AGENA
FA

Presentation to the Arlington County Board on the The Cash Balance Alternative and Other Retirement Issues

Arlington General Employees Association
November 4, 2011

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Key Retirement Issues

Three proposed Code changes coming before County Board:

1. In November: To let Manager's actuary assess impact of benefit changes for the Board.

2. Also November: To authorize a MAP (senior management) New Hire Defined Contribution (DC) plan.

3. Sometime later: To approve the structure & scope of alternative plan (if Manager agrees to Board review).
   - Manager now says only a DC plan is acceptable.
   - AGENA & others prefer Cash Balance option.

ACTUARY & MAP NEW HIRE OPTION

1. Actuary Issue

- Currently, ACERS actuary prepares impact analysis before Board votes.
  - Is independent; has fiduciary duty to protect pension.
  - Provides true "checks and balances" **before** Code change made.
  - Good governance approach used by VA General Assembly and others.
- Manager wants to use HR's paid consultant.
  - Has no fiduciary duty to plan.
  - Past analyses misleading—simply "assumed" outcome HR asked for.
  - Manager's alternate "checks and balances"—ACERS actuary assesses impact **after** the Code change already is in effect—is too little too late.

2. MAP New Hire DC Plan (re-adoption)

- Trying to work out solution with HR before hand
- Concerns:
  - Doesn't say what the plan will look like.
  - Doesn't require County Board approval of plan itself.
  - Prejudges structure of new DC-like option before Retirement Sustainability Workgroup has acted.

3. CASH BALANCE OPTION

Background

- In June 2011, Manager formed Retirement Sustainability Workgroup (RSW) to develop alternates to traditional pension (Defined Benefit, or DB). Goal: increase portability and competitiveness.
- RSW advised at first meeting that it could look at any structure, not just DCs.
- Due to concerns with DCs, the RSW asked AGENA to suggest alternative plan. AGENA proposed a "Cash Balance" (CB) option. This structure
  - Wraps a DC plan inside the existing DB.
  - Follows an approach widely used in private sector; 33% of DBs use Cash Balance approach.
- Many RSW members expressed interest in Cash Balance plan and asked for an actuarial review .
- On October 25, 2011—before Workgroup could vote on this action—RSW was informed that the Manager
  - Had already decided to pursue more "commonplace" DC plan structure.
  - Was unwilling to have the actuary or County Board consider AGENA's Cash Balance alternative.

Why the Board Should Ask the Manager to Reconsider

- The Manager's decision unfairly
  - Dismisses AGENA's proposal before the actuary can compare its costs and benefits with a DC, depriving all parties of valuable information.
  - Preempts RSW's role in developing alternatives.
  - Ignores an option that is far superior—and safer—for workers and the Defined Benefit plan alike.

How Cash Balance Option Works

- Worker get the same economic benefit as a DC, but ACERS handles investments.
- Worker's DB individual account credited with DC component:
  - 4% employee contribution
  - 4.2%-6% employer contribution (varies by years of service).
  - Investment return (fixed or variable, e.g., linked to ACERS' own return).
- When worker leaves he has choice of taking:
  - A lump sum distribution of the individual account.
  - The 1.7% multiplier annuity benefit.

Cash Balance Cost Savings Mirror a DC

- Contribution costs for workers taking a 6% CB option are the same as for a 6% DC.
- Cost savings are the same as well:
  - Cost per year of service (YOS) if worker takes Cash Balance: 6.0%
  - Cost per YOS if worker takes the DB (14.6% normal cost + 4.2% 401(a)) 18.8%.
  - Savings per YOS to the County 12.8%
- However, wouldn't need to pay separate disability coverage as do with DC.

Cash Balance Advantages over DC

- The best of both worlds: portability like a DC & lifetime retirement income like a DB.
- Not risk free, but better than a DC
  - Neither DCs nor CBs provide adequate retirement income for long term workers.
    - Milliman projections show they **provide about 1/3 of DB benefit** for long term workers.
    - Only short term younger workers (< 5 years) fare well with DC-like structures.
  - County is considering making its DC richer to close gap with DB and protect workers who made "mistake" in choosing DC when they are hired.
  - Yet to match DB, County would **need to contribute over 22% per worker**. See Attachment 1.
  - Since Cash Balance option remains part of DB, it avoids inadequacy and mistaken choice problems.
- Better for workers
  - Don't have to forfeit the DB benefit to get the portable option; both available.
  - No-worries investment approach; handled by ACERS professionals.
  - Risk of loss reduced because ACERS outperforms DCs.
- Better for the current DB plan
  - Savings stay within the DB. This helps reduce the average cost for the all DB workers.
  - By contrast, the **DC option raises the DB costs on a per worker basis.**
    - Workers who opt-out of DB no longer are charged with new hires' share of certain pension costs (e.g., for benefit changes and bear markets). These costs get shifted to remaining DB workers.
    - DC options also can create new DB costs due to loss of new hires. See Attachment 2.

Conclusion

- The County has stated it is committed to sustaining the Defined Benefit plan long term.
- Why, then, adopt a DC plan?
  - Will force County to contribute a higher and higher % of salary for each remaining DB worker.
  - By contrast, DC costs will remain flat.
  - This increasing disparity could prompt future leaders to scale back the DB plan.
  - HR staff acknowledged that if DB costs increase, "changes to the DB might be needed."
- The Cash Balance option protects workers and the DB, yet adds the portability that the County seeks.
- It should be reviewed by the actuary, and then presented to the County Board.

Attachment 1

Should Arlington Try to Provide Adequate Retirement Income in a DC-like Alternative?

- **Policy answer: No**
  - Existing DB offers that. Its features—lifetime income & inflation protection—are far superior to DCs & CBs.
  - Don't want to provide incentive for workers to gamble on their retirement if they need retirement security.
- **Financial answer: No**
  - **Milliman actuarial projections** show DC will provide about 1/3 of DB benefit for 30 years service.
  - **Reason? You get what you pay for.**
    - DC can only provide a benefit equal to current system if at least the same % contribution goes in.
    - DC actually needs more, because DCs have lower investment returns than DBs
      - New NIRS/Milliman study finds investment gaps ranging from1.0% to 2.7%
  - **What Current Benefit Costs Employer (FY 2012):**

DB Normal Cost (General):	14.6%
401(a)	4.2%
Total	18.8%

  - **Estimated Contribution to Cover 1 % Investment Gap:**

On Normal Cost:	2.7%
On 401(a)	0
On Employee 4% Contribution	.7%
Total	3.4%

  - **Total Estimated DC Employer Contribution Needed to Provide Equivalent Benefit: 22.2%**

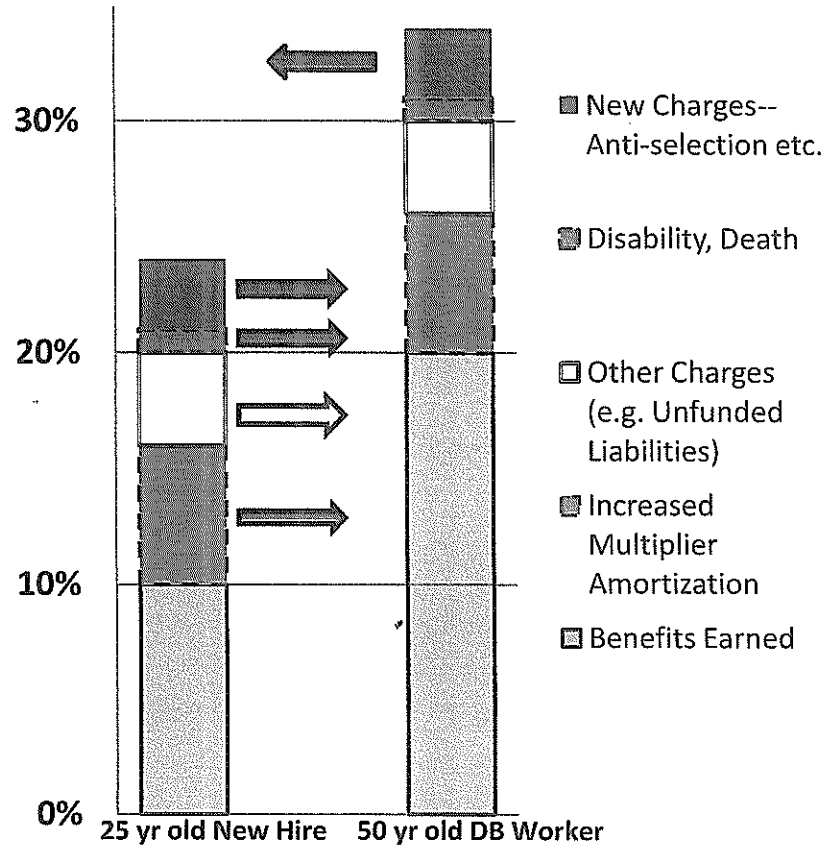
Attachment 2

How a DC Option Increases DB Per Employee Costs

- Pension costs are determined as a percentage of salary per employee. The yearly cost is a blend of
  - **Normal costs**, for benefits projected to be earned by each worker. These are higher for older workers.*
  - **Amortization charges** for non-worker specific costs, which are spread out over many years. These are allocated among all workers.
- **Normal costs for new hires disappear when they opt out of the DB. Amortization charges do not. They are shifted to remaining workers.**
- Arlington currently amortizes charges for:
  - **Retroactive benefit increases**. Charge started at about 6% per employee (2009).
  - **Unfunded liabilities** due to investment losses, etc. (ACERS will be 89% funded in 2013).
  - **Changes in actuarial assumptions** such as lowering expected investment return.
- **New amortization charges** could be created, due to few new hires & anti-selection.
- **Supplemental charges** also arise for disability & death insurance for DC.
- **The result: DB gets more expensive on per worker basis. The increase grows cumulatively each year.**

*Actuaries can use funding methods to smooth out the cost differences for workers as they age.

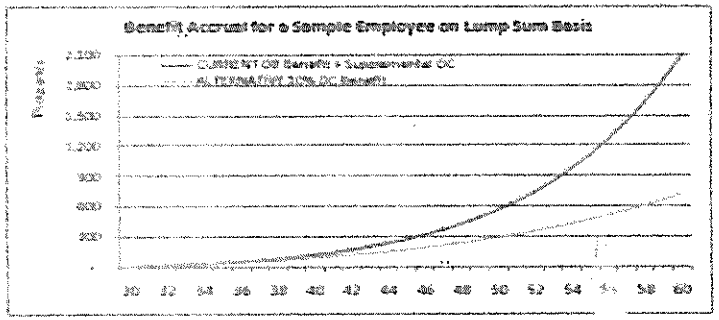
DB Costs No Longer Paid by New Hires Choosing DC, or Caused by Their Exit from DB Pool**



**Note: Chart numbers are rough estimates for illustration.

Milliman, Inc. Comparison of Arlington County Current Benefit Structure with a 10% Defined Contribution Plan
Percentage Value Replaced by DC

Employee Profile: New Hire, Age 30; Discount Rate: 4.0%; Starting Salary: $55,000



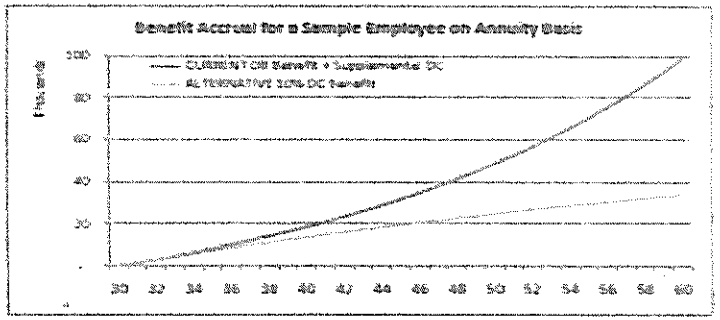


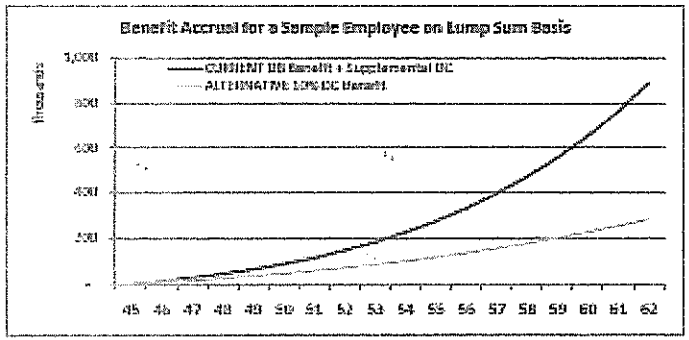
Illustration: Benefit accrual for a sample employee (lump sum basis)

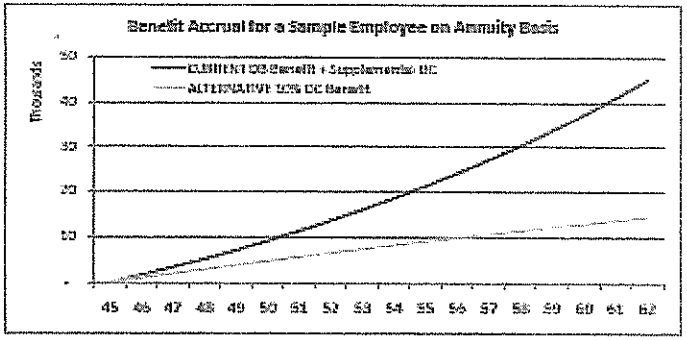
Age	CURRENT DB Benefit + Supplemental DC (present value)	ALTERNATIVE 10% DC Benefit (account balance)	% of DB replaced by DC
30	-	-	
31	5,674	5,500	97%
32	12,146	11,564	95%
33	19,733	18,235	92%
34	28,529	25,562	90%
35	38,680	33,594	87%
36	50,323	42,325	84%
37	63,540	51,993	81%
38	79,285	62,480	79%
39	96,823	73,912	76%
40	117,231	86,360	74%
41	140,364	99,899	71%
42	166,760	114,610	69%
43	196,846	130,578	66%
44	231,120	147,898	64%
45	270,064	166,665	62%
46	314,344	186,987	59%
47	364,624	208,975	57%
48	421,675	232,750	55%
49	486,361	258,438	53%
50	559,655	286,175	51%
51	642,693	316,126	49%
52	736,582	348,406	47%
53	842,825	383,216	45%
54	962,939	420,723	44%
55	1,098,654	461,117	42%
56	1,251,940	504,598	40%
57	1,424,991	551,384	39%
58	1,620,275	601,704	37%
59	1,840,560	655,804	36%
60	2,088,953	713,944	34%

Illustration: Benefit accrual for a sample employee (annuity basis)

Age	CURRENT DB Benefit + Supplemental DC (annual benefit at age 60)	ALTERNATIVE 10% DC Benefit (annuity with COLA at age 60)	% of DB replaced by DC
30	-	-	
31	1,548	1,501	97%
32	3,120	2,970	95%
33	4,770	4,408	92%
34	6,490	5,816	90%
35	8,283	7,193	87%
36	10,154	8,542	84%
37	12,109	9,862	81%
38	14,154	11,154	79%
39	16,295	12,419	76%
40	18,539	13,657	74%
41	20,891	14,868	71%
42	23,360	16,055	69%
43	25,952	17,219	66%
44	28,676	18,332	64%
45	31,540	19,464	62%
46	34,551	20,553	59%
47	37,720	21,619	57%
48	41,056	22,662	55%
49	44,569	23,683	53%
50	48,269	24,682	51%
51	52,167	25,660	49%
52	56,274	26,618	47%
53	60,603	27,555	45%
54	65,167	28,472	44%
55	69,973	29,370	42%
56	75,051	30,249	40%
57	80,400	31,110	39%
58	86,040	31,952	37%
59	91,985	32,776	36%
60	98,262	33,583	34%

Employee Profile: New Hire, Age 45; Discount Rate: 4.0%; Starting Salary: $75,000





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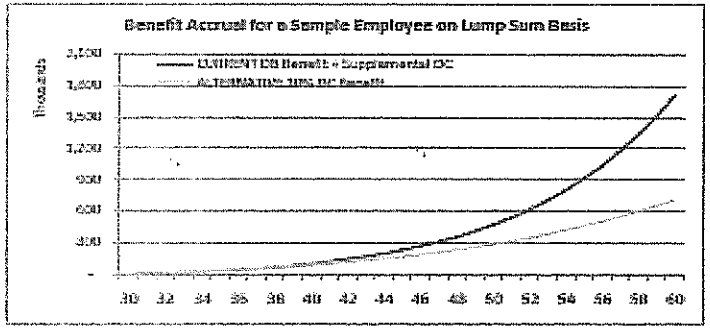
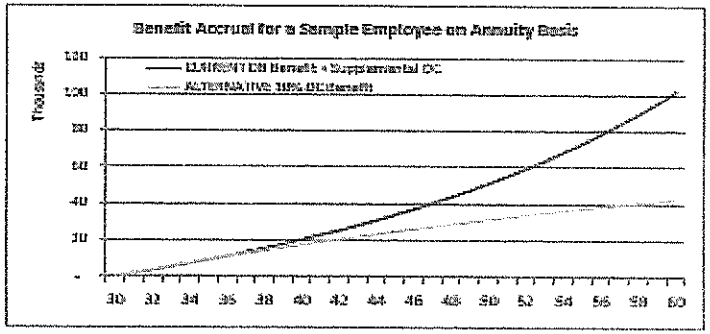
45	-	-	
46	12,505	7,530	60%
47	26,910	15,769	59%
48	44,087	24,966	56%
49	64,208	34,857	54%
50	87,706	45,809	52%
51	115,060	57,797	50%
52	146,815	70,980	48%
53	183,596	85,200	46%
54	226,868	100,730	45%
55	275,843	117,754	43%
56	331,416	136,225	41%
57	396,177	156,285	39%
58	470,466	178,062	38%
59	555,364	201,678	36%
60	652,918	227,271	35%
61	764,157	254,982	33%
62	891,120	284,966	32%

Illustration: Benefit accrual for a sample employee (annuity basis)

Age	CURRENT DB Benefit + Supplemental DC (annual benefit at age 62)	ALTERNATIVE 10% DC Benefit (annuity with COLA at age 62)	% of DB replaced by DC
45	-	-	
46	1,670	1,002	60%
47	3,382	1,982	59%
48	5,216	2,942	56%
49	7,149	3,881	54%
50	9,191	4,800	52%
51	11,348	5,700	50%
52	13,628	6,581	48%
53	16,039	7,444	46%
54	18,589	8,288	45%
55	21,286	9,114	43%
56	24,140	9,922	41%
57	27,159	10,714	39%
58	30,355	11,489	38%
59	33,737	12,247	36%
60	37,316	12,989	35%
61	41,105	13,715	33%
62	45,115	14,427	32%

Employee Profile: New Hire, Age 30; Discount Rate: 6.0%; Starting Salary: $55,000





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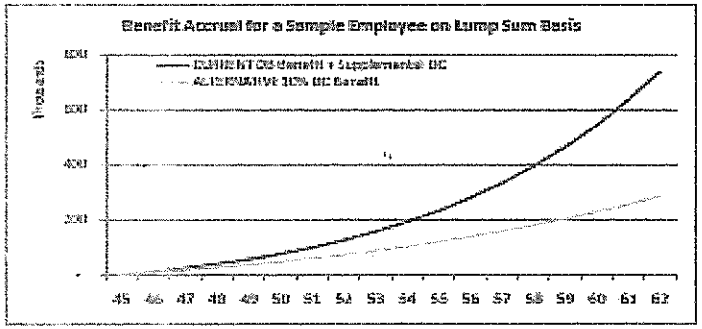
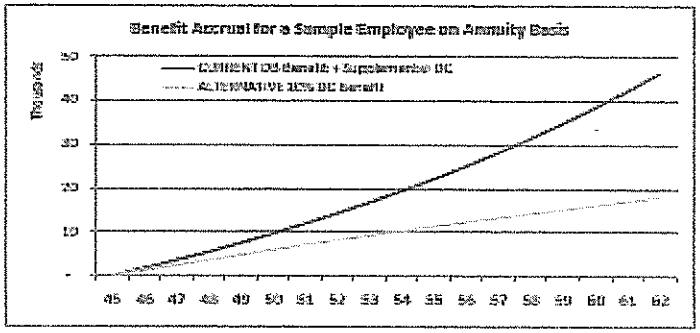
Age	CURRENT DB Benefit + Supplemental DC (present value)	ALTERNATIVE 10% DC Benefit (account balance)	% of DB replaced by DC
30	-	-	
31	4,934	5,500	110%
32	10,650	11,364	106%
33	17,255	18,235	106%
34	24,874	25,362	103%
35	33,638	33,554	100%
36	43,696	42,385	97%
37	55,220	51,853	94%
38	68,399	62,480	91%
39	83,450	73,942	89%
40	100,615	86,360	86%
41	120,168	99,899	83%
42	142,415	114,610	80%
43	167,703	130,578	78%
44	196,420	147,896	75%
45	229,805	166,665	73%
46	265,949	186,967	70%
47	307,806	208,975	68%
48	355,197	232,750	66%
49	408,822	258,436	63%
50	469,465	286,178	61%
51	538,018	316,116	59%
52	615,445	348,406	57%
53	703,885	383,216	55%
54	801,577	420,723	52%
55	912,924	461,117	51%
56	1,038,500	504,556	48%
57	1,180,069	553,384	47%
58	1,339,612	603,704	45%
59	1,519,351	655,604	43%
60	1,721,779	713,544	41%

Illustration: Benefit accrual for a sample employee (annuity basis)

Age	CURRENT DB Benefit + Supplemental DC (annual benefit at age 60)	ALTERNATIVE 10% DC Benefit (annuity with COLA at age 60)	% of DB replaced by DC
30	-	-	
31	1,711	1,888	110%
32	3,442	3,737	109%
33	5,248	5,545	106%
34	7,121	7,317	103%
35	9,063	9,051	100%
36	11,080	10,748	97%
37	13,179	12,409	94%
38	15,364	14,084	91%
39	17,642	15,825	89%
40	20,020	17,188	86%
41	22,504	18,708	83%
42	25,101	20,200	80%
43	27,819	21,661	78%
44	30,666	23,091	75%
45	33,651	24,490	73%
46	36,780	25,860	70%
47	40,065	27,201	68%
48	43,514	28,513	66%
49	47,137	29,798	63%
50	50,946	31,056	61%
51	54,949	32,285	59%
52	59,161	33,491	57%
53	63,592	34,670	55%
54	68,255	35,825	52%
55	73,163	36,955	51%
56	78,331	38,061	49%
57	83,774	39,143	47%
58	89,506	40,203	45%
59	95,543	41,240	43%
60	101,904	42,255	41%

Employee Profile: New Hire, Age 45; Discount Rate: 6.0%; Starting Salary: $75,000





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45	-	-	
46	10,889	7,500	70%
47	22,570	15,769	69%
48	37,354	24,865	66%
49	54,382	34,857	64%
50	74,410	45,809	62%
51	97,430	57,797	59%
52	124,087	70,800	57%
53	154,883	85,200	55%
54	190,386	103,790	55%
55	231,233	117,754	51%
56	278,167	136,226	49%
57	331,987	156,286	47%
58	393,626	178,062	45%
59	464,124	201,678	43%
60	544,659	227,271	42%
61	636,556	254,982	40%
62	741,309	284,966	38%

Illustration: Benefit accrual for a sample employee (annuity basis)

Age	CURRENT DB Benefit + Supplemental DC (annual benefit at age 62)	ALTERNATIVE 10% DC Benefit (annuity with COLA at age 62)	% of DB replaced by DC
45	-	-	
46	1,772	1,243	70%
47	3,383	2,460	69%
48	5,313	3,651	66%
49	7,542	4,836	64%
50	9,677	5,937	62%
51	11,925	7,074	59%
52	14,285	8,167	57%
53	16,793	9,238	55%
54	19,428	10,383	53%
55	22,208	11,330	51%
56	25,144	12,334	49%
57	28,244	13,256	47%
58	31,518	14,257	45%
59	34,975	15,199	43%
60	38,631	16,120	42%
61	42,493	17,021	40%
62	46,575	17,804	38%

Benefit Illustrations for AGENA

Assumptions

Overall

Valuation Date: January 1, 2011

Assumed Retirement Age: 62 or after 30 years of service, if earlier

Salary Increase Rate: 4.0%

Current Defined Benefit Plan

Discount Rate: 4.0% (recommended) and 6.0% (alternate)

Cost-of-Living Rate: 3.5%

Alternative Defined Contribution Plan

Employee Contribution Rate: 4.0%

Employer Contribution Rate: 6.0%

Investment Return Rate: 6.25%

Annuity Conversion Rate: 4.0% (recommended) and 6.0% (alternate) with a 3.5% post-retirement cost of living adjustment

Benefit provisions reflect current Arlington Code unless otherwise specified.