variable benefit provisions are guaranteed by the City. It is only fair to the retirees and beneficiaries that with the discontinuation of the existing post-retirement increase provisions that these liabilities would also be guaranteed by the City. This same guarantee has been adopted for the post-retirement increase liabilities of the Employees' Retirement System.
- Examination by the City of the feasibility of reestablishing post-retirement benefit provisions for the F&P retirees and beneficiaries once the System attains and maintains an 85% funded ratio based on the market value of assets for a minimum of three consecutive years. This provision allows the System time to recover from the recent downturn in the investment markets. It also affords the City administration time to examine the overall provisions of the F&P and to explore post-retirement increase provisions acceptable to both the City Administration and the F&P membership. It should be noted that according to the existing variable benefit provisions, F&P retirees and beneficiaries will not receive any increase in their retirement benefits in January 2010.

- If passed by the Council and signed by the Mayor, City Council Bill 09-0348 will become law on the 30th day after enactment.

Recommended amendment

On behalf of the Board of Trustees of the Fire and Police Employees' Retirement System, I request and recommend that the discontinuation date for the current post-retirement benefit increase provisions be changed from June 30, 2008 to June 30, 2009. This amendment will more closely align the discontinuation date with the possible bill passage date. It has no effect since F&P retirees and beneficiaries will not be due an increase in January 2010 under the present post-retirement increase provisions. The amendment is as follows:

On page 2, line 15 after "ending June 30," delete "2008" and insert "2009".

I will attend the City Council hearing to provide testimony on this bill. Please let me know if I can provide any additional information. I can be reached at 443-984-2800.

cc: Angela Gibson, Mayor's Legislative Liaison to the City Council
Board of Trustees of the Fire & Police Employees' Retirement System

Attachments: (3)

July 7, 2009 Analysis from Douglas L. Rowe, Actuary
Recommended amendment to CC Bill 09-0348
Report to the City Council regarding CC Bill 08-0220

MERCER

 MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Douglas L. Rowe

Principal

120 E Baltimore St., 20th Floor
Baltimore, MD 21202
410 727 3345 Fax 410 727 3347
douglas.rowe@mercer.com
www.mercer.com

July 7, 2009

Thomas P. Taneyhill, CPA
Executive Director
Fire and Police Employees' Retirement System
7 E. Redwood Street
19th Floor
Baltimore, MD 21202

Subject: Cost Estimate for City Council Bill 09-0348

Dear Tom:

As part of our work for the Fire and Police Employees' Retirement System, you requested we prepare estimated cost decreases to the City due to the proposed legislation. Below is a summary of the proposed changes to the current plan structure:

- Suspends future post-retirement benefit increases under the current variable benefits structure, effective June 30, 2008
- Provides no annual benefit increases to retirees
- Transfers assets from the Paid-up Benefit Fund and the Contingency Reserve Fund into the general asset account (Annuity Reserve Fund, Pension Accumulation Fund, Pension Reserve Fund, Annuity Savings Reserve), effective June 30, 2009
- Transfers post-retirement benefit liabilities from the Paid-up Benefit Fund to the Pension Reserve, effective June 30, 2009
- States the intention of the City to establish benefit increase provisions for benefit recipients once the System maintains a funded ratio of 85% for at least three consecutive years

Based on the asset information we were provided and estimated June 30, 2009 liabilities, the proposed legislation would result in a decrease to the City's contributions. The actual impact on the City's contribution will depend on final liability calculations.

The table below shows the estimated increase in Actuarial Accrued Liability and the City's annual contribution for the first year, rounded to the nearest thousand:

1. Estimated variable benefits actuarial accrued liability at July 1, 2009:	\$ 366,579,000
2. July 1, 2009 assets from the Paid-up Benefit Fund and the Contingency Reserve Fund:	469,092,000
3. Estimated decrease to unfunded actuarial accrued liability at July 1, 2009 (1) - (2):	(102,513,000)
4. 20-year amortization with interest to July 1, 2010:	(10,636,000)
5. Estimated change in normal cost at end of year:	0
6. Estimated contribution reduction for FY 2011 (4) + (5):	\$ (10,636,000)

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Page 2
July 7, 2009
Thomas P. Taneyhill, CPA
Fire and Police Employees' Retirement System

This is only an estimate; the actual cost of the proposed bill would be determined based on demographic and financial data as of June 30, 2009.

Our calculations are based on the following assumptions:

- The variable increase account would be invested in the same proportion of stocks and bonds as the General Asset Account and would not consist of segregated assets for investment purposes. If higher/lower investment returns are realized, this could lower/increase the cost of benefit changes.
- For purposes of this calculation, we have only reviewed the short-term implications of the proposed bill. A longer-term picture would require the analysis of multiple investment scenarios, which we can prepare at the City's request.
- This calculation does not take into account any future retiree benefit increases. The proposed bill states the City's intention to provide increases after the funded status of the plan is above 85%. Because the bill provides no guidance about the form or amount of increases at that time, we cannot provide any information about the impact on City contributions and have not attempted to do so. We would need to re-examine the cost of the proposal when benefit increases take effect.
- Benefit liabilities as of June 30, 2008 were rolled forward to June 30, 2009 using expected benefit payments and the assumed rate of return of 6.8%. Note that actual experience (retiree deaths) will differ and the July 1, 2009 liabilities will likely differ from the figure shown above. A difference in the liability will mean a change in the City's contribution savings from the amount shown above.
- Asset amounts as of June 30, 2009 for the Paid-up Benefits Fund and Contingency Reserve Fund were taken from your email dated July 2, 2009. If these amounts were to differ, the contribution savings would also change.
- Based on the information provided, the proposed plan change would first be reflected in the June 30, 2009 actuarial valuation. This, in turn, would impact the City's contribution for the fiscal year ending June 30, 2011.
- Except as noted earlier, all actuarial assumptions, methods, and plan provisions utilized in this analysis are the same as those used for the June 30, 2008 valuation report.

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.

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Page 3
July 7, 2009
Thomas P. Taneyhill, CPA
Fire and Police Employees' Retirement System

The undersigned credentialed actuary meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this analysis. Please give me a call if you have any questions.

Sincerely,

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

Douglas L. Rowe, FSA, MAAA, EA
Principal

g:\wp51\db\bziwas\cc 09-0348.doc

**FIRE & POLICE EMPLOYEES' RETIREMENT SYSTEM
BOARD OF TRUSTEES**

RECOMMENDED CHANGES TO CITY COUNCIL BILL 09-0348

Fire & Police Employees' Retirement System – Benefits
Post-Retirement Increases

On page 2, line 15 after “ending June 30,” delete “2008” and insert “2009”.

**FIRE & POLICE EMPLOYEES' RETIREMENT SYSTEM
BOARD OF TRUSTEES**

RECOMMENDED CHANGES TO CITY COUNCIL BILL 08-0220

**Fire & Police Employees' Retirement System – Benefits
Post-Retirement Increases**

On Page 6, lines 33-34, after "for the", delete "U.S. city average" and insert "Washington-Baltimore, DC-MD-VA-WV CMSA".

On page 6, line 34, after "items", delete "(1982 – 84= 100)" and insert "(November 1996= 100)".

On page 6, line 35, after "preceding" delete "June" and insert "May, or the closest comparable regional and periodic statistical data issued by the U.S. Bureau of Labor Statistics applicable to the annual variable increase being calculated."

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Douglas L. Rowe

Principal

120 E Baltimore St., 20th Floor
Baltimore, MD 21202
410 727 3345 Fax 410 727 3347
douglas.rowe@mercer.com
www.mercer.com

November 17, 2008

Mr. Thomas P. Taneyhill, CPA
Executive Director
Fire and Police Employees' Retirement System
7 E. Redwood Street
4th Floor
Baltimore, MD 21202

Subject: Cost Estimate of City Council Bill 08-0220

Dear Tom:

As requested, we have prepared estimated cost increases to the City due to the proposed legislation. Below is a summary of the proposed changes to the current plan structure:

- Modifies the post-retirement interest rate assumption from 6.80% to 7.75%
- Suspends future post-retirement benefit increases under the current variable benefits structure, effective June 30, 2008
- Transfers assets from the Paid-up Benefit Fund and the Contingency Reserve Fund into the general asset account (Annuity Reserve Fund, Pension Accumulation Fund, Pension Reserve Fund, Annuity Savings Reserve), effective June 30, 2009
- Transfers post-retirement benefit liabilities from the Paid-up Benefit Fund to the Pension Reserve, effective June 30, 2009
- Provides automatic annual benefit increases to retirees of 1.50% for retirees who have been retired for 2 or more years, effective January 1, 2010,
- Establishes the variable increase account to provide for benefit increases if cumulative investment returns in the ARF/PRF are over 8%, effective June 30, 2009
- Limits the combined automatic 1.50% increase and any increases from the variable increase account to the CPI-U
- Exempts retirees from Basic DROP from the 2-year wait requirement for benefit increases

While the proposed legislation would result in an immediate increase to the plan contributions, it is anticipated that over time this would result in cost savings. This is due to several factors:

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Page 2

November 17, 2008

Mr. Thomas P. Taneyhill, CPA

Fire and Police Employees' Retirement System

- The variable increase account would be invested in the same proportion of stocks and bonds as the General Asset Account and would not consist of segregated assets for investment purposes. The Paid-up Benefits Fund and Contingency Reserve Fund, which the variable increase account would be replacing, are invested primarily in fixed income securities and are anticipated to yield lower returns over the long-term. If higher investment returns are realized, this could lower the cost of benefit changes.
- The amount of funds to be used for variable benefit increases would also be limited to 20% of returns over 8% as opposed to 100% of returns between 7.5% and 10% and 50% of returns over 10%. There is also a 4-year phase-in period for the 20% limit. The limit is 5% as of June 30, 2009 and increases by 5% per year until it reaches the ultimate limit of 20% as of June 30, 2012.
- Benefit increases due to the proposed variable increase account would also be smoothed such that the availability for benefit increases is based on accumulated investment returns beginning June 30, 2009 through each subsequent year. Under the current variable benefits structure, benefit increases are based on the investment return for each year.
- Annual benefit increases would also be limited by the CPI-U. The current variable structure does not have a limit on benefit increases.

While we anticipate that the proposed bill would reduce City contributions over time, the initial impact is a contribution increase. The table below shows the estimated increase in Actuarial Accrued Liability and the City's annual contribution for the first year, rounded to the nearest thousand:

1. Estimated increase to actuarial accrued liability at July 1, 2008:	\$ 48,000,000
2. 20-year amortization at end of year:	4,900,000
3. Estimated increase to normal cost at end of year:	2,800,000
4. Estimated additional contribution for FY 2010 (2) + (3):	\$ 7,700,000

The ongoing cost of the proposed structure is based on the increase to the normal cost (\$2.8M), which is anticipated to grow as a percentage of active payroll assuming that other population demographics are consistent from year to year. Under the F&P's current funding method, the amortization component of the additional contribution would decrease over time.

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Page 3
November 17, 2008
Mr. Thomas P. Taneyhill, CPA
Fire and Police Employees' Retirement System

The guaranteed annual increase that could be provided with no current increase in City contributions is 1.27%.

The actual cost of the proposed bill would be determined based on demographic and financial data as of June 30, 2009.

Our calculations are based on the following:

- For purposes of this calculation we have only reviewed the short-term implications of the proposed bill. A longer-term picture would require the analysis of multiple investment scenarios, which we can prepare at the City's request.
- We assumed that the CPI limit would have no impact on benefit increases
- Benefit liabilities were calculated as of June 30, 2008.
- Assets as of June 30, 2008, but reflecting investment losses in the Paid-up Benefits Fund and Contingency Reserve Fund between June 30, 2008 and September 30, 2008.
- Based on the information provided, the proposed plan change would probably first be reflected in the June 30, 2009 actuarial valuation. This, in turn, would impact the City's contribution for the fiscal year ending June 30, 2011.
- Except as noted earlier, all actuarial assumptions, methods, and plan provisions utilized in this analysis are the same as those used for the June 30, 2008 valuation report.

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.

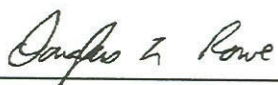

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Page 4
November 17, 2008
Mr. Thomas P. Taneyhill, CPA
Fire and Police Employees' Retirement System

Collectively, the undersigned credentialed actuaries meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this analysis. Please give us a call if you have any questions.

 <hr/>	November 17, 2008 <hr/>
Douglas L. Rowe, FSA, MAAA, EA	Date
 <hr/>	November 17, 2008 <hr/>
James Baughman, ASA, EA	Date
 Mercer 120 E. Baltimore Street 20th Floor Baltimore, MD 21202 410 727 3345 Mercer 1255 23rd Street, NW Suite 500 Washington, DC 20037 202 331 5200	

Fire and Police Employees' Retirement System
Variable Benefit Increase Comparison to Social Security Increase and CPI-U Increase

Fiscal Year	Investment Income	Variable Benefit Increase	Social Security Increase	CPI-U Increase
1983	41.6%	1% to 20% * plus 9.66%	3.5%	2.58%
1984	0.0	0.00	3.5	4.22
1985	26.8	10.39	3.1	3.76
1986	24.8	8.67	1.3	1.77
1987	12.9	3.38	4.2	3.65
1988	(0.1)	0.00	4.0	3.69
1989	16.1	4.81	4.7	5.17
1990	10.9	2.21	5.4	4.67
1991	7.4	0.00	3.7	4.70
1992	13.0	3.44	3.0	3.09
1993	12.6	3.43	2.6	3.00
1994	2.2	0.00	2.8	2.49
1995	16.1	4.86	2.6	3.04
1996	17.6	5.71	2.9	2.75
1997	22.0	7.33	2.1	2.30
1998	21.0	6.33	1.3	1.68
1999	11.0	1.75	2.5	1.96
2000	7.5	0.00	3.5	3.73
2001	(6.7)	0.00	2.6	3.25
2002	(8.6)	0.00	1.4	1.07
2003	(0.1)	0.00	2.1	2.11
2004	16.3	4.05	2.7	3.27
2005	11.6	2.20	4.1	2.53
2006	12.0	2.60	3.3	4.32
2007	19.4	5.34	2.3	2.69
2008	(7.5)	0.00	5.8	5.02

Investment income is the return percentage for the Variable Benefit increase calculation presented in the actuarial valuation report.

The variable benefit increase percentage is paid beginning in the January following the June 30 fiscal year.

The Social Security increase percentage is from the Social Security Cost-of-Living Adjustment Schedule.

The CPI-U percentage increase is calculated from June to June and is from the U.S. Department of Labor, Consumer Price Index, All Urban Consumers Schedule.

FIRE AND POLICE EMPLOYEES' RETIREMENT SYSTEM

**POST RETIREMENT BENEFIT INCREASES
"VARIABLE BENEFITS INCREASES"**

AVERAGE INCREASES DETERMINED AS OF JUNE 30, 2008

<u>Number of Average Years</u>	<u>Average Variable Benefit Increase</u>	<u>Average Social Security Increase</u>	<u>Average CPI-U Increase</u>
Since inception	3.35% - 4.08%	3.0%	3.17%
25	3.06%	3.1%	3.20%
20	2.70%	3.1%	3.14%
15	2.68%	2.8%	2.81%
10	1.59%	3.0%	3.00%
7	2.03%	3.1%	3.00%
5	2.84%	3.6%	3.57%
3	2.65%	3.8%	4.01%
1	0.00%	5.8%	5.02%

FIRE AND POLICE EMPLOYEES' RETIREMENT SYSTEM

**POST RETIREMENT BENEFIT INCREASES
"VARIABLE BENEFITS INCREASES"**

**AVERAGE INCREASES AS OF JUNE 30, 2009 IF INVESTMENT EARNINGS
ARE BELOW 7.5% UTILIZING CURRENT VARIABLE BENEFIT PROVISIONS**

<u>Number of Average Years</u>	<u>Average Variable Benefit Increase</u>
Since inception	3.35% - 4.08%
25	3.06%
20	2.46%
15	2.68%
10	1.42%
7	2.03%
5	2.03%
3	1.78%
1	0.00%

FIRE AND POLICE EMPLOYEES' RETIREMENT SYSTEM

**POST RETIREMENT BENEFIT INCREASES
"VARIABLE BENEFITS INCREASES"**

**AVERAGE INCREASES IF INVESTMENT EARNINGS
ARE BELOW 7.5% THROUGH JUNE 30, 2011**

<u>Number of Average Years</u>	<u>Average Variable Benefit Increase</u>
Since inception	3.35% - 4.08%
25	2.30%
20	2.35%
15	1.97%
10	1.42%
7	1.45%
5	1.07%
3	0.00%
1	0.00%