

## MEMORANDUM

TO: Denise Moretz/Bob Cross  
City of Knoxville Pension Task Force Committee

FROM: Jim Wansley

SUBJECT: Thoughts/Recommendations on Knoxville Pension Systems

DATE: December 14, 2011

### Personal thoughts and reflections:

These are my personal thoughts and reflections regarding the current pension systems of the City of Knoxville, and they do not necessarily the view of other committee members.

### Charge to the Committee:

As a committee, we have been asked to "...review, analyze and evaluate the sustainability of the current City Pension System, and, if necessary, to offer advice and recommendations to City Council pertaining to maintaining or enhancing the long-term viability and sustainability of that system".

The City of Knoxville has an obligation both to current and former employees of the City and to city residents and taxpayers to operate and maintain an appropriate and sustainable pension system and plan. In fact, both the words "viable" and "sustainable" appear in the charge to the task force. To some extent there is a natural tension between these above two groups, and it is incumbent on the City to design and maintain an appropriate pension plan, as part of the employees' total compensation plan, while insuring the sustainability and affordability of any such plans.

### Problems/Issues Facing the Pension Fund

1. City pension contributions are projected to rise from a 2011 level of approximately \$13 million to over \$30 million (using a 7.5% discount rate).

[See the City of Knoxville Pension System Experience Study, 2006-11, Bryan, Pendleton, Swats & McAllister, LLC, a Wells Fargo Company].

2. The City of Knoxville Pension System is currently underfunded (9/30/2011), with a funding ratio of 71% (MV Assets/Liabilities). [See Summit Strategies Group, De-risking Discussion, November 10, 2011, p. 2.]. While a substantial amount of this underfunding can be traced to the market meltdown during 2008-09, it is also the case that the market has outperformed during 2009-10.
3. Current pension plans do not allow for increasing the employee contributions as total expected costs rise. Thus, the total burden of increasing pension expenses falls on the City.
4. We have been informed that current case law in Tennessee (Blackwell vs. Quarterly County Court of Shelby County) makes it unlikely that modifications that reduce benefits of current plans would be approved by the courts, assuming litigation.

It is my sense that the current pension plans are relatively rich, given the current economic environment. During the past 20 years or so, corporate and government pensions have moved from defined benefit plans (such as Knoxville's) to defined contribution plans of various types, e.g., 401-K plans.

Even social security has redefined "full retirement" ages. For example, for individuals born between 1943-54, the full retirement age is 66. For individuals born after 1960, the full retirement age is 67. Social security benefits are significantly reduced for individuals who begin taking payments before their full retirement age.

As an example, if an individual whose full retirement age is 67 begins taking SS payments at 62, the benefits are reduced by 30%. In this way, individuals are discouraged from taking SS payments before their full retirement age.

Life expectancy today for a 62 year old male/female is 18.5/21.75 years; for a 50 year old male/female today, life expectancy is 28/32 years.

### Recommendations

1. The existing City of Knoxville pension plans should be closed as soon as practical.
2. City Council should immediately task a new committee comprised primarily or exclusively of individuals with expertise in pension issues to explore alternative plans, e.g., 401-K type plans or some combination of more modest defined benefit plans and 401-K plans.

3. While any new pension plan(s) would be the purview of a separate committee, characteristics of any such plan should recognize an equitable sharing of costs between the City and city employees.
4. No transfers should be allowed from one city pension plan to a "richer" plan during this transition period. We should anticipate such requests.
5. I anticipate considerable angst over any pension plan changes, and given the very political nature of the charge to this task force, City Council might want to consider ways to manage this transition.
6. While the Blackwell case makes it potentially more difficult to implement changes to provisions of current plans, City Council should explore the costs and benefits of making such reasonable changes. We understand that several unanswered questions exist relating to pension plan changes. These unanswered questions include:
  - a. Is it reasonable that substantial increases in pension costs be borne exclusively by the City?
  - b. At what point (financial or actuarial) could the City reduce pension benefits provided under a pension plan for its employees?

**Final**

Knoxville City employees are a valuable asset to the City, and pension benefits represent a significant portion of any employees' total compensation plan. Any changes to these plans should be made with due consideration to the impact on both the employees and the City. A balance needs to be maintained between the financial health and viability of the City and the financial security of its employees.