

**City of Knoxville Pension Task Force Meeting  
January 19, 2012  
4:00 p.m. KCDC Board Room, 901 Broadway**

**CALL TO ORDER**

Denise Moretz, Co-Chair of the Task Force, called to order the meeting of the City of Knoxville Pension Task Force at 4:00 p.m. in the Board Room of Knoxville's Community Development Corporation (KDCD), 901 Broadway.

**ROLL CALL**

Task Force Members Present:

Veenita Bisaria  
Anita Cash  
Art Cate  
Gordon Catlett  
Bob Cross, Co-Chair  
Greg Fay  
Denise Moretz, Co-Chair  
Barbara Pelot  
William Pender  
James Wansley  
Bill Warwick

Task Force Members Absent:

Joe Hackney  
Frank Shanklin, Jr.

Also Present:

Mike Cherry, Pension Board  
Charles Swanson, City Council Attorney  
Susan Wilson, Assistant City Recorder  
Audience members

**APPROVAL OF MINUTES**

Motion: Bill Warwick moved to approve minutes of December 15, 2011  
Second: Barbara Pelot  
Vote: Unanimous "Aye"  
Disposition: Minutes approved

## **DISCUSSION AND PRESENTATIONS**

Denise Moretz presented a draft document titled "Pension Task Force Report To Knoxville's City Council" (See attached Exhibit 1) to use as a working document and starting point for discussion.

The Task Force reviewed and discussed the working document page by page, covering pages 1 through 16, and made changes to be included in the final report (see redlined copy attached as Exhibit 2).

Discussion ensued regarding dates for future meetings to continue and conclude review and revision of the working document. The Task Force set the following dates:

Monday, February 13 at 4:00 pm to continue review and revision of working document  
Thursday, February 16 at 4:00 pm to review and finalize final report document

Veenita Bisaria presented written recommendations to be considered for inclusion in the final report to City Council. (See attached Exhibit 3)

## **ADJOURNMENT**

Meeting adjourned at 6:19 PM.

## **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 Hacknewy, Representative of  
KFD

Barbara Pelot, Representative of the City  
Pension Board

Bill Warwick, Retiree Representative

Dr. Jim Wansley

Rev. William Pender

Veenita Bisaria

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.

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 7 and the Experience Study is attached as Exhibit 8.

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 with regard to the following facts/matters:

- The Knoxville Pension System includes three (3) separate active Plans – A, C, and G. 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. Plan A is only a small liability to the system.

- Plan C includes participants from what was Plan F which represents \$50 million plus liability to the system. 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 for the pension system.
- The Knoxville Pension System is in the top 1% in performance as compared to like public pension funds. While the Task Force recognizes the efforts of the Knoxville Pension Board, its actuary,

trustee, investment, consultant, auditor, custodian and City of Knoxville in being among the top performers, the Task Force evaluated the Pension System on its individual sustainability not based on its competitive performance based on like pension systems.

- The Knoxville Pension System pays out \$3.26 million in monthly benefits and the monthly contributions, including the employer and employee contributions is \$1.10 million.
- 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.
- 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:

1. Does the Blackwell opinion apply to government defined contribution or just defined benefit plans?
  2. Does the Blackwell holding prevent a governmental employer from increasing the required employee contribution rate for its vested employees?
  3. Does a public employee have a protected right in the factors used by a governmental pension plan to determine actuarial equivalence of benefits?
  4. Are there financial or actuarial circumstances under which a governmental employer could reduce vested, accrued benefits provided under a pension plan for its employees?
- Any attempted modifications to the current plans would likely result in

litigation citing the Blackwell opinion, so any attempted modifications in the current plans should anticipate such litigation in calculating any anticipated savings as a result of the proposed changes.

- The City of Knoxville's contribution to the Pension System for 2011/2012 is \$13.1 million.
  
- The 10 year average history return rate for the City of Knoxville Employees' Pensions Plan has been as follows:

2011	6.54
2010	4.82
2009	3.54
2008	6.58
2007	9.26
2006	9.49
2005	10.10
2004	10.47

2003	8.94
2002	10.15
2001	11.93
2000	12.41
1999	13.20

- 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.
- The Knoxville Pension Board at its November, 2011 meeting, reduced the anticipated rate of return on investments from 8% to 7.375% based on recent



investment performance and anticipated future return.

- 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 7 and 8.
- The assets of the Knoxville Pension System were \$468.4 million as of July 1, 2011, representing a \$62.3 million gain over July 1, 2010.
- The accrued liability of the Knoxville Pension System was \$595 million as of July 1, 2011.
- The total liability includes \$413 million in inactive liability (liability to beneficiaries who are no longer

contributing to the plan), and \$182 million in active liability (current employees).

- The Experience Study included as Exhibit 8 herein recommends/requires alteration of the liability assumptions for the Plan with a total increased cost of liability assumption changes being \$7.9 million.
- Markets may have fundamentally changed which may require a re-evaluation of the investment strategy:

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

Exhibit 8, p. 34.

## CONCLUSION/RECOMMENDATIONS

It is the conclusion of the majority of the Task Force that the Knoxville Pension System is not “sustainable.” The Task Force defined “sustainable” as able to meet current and future liabilities based on an investment return of 7.375% per year and the City of Knoxville’s annual contribution rate averaging \$13.1 million.

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

- The Pension Task Force is without the expertise and 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 good benefit package, including retirement benefits, is key to employee recruiting and retention.

- The Evaluation Report is a snap shot of the system's value on any given day, and should not drive specific action based only on that "day's" valuation.
  
- 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 options 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 all current Pension Plans and convert all non-vested employees to a defined contribution plan;
- Close all current Pension Plans and convert all non-vested employees to some combination of a defined benefit/defined contribution plan;
- Increase the age at which an employee is eligible for full pension benefits; and
- Make a large one time investment in the current system plan to decrease the anticipated rise in the annual employer contribution.

However, as noted above, the Task Force is unable to make any specific recommendation without a detailed financial analysis of the discussed options. Therefore, as recommended above the Task Force encourages the retention of the appropriate experts to evaluate all options and suggest the best solution for ensuring the financial stability of the Pension System.

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

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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.

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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.

- 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.

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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.

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- 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.

- The Tennessee Supreme Court, in Blackwell v. Quarterly County Court of Shelby County, 622 SW2d 535 (Tenn.

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- The City of Knoxville's actuarially recommended contribution to the

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Pension System for fiscal year beginning July 1, 2012 is \$13.1 million.

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- The projected actuarially recommended employer contribution based on an assumed 7.5 % investment return rate is projected as follows:

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<u>o 2011</u>	<u>\$13.02 million</u>
<u>o 2012</u>	<u>\$19.50 million</u>
<u>o 2013</u>	<u>\$21.08 million</u>
<u>o 2014</u>	<u>\$22.71 million</u>
<u>o 2015</u>	<u>\$24.30 million</u>

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See Exhibit 9, page 51. 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.

- The total fund composite return for each respective year ending June 30 for the

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City of Knoxville Employees' Pensions  
Plan has been as follows:

2011	<u>25.13</u>	Deleted: 6.54
2010	<u>14.59</u>	Deleted: 4.82
2009	<u>-18.59</u>	Deleted: 3.54
2008	<u>-6.22</u>	Deleted: 6.58
2007	<u>17.09</u>	Deleted: 9.26
2006	<u>10.85</u>	Deleted: 9.49
2005	<u>10.22</u>	Deleted: 10.10
2004	<u>17.84</u>	Deleted: 10.47
2003	<u>5.07</u>	Deleted: 8.94
2002	<u>-2.85</u>	Deleted: 10.15
2001	<u>6.31</u>	Deleted: 11.93
2000	<u>1.38</u>	Deleted: 12.41
1999	<u>8.73</u>	Deleted: 13.20
1998	<u>20.20</u>	
1997	<u>19.58</u>	
1996	<u>17.21</u>	

Exhibit 4, page 13.

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- 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.

- 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.

- The reduced return rate on investment will require increased contributions by the City of Knoxville to fund the Pension System liabilities as generally

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noted in the Valuation Report and Experience Study attached as Exhibits 8 and 9.

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- The assets of the Knoxville Pension System were \$468.4 million as of July 1, 2011, representing a \$62.3 million gain over July 1, 2010.
- The accrued liability of the Knoxville Pension System was \$595 million as of July 1, 2011.
- The total liability includes \$413 million in inactive liability (liability to beneficiaries who are no longer contributing to the plan), and \$182 million in active liability (current employees).
- The Experience Study included as Exhibit 9, page 46, herein recommends/requires alteration of the

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liability assumptions for the Plan with a total increased cost of liability assumption changes being \$40.1 million.

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- Fundamental market changes, may require a re-evaluation of the investment strategy:

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

Exhibit 8, p. 34.

## CONCLUSION/RECOMMENDATIONS

It is the conclusion of the Task Force that the Knoxville Pension System is not "sustainable", under the current actuarial

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assumed rate of annual return of 7.375%, and the City of Knoxville's current annual contribution rate of \$13.1 million.

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¶ The Pension Task Force is without the expertise and resources to make specific recommendations about the changes that should be made to the pension plans and the resulting projected savings which might result.

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¶ The Evaluation Report is a snap shot of the system's value on any given day, and should not drive specific action based only on that "day's" valuation.

¶ 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 options 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;

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¶ Make a large one time investment in the current system plan to decrease the anticipated rise in the annual employer contribution.

¶ However, as noted above, the Task Force is unable to make any specific recommendation without a detailed ... [1]

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

The Pension Task Force is without the expertise and 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 good benefit package, including retirement benefits, is key to employee recruiting and retention.

The Evaluation Report is a snap shot of the system's value on any given day, and should not drive specific action based only on that "day's" valuation.

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 options 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 all current Pension Plans and convert all non-vested employees to a defined contribution plan;

Close all current Pension Plans and convert all non-vested employees to some combination of a defined benefit/defined contribution plan;

Increase the age at which an employee is eligible for full pension benefits; and

Make a large one time investment in the current system plan to decrease the anticipated rise in the annual employer contribution.

However, as noted above, the Task Force is unable to make any specific recommendation without a detailed financial analysis of the discussed options. Therefore, as recommended above the Task Force encourages the retention of the appropriate experts to evaluate all options and suggest the best solution for ensuring the financial stability of the Pension System.

In addition to closing the current pension plan and start a new defined contribution plan for new employees, I also recommend that the current pension plan should be evaluated for possible changes that are not drastic but incremental. These incremental changes compound over time and will have beneficial changes in the long term. The advisory board is unable to price these changes but each of these needs to be priced out and the economic impacts for the plan participants and the plan evaluated carefully. I am optimistic that changes to the plan that are shared by everyone would be more palatable and acceptable to all parties.

I recommend that the pension board evaluate each of the major features for the pension plan and discuss the pros and cons of changing/updating each of these. Some of these cannot be changed without a referendum or contractually but should be pursued. This course may not be popular but the longer it is postponed, the decisions have to get tougher.

1. Employer contribution- Projected to increase. City absorbs most of the costs, unless investment returns are higher than assumed rate
2. Employee contributions-Increase the employer contribution rate, possibly make it variable or have a fixed portion for normal cost and an additional rate for potential cost volatility
3. Benefit Design-Change the automatic COLA. Value benefit changes before adoption and properly fund them on adoption. Determination of pension benefit.
4. Pension Investment philosophy, Rate of return assumption, Inflation and Discount rate

In addition the city should also consider making a lump sum investment into the plan to put the plan on sound footing.

Veenita Bisaria  
December 2011