

**City of Knoxville Pension Task Force Meeting  
February 13, 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  
Joe Hackney  
Denise Moretz, Co-Chair  
Barbara Pelot  
William Pender  
James Wansley  
Bill Warwick

Task Force Members Absent:

Frank Shanklin, Jr.

Also Present:

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

**APPROVAL OF MINUTES**

Motion: Art Cate moved to approve minutes of January 19, 2011  
Second: Barbara Pelot  
Vote: Unanimous "Aye"  
Disposition: Minutes approved

### **REVIEW OF REDLINE WORKING DRAFT**

The Task Force reviewed the redline version of the working document to insure that the amendments made at the January 19 meeting were correctly reflected in the draft report. (see pages 1 through 6 of redline document attached as Exhibit 1)

### **CONTINUED REVIEW OF WORKING DRAFT**

The Task Force continued review and discussion of the working document and made changes to be included in the Final Report. (See pages 6, beginning with first bullet point, through 7 of attached Exhibit 1)

Bill Warwick submitted a written report reflecting his opinion on the status of the pension system and what the Task Force should recommend to the City. (See Attached Exhibit 2)

Gordon Catlett submitted a letter written by Mark A. Taylor, President of the Fraternal Order of Police, and asked that it be labeled Exhibit 10 to the Final Report to City Council. (See attached Exhibit 3)

Denise Moretz submitted an additional recommendation to be considered by the Task Force. (See Exhibit 4) Discussion ensued. Following the discussion, Ms. Moretz withdrew the recommendation.

Art Cate made a motion to approve the draft report as amended. Joe Hackney seconded the motion. Discussion ensued. Art Cate withdrew his motion.

### **NEXT STEPS**

The Task Force agreed to meet on Thursday, February 16, at 4:00 pm to review and adopt the Final Report.

### **ADJOURNMENT**

Meeting adjourned at 5:35 PM.

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

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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."

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

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Bob Cross, Co-chair  
Denise Moretz, Co-chair  
Anita Cash, Representative General Government Employees  
Capt. Gordon Catlett, Representative of the KPD  
Capt. Joe Hackney, 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

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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;

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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.

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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.

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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.

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:

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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

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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?

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

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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:

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

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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

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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

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Exhibit 4, page 13.

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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.

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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.

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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.

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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.

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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.

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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.

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17. Fundamental market changes in the health of the US economy may require a re-evaluation of the investment strategy. For example:

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

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Exhibit 9, p. 34.

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### 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.

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

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- 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:

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- 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

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- 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: \_\_\_\_\_

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Exhibit 2  
presented by Bill Warwick  
02-13-2012

Bill Warwick, Retired  
City of Knoxville Fire Department

We all are aware of the fact that the City of Knoxville Pension System has suffered set backs in recent years due to decreasing assets and increased liabilities. This condition seems to have been derived primarily from two specific events, one in 2001 and the other in 2008-2009.

In 2001 the City of Knoxville Pension System was mandated to take on the liabilities of an old, closed pension plan (Plan F). This mandate brought with it a 50 million dollar liability. At that time, our Pension System was in such sound fiscal condition that this increased liability caused little concern.

In 2008-2009, the Pension System hit a major bump in the road when the stock market went into freefall. There was an assets loss of 175 million dollars during these two years. The combination of the additional liability incurred in 2001 and the loss of assets due to the stock market decline in 2008-2009 caused a negative impact of 225 million dollars to the Pension System.

The stock market seems to be in a recovery mood and is headed in the right direction. The Pension System enjoyed an asset gain of 62.3 million dollars in 2010. ABC news reported on January 31, 2012 that the DOW was at its highest point for a January in 15 years, (up 3.3 %, while the NASDAQ was up 4%.) Recovery seems to be gaining momentum.

Prior to 2001 the City of Knoxville was able to fund the liability demands for Plan F as well as to add to the General Fund Ending Fund Balance. Since the 2001 change of responsibility for funding Plan F our city has been able to accrue a Fund Balance more than of 60 million dollars, largest fund balance in the history of the city, which is good.

In conclusion I am convinced the City of Knoxville Pension System is alive and well. Since the Pension Task Force Committee has no means to determine any effect proposed changes would have on the required employer funding to keep the system palatable we are at a distinct disadvantage to make any suggested plan changes.

It is my belief that a recommendation from this committee would be:

Ask the City to make a one-time contribution along with the annual contributions to the pension system to cover what is left of the 50 million dollar liability from the transfer of funding responsibility for Plan F.

After the one-time contribution is infused into the funding pool for the system, have an actuarial study executed to determine the necessary funding to be required of the City to keep the Pension System actuary sound. Prior to this it seems any suggested changes are premature.

**VOLUNTEER LODGE  
No. 2**



801 E. 5th Avenue  
Knoxville, TN 37917

February 13, 2012

Pension Task Force  
901 North Broadway  
Knoxville, TN 37917

Pension Task Force Members,

I would like to take a moment and thank you for your service on this important task force and acknowledge the difficult task you have been given. I have had the opportunity to attend several meetings and listen to the presentations and ensuing discussion on this important topic. Please allow me to share my thoughts with you on the subject.

The current financial projection for the pension plan is a serious issue that requires careful analysis and review. Some factors that contributed to the current situation include: the transfer of liability for the City's unfunded pension plans to the current system, unstable market conditions in the early and late 2000's, and the absence of minimum funding policies in previous years when the plan performed well. Consideration of such factors becomes important to effectively insulate the plan going forward.

A good defined benefit pension is necessary to recruit and retain high quality public safety employees the City of Knoxville will need in the future. The cost for recruiting and training these employees is substantially higher than traditional employees and preventable turnover has real monetary and operational costs. Without a competitive pension plan, our valuable human capital would be vulnerable to other agencies that realize the high quality of our employees and the worth of their training.

For these reasons, I believe great care should be exercised when making recommendations to modify the pension plan. If changes are needed, they should be modest and designed to correct the known historical problems that contributed to our current situation. Any changes considered should be evaluated for their financial impact and tied to meeting the new "Expected Rate of Return" of 7.375% decided by the Pension Board. To drastically alter the design of the plan would create another large "unfunded liability" as current participants reach retirement age and no new workers enter the plan to offset those costs.

Respectfully submitted,

A handwritten signature in cursive script that reads "Mark A. Taylor".

Mark A. Taylor, President  
FRATERNAL ORDER of POLICE  
Volunteer Lodge #2

The Pension Task Force recommends that the Pension Board be expanded adding an additional four (4) members with a requirement that the four (4) new members have specific investment, actuarial and/or accounting expertise giving the Pension Board additional expertise with which to make the important investment decisions for the Pension System. The four (4) additional members could be appointed by City Council and the Administration with specific outlined criteria for selection included in the appointment process.