

**PENSION TASK FORCE REPORT
TO KNOXVILLE'S CITY COUNCIL**

On May 31, 2011 the Knoxville City Council approved a resolution appointing a “special pension task force 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 Pension Task Force was specifically asked to “study, review and analyze and evaluate the pension system of the City of Knoxville as well as the critical economic assumptions upon which that system is based to determine the sustainability of that system, to identify any threats or concerns associated with the system, and to make suggestions or recommendations to the City Council with respect to any action needed to maintain enhance or secure the continued viability of the City pension system in a sound and economically feasible fashion.”

The following people were appointed and agreed to serve on the Pension Task Force:

Bob Cross, Co-chair
Denise Moretz, Co-chair
Anita Cash, Representative General Government Employees
Capt. Gordon Catlett, Representative of the KPD
Capt. Joe Hackney, EMT-P, Representative of KFD
Barbara Pelot, Representative of the City Pension Board
Bill Warwick, Retiree Representative
Dr. Jim Wansley, CFA
Rev. William Pender
Veenita Bisaria, CFA
Frank Shanklin, Jr.
Art Cate
Greg Fay

After the organizational meeting of the Task Force which occurred July 12, 2011, it was determined that the Task Force would meet on the third Thursday of each month at 4:00 p.m. in the KCDC Boardroom at 901 North Broadway. All meetings and discussions of the Pension Task Force were conducted in compliance with the “Sunshine Law”.

All Task Force members were provided with the following historical materials regarding the assets, liabilities and investment performance of the City of Knoxville Pension System:

1. Investment Performance of the Pension System;
2. 2003 Amended and Restated Supplemental Plan Provisions for the City of Knoxville Pension System;
3. City of Knoxville Pension System Valuation and Report as of July 1, 2010;
4. City of Knoxville Pension System Valuation and Report as of July 1, 2009;

5. City of Knoxville Pension System valuation and Report as of July 1, 2008;
6. City of Knoxville Pension System Valuation and Report as of July 1, 2007;
7. City of Knoxville Pension System Valuation and Report as of July 1, 2006;
8. June 30, 2010 Financial Report;
9. June 30, 2009 Financial Report;
10. June 30, 2008 Financial Report;
11. City of Knoxville Pension System Pension Provision Summary Plan A;
12. City of Knoxville Pension System Pension Provision Summary Plan C;
13. City of Knoxville Pension System Pension Provision Summary Plan G Option 1;
14. City of Knoxville Pension System Pension Provision Summary Plan G Option 2;
15. The City of Knoxville Employees Pension System Statement of Investment Policy;
16. City of Knoxville Pension System Experience Study 2001-2006 Presented December 14, 2006;
17. BPS&M Active and Inactive Liability 1-21-10;
18. BPS&M Risk Profiles and Self Insurance 3-10-10;
19. BPS&M Financial Plan and Pension Plan Design Pleasing Employees and Taxpayers 8-12-10;
20. BPS&M what now? 10-29-09;
21. 12-21-10 Attorney letter to auditors; and
22. List of Money Managers.

These materials were also made available to the public via the City of Knoxville website.

The Task Force met on August 18, 2011 and as requested by the Task Force, the City of Knoxville Pension Board represented by Mike Cherry, Alan Pennington and Bud Gilbert appeared and made presentations. Mike Cherry and Alan Pennington provided information on the "Sustainability of Pension System" with a Power Point presentation which is attached hereto as Exhibit 1. Mike Cherry also provided a chart regarding the various Pension Plans which make up the Knoxville Pension System which is attached hereto as Exhibit 2. Bud Gilbert presented the history of the pension system and provided the legal framework in which the Knoxville Pension System must operate. His written materials are attached hereto as Exhibit 3.

On September 15, 2011, the Pension Task Force conducted a conference call with Daniel J. Holmes and Ann R. Bryant from Summit Strategies Group which is the investment consultant to the Knoxville Pension Board to discuss the expected return on asset assumption. Summit Strategies Group's presentation is attached hereto as Exhibit 4.

On October 20, 2011, Larry Martin, Senior Director of Finance and Deputy to the Mayor, KPD Deputy Chief Cindy Gas, and KFD Chief Stan Sharp appeared before the Task Force to answer questions and to make presentations. The KPD 2010 Annual Report was provided to the

Task Force and it is attached hereto as Exhibit 5. Prompted by discussion with the Task Force, Larry Martin provided a Memorandum to the Pension Task Force dated October 25, 2011 and the Memorandum is attached hereto as Exhibit 6. Mr. Martin's Memorandum references the 2010 General Fund Ending Balance, and the Task Force was provided a chart by the Finance Department of the City of Knoxville entitled General Fund Ending Fund Balance FY 86/87 – FY 09/10 which is attached hereto as Exhibit 7.

The November 17, 2011 meeting included a presentation by Alan Pennington and Mike Cherry outlining the July 1, 2011 Valuation Results and July 1, 2011 Experience Study which had recently been presented to the Knoxville Pension Board. The Valuation Results are attached hereto as Exhibit 8 and the Experience Study is attached as Exhibit 9.

On December 15, 2011 the Pension Task Force began its evaluation and discussion of the City of Knoxville's Pension System. The Pension Task Force began the work of preparing its report to City Council by exploring facts and areas of agreement among its members. To facilitate the discussion process, a draft report to City Council was prepared by Task Force Co-Chair, Denise Moretz, and said draft was reviewed and revised at the January 19, 2012 meeting of the Pension Task Force. There is general consensus among the Task Force members with regard to the following facts/matters:

1. The Knoxville Pension System includes five (5) separate active Plans. Three of the plans are closed plans – A, B and F. Plan A includes some active employees. Plans C and G are open plans. Plan C includes employees of the police and fire departments hired after 1/1/71 (or that opted to transfer to Plan C) and Plan G includes all general government employees hired after 1/1/97 (or that opted to transfer to Plan G in 1997). Plan A includes former employees of Knoxville City Board of Education and some general government employees. Employee contributions are currently being made by active participants in Plans A, C and G.
2. Liabilities of Plan F had been paid by the City out of current operating budgets, but in 2001 Plan F was transferred to the Knoxville Pension System which resulted in substantial additional liability (\$50 million plus) for the pension system.
3. Based on the report of Summit Strategies, Exhibit 4, page 12, the Knoxville Pension System investment performance has regularly been in the top 25% in performance as compared to like public pension funds.
4. The Knoxville Pension System pays out \$3.26 million in monthly benefits and the monthly contributions, including the employer and employee contributions, are \$1.10 million. See Exhibit 1, page 4.
5. Market conditions in 2008 and 2009 resulted in substantial losses to the assets of the pension system with the assets going from almost \$550 million to approximately \$375 million at its lowest point.

6. The Tennessee Supreme Court, in Blackwell v. Quarterly County Court of Shelby County, 622 SW2d 535 (Tenn. 1981), was presented with the issue of “the extent to which a local legislative body may validly modify the terms of a retirement and pension plan which it had previously adopted for the benefit of public employees.” The Court held “that public policy demands that there be a right on the part of the public employer to make reasonable modifications in an existing plan if necessary to create or safeguard actuarial stability, provided that no then accrued or vested rights of members or beneficiaries are thereby impaired.” In other words, the modifications may not “adversely affect an employee who has complied with all conditions necessary to be eligible for a retirement income.” As with most case law, Blackwell leaves unanswered questions such as:

- A. Does the Blackwell opinion apply to government defined contribution or just defined benefit plans?
- B. Does the Blackwell holding prevent a governmental employer from increasing the required employee contribution rate for its vested employees?
- C. Does a public employee have a protected right in the factors used by a governmental pension plan to determine actuarial equivalence of benefits?
- D. Are there financial or actuarial circumstances under which a governmental employer could reduce vested, accrued benefits provided under a pension plan for its employees?

7. The City of Knoxville’s actuarially recommended contribution to the Pension System for fiscal year beginning July 1, 2012 is \$13.1 million.

8. The projected actuarially recommended employer contribution based on an assumed 7.5 % investment return rate is projected for the respective fiscal year beginning July 1 is as follows:

- 2013 \$19.50 million
- 2014 \$21.08 million
- 2015 \$22.71 million
- 2016 \$24.30 million

The graph as presented in Exhibit 9, page 53 illustrates the projected contributions (\$millions) using two different return rates (8% and 7.5%) over the next 30 years. The referenced graph is attached as Appendix A to this report.

9. The total fund composite return for each respective year ending June 30 for the City of Knoxville Employees’ Pensions Plan has been as follows:

2011	25.13
2010	14.59

2009	-18.59
2008	-6.22
2007	17.09
2006	10.85
2005	10.22
2004	17.84
2003	5.07
2002	- 2.85
2001	6.31
2000	1.38
1999	8.73
1998	20.20
1997	19.58
1996	17.21

Exhibit 4, page 13.

10. The Knoxville Pension Board, represented by Executive Director Mike Cherry along with the actuary Alan Pennington presented the July 1, 2011 Valuation and Experience Study which informed the Pension Task Force with regard to the current status of the Knoxville Pension System and provided the basis for the Pension Task Force's review of the sustainability of that system.
11. The Knoxville Pension Board at its November, 2011 meeting, reduced the projected rate of return on investments from 8% to 7.375% based on recent investment performance and projected future return.
12. The reduced return rate on investment will require increased contributions by the City of Knoxville to fund the Pension System liabilities as generally noted in the Valuation Report and Experience Study attached as Exhibits 8 and 9.
13. The market value of assets of the Knoxville Pension System was \$468.4 million as of July 1, 2011, representing a \$62.3 million gain over July 1, 2010.
14. Initially, under the actuarial assumptions in place prior to December 2011, the accrued liability of the Knoxville Pension System was \$595 million as of July 1, 2011. Under the new actuarial assumptions as adopted by the Pension Board in December 2011 the accrued liability increases to approximately \$650 million.
15. Initially, under the actuarial assumptions in place prior to December 2011, the total liability included \$413 million in inactive liability (liability to beneficiaries who are no longer contributing to the plan), and \$182 million in active liability (current employees). Under the new assumptions as adopted by the Pension Board in December 2011, these numbers increase proportionately.

16. The Experience Study included as Exhibit 9, p. 46, herein recommends/requires alteration of the liability assumptions for the Plan with a total increased cost of liability assumption changes being \$40.1 million.
17. Fundamental market changes in the health of the US economy may require a re-evaluation of the investment strategy. For example:

	<u>2002</u>	<u>2011</u>
US Credit Card Debt	\$200B	\$800B
US National Debt	\$ 6T	\$ 15T
Unemployment	6%	9%

Exhibit 9, p. 34.

CONCLUSION/RECOMMENDATIONS

It is the conclusion of the Task Force that the Knoxville Pension System is not “sustainable”, under the current actuarial assumed rate of annual return of 7.375% and the City of Knoxville’s current annual contribution of \$13.1 million.

In addition, the Task Force came to the following conclusions and/or recommendations:

- The Pension Task Force is without the resources to make specific recommendations about the changes that should be made to the pension plans and the resulting projected savings which might result.
- Everyone agrees that a competitive benefit package, including retirement benefits, is key to employee recruiting and retention. See February 13, 2012 letter from Mark A. Taylor, President, Fraternal Order of Police, Volunteer Lodge #2 attached hereto as Exhibit 10.
- The Pension Task Force recommends that the City of Knoxville employ the appropriate experts to evaluate the available options for making the Pension System sustainable and to make specific recommendations to the City of Knoxville with regard to the necessary changes to its Pension System.


The Pension Task force has discussed a number of ways to maintain the sustainability of the City of Knoxville Pension System including:

- Reduce/adjust the Cost of Living Allowance (COLA) currently allowed by the City’s Pension Plans;
- Close or amend all current Pension Plans and convert all future employees to a defined contribution plan;
- Close or amend all current Pension Plans and convert all future employees to some combination of a defined benefit/defined contribution plan;
- Increase the age or years of service at which future employees are eligible for pension

benefits;

- Increase significantly the contributions to the Pension System by the City of Knoxville;
- Make a large one time investment in the current system plan to decrease the anticipated rise in the annual employer contribution; and
- The City of Knoxville's annual contribution to the Pension System should be equal to or above the recommended actuarially calculated contribution.

On Behalf of the Pension Task Force



Bob Cross, Co-Chair

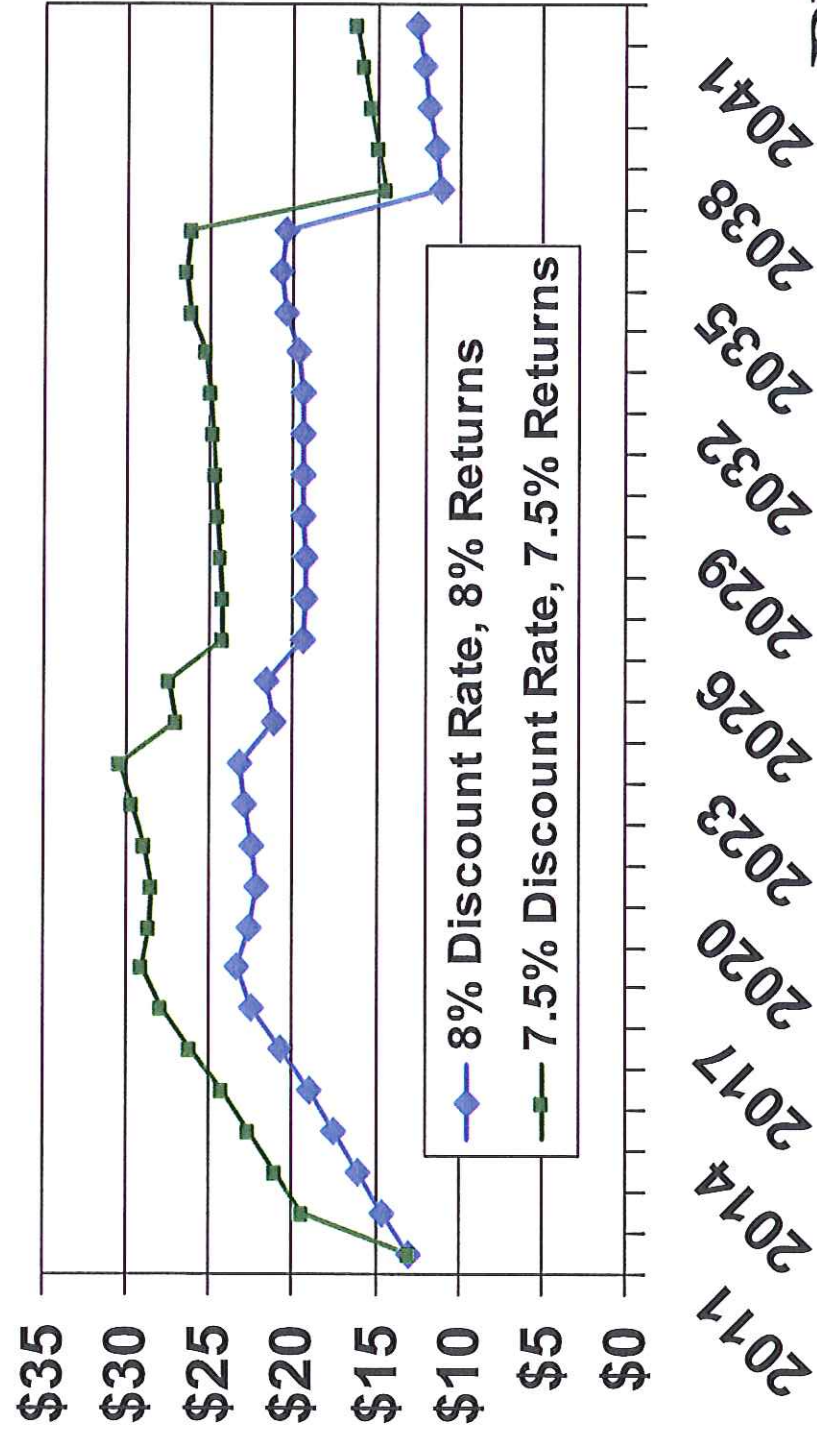


Denise Moretz, Co-Chair

Dated: *February 16, 2012*

Knoxville Pension System

Projected Contributions (\$millions)



The general members of the special City of Knoxville Pension Taskforce would like to express their great appreciation for the leadership of the co-chairs, Bob Cross and Denise Moretz, in this process. Both have been invaluable in sifting through complicated details and in leading the taskforce forward. The general membership of the taskforce wants our report to include this word of appreciation for their superb leadership.

Wm Pender

Bill Warlick