

CITY OF KNOXVILLE PENSION QUESTIONS AND ANSWERS

Let's start with some pension basics: What are Defined Benefits and Defined Contributions?

A Defined Benefit pension plan is one in which an eligible employee is promised a set amount of money (usually a percentage of salary), typically payable in monthly checks from their retirement date until death. There is no maximum total amount; as long as the retiree is alive, they can continue to collect. A Defined Contribution plan is one in which an employee and/or employer contribute a set amount of money (usually a percentage of salary) during each pay period for as long as the employee is employed. The money is usually invested in stocks or bonds, and the employee can withdraw it upon retirement. (This is familiar in the private sector as a 401(k) plan.) There is no guaranteed set payment under a defined contribution plan. The employee's retirement funds come from the accumulated gains or losses of the money invested in his or her account.

What are the risks of Defined Benefit and Defined Contribution plans?

Risks in all retirement plans are based on the market performance of investments. In Defined Benefit plans, that risk lies mostly with the employer, because if the investments underperform, the employer has to pay extra money into the fund to cover the guaranteed benefits. In Defined Contribution plans, the market risk is with the employee.

What are the City's current pension plans?

There are two current pension plans. (About half of current retirees are covered under older plans that have since closed, including 963 former teachers in the old City of Knoxville school system.)

- Plan C covers uniformed employees of the Knoxville Police Department and Knoxville Fire Department. It is a Defined Benefits plan, with employees contributing 6 percent of their paychecks. With a full 30 years of service, retirees can collect up to 75 percent of their monthly salary (averaged from their two top-earning years). As of April 2012, there were 703 active employees on this plan, and 537 retirees and beneficiaries.
- Plan G is the general city plan for all other employees. It has two parts. All new employees start out on Option 1, which is a half-and-half mix of Defined Benefits and Defined Contributions. Employees contribute 6 percent of their paycheck, with half going into a Defined Contribution fund matched by the city, and half toward a Defined Benefits pension fund. After 10 years on Option 1, employees can choose to switch to Option 2, which is a full Defined Benefits plan. Its benefits are calculated at a lower percentage of salary than Plan C. As of April 2012, there were 736 active employees on this plan, and 335 retirees. Employees are eligible to collect retirement benefits at the age of 62 or when age plus years of service = 80 (this is known as the Rule of 80).

- Both plans have a built in Cost of Living Adjustment (COLA) for retirement benefits that ranges between 3 and 4 percent each year and a Delayed Option Retirement Plan (DROP) that allows the employee to retire early with certain benefits.

How long does an employee have to work for the City to become vested in a pension plan?

Five years, under the current plans.

How were the pension plans created? How can they be changed?

The pension plans were created as part of the City's charter. They can be changed only by a ballot referendum approved by City voters. The most recent changes to the pension plans were approved by voters in 1996, 1998, and 2000.

How much do the pension plans cost the City?

Since 2002, the City has been making annual payments from the general fund to cover unfunded liabilities in the pension fund. These payments increased significantly after the financial crisis that began in 2008, because of a drop in the value of the pension fund assets. The estimated payment for 2012-13 is \$14.4 million, about 8 percent of the general fund. That is currently projected to rise to \$20 million in 2013-14, and \$30 million by 2021.

What can the City do about those rising costs over the next 10 to 20 years?

Very little. Those estimated costs are based on the pensions of people already retired or vested in the City's current plans. Under state Supreme Court precedent (the *Blackwell* case, 1981) and a ruling from the state Attorney General, benefits cannot be reduced for people who are already vested in a plan. The City is contractually obligated to pay the pensions of people already in the system.

What can the City do about costs for future employees?

Any changes to the pension system for future employees would have to be approved by Knoxville voters in a ballot referendum.