

## Seattle City Employees' Retirement System (SCERS) Frequently Asked Questions

### 1. Why is the pension fund being looked at now? What's driving this?

The retirement system asks its independent actuary to review the system's finances every two years. The January 1, 2010 Actuarial Valuation was just completed and is being presented to the SCERS Board and the City Council. The study concluded that SCERS has 62% of the reserves it needs to pay all the promised benefits, down from 92% at the beginning of 2008. A funding ratio that is around 80% and stable or improving is considered "safe" by pension experts.

### 2. Where do the pension fund's reserves come from?

Currently, 8.03% of employees' salaries are deducted and sent to the retirement fund. The City matches this amount, and the combined 16.06% of payroll is invested in a portfolio of stock, bond, real estate and other investments. Both the contributions and the investment returns are used to pay pension benefits when employees retire. The SCERS investment fund currently has \$1.6 billion worth of cash and investments.

### 3. Why did the funding ratio decline so much?

SCERS, like most other pension systems, took significant market losses in 2008. The portfolio was down about 27 percent in 2008 and has only recovered somewhat since then. Indeed, the 1999-2009 decade (which has seen two recessions) has been a poor one for investors of all stripes, with major stock indexes no higher now than at the beginning of the period. Investments just have not been growing fast enough to keep up with retirement costs. In addition, City employees are tending to live longer than SCERS previously assumed, so cost estimates have increased.

### 4. How does Seattle's situation compare to Washington PERS or other states and cities?

SCERS is very much in the same boat as other city and state pension systems. The Pew Center on the States estimated that state pension systems collectively face a funding gap that's \$1 trillion and growing. [http://downloads.pewcenteronthestates.org/The\\_Trillion\\_Dollar\\_Gap\\_final.pdf](http://downloads.pewcenteronthestates.org/The_Trillion_Dollar_Gap_final.pdf) Another Pew report shows many city pension systems with funding ratios even lower than Seattle's, including Atlanta, Boston, Chicago, Philadelphia, and Pittsburgh (see figure 2 in [http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Philadelphia\\_Research\\_Initiative/Not%20Out%20of%20the%20Woods\\_May%2026.pdf?n=203](http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Philadelphia_Research_Initiative/Not%20Out%20of%20the%20Woods_May%2026.pdf?n=203) ). Some cities currently show higher funding ratios, but this is largely due to reporting lags and data "smoothing" that averages several years worth of investment data, so those ratios are expected to fall in the coming years as the 2008 impact makes its way through their data.

At PERS, the Washington State Office of the Actuary is projecting a similar 25-30% drop in funding ratios for the various state systems (see "bad news" slide 8 in [http://osa.leg.wa.gov/Actuarial\\_Services/Publications/PDF\\_Docs/Presentations/DRS\\_Advisory\\_Committee\\_OSA\\_5-21-10.pdf](http://osa.leg.wa.gov/Actuarial_Services/Publications/PDF_Docs/Presentations/DRS_Advisory_Committee_OSA_5-21-10.pdf) ) The state actuary is also projecting the need for Olympia to substantially increase contributions over the coming decade (see slides 9-16) which will place a significant strain on state budgets (see slide 18). It is important to note that the state also employs "smoothing" of its funding ratios, so while the ratios appear high currently, the bad market performance of 2008 will be averaged into the state's funding statistics over several years. SCERS marks to market each year, so all the bad news of 2008 is reflected in our funding statistics today.

**5. I'm a City employee/retiree. Are my benefits safe?**

Yes, your earned retirement benefits are a guaranteed part of your employment contract, and they are safe. With \$1.6 billion of assets on hand, the SCERS pension fund has more than two decades' worth of ability to pay retirement benefits for retirees and current workers. Even if the retirement system were to run short in the future, the City would be obligated to pay promised benefits out of current revenue.

**6. What does it mean that the funding ratio is 62%? What does it mean that SCERS' Unfunded Actuarial Accrued Liability (UAAL) is \$1 billion?**

The actuary projected all the future costs for current retirement system members, which includes current employees and current retirees, at a present value of \$3.3 billion. They then subtracted out the current assets (\$1.6 billion) and the expected future contributions for current employees (\$0.7 billion, also present value). The remainder is \$1 billion. This is the unfunded liability. Said another way, the system, with \$1.6 billion in assets, has 62% of the \$2.6 billion it should have on hand to pay all benefits earned to date. This is a long-run shortfall, to be incurred over the life of all the current members and their beneficiaries.

**7. How do we fix this problem? How much will that cost?**

The City's response strategy is twofold: increasing contributions into the system and reviewing the investment portfolio to try and improve investment performance in the future.

The SCERS board is currently midway through a top-to-bottom review of its investment allocations, assisted by our outside investment consulting firm. The review is looking at market data and the performance of various types of investments (stocks, bonds, real estate, etc). The consulting firm will design an optimized portfolio that will attempt to meet SCERS needs for market return and funding volatility. The board will consider a range of portfolio options this summer.

The Mayor, the Council and the City Budget Office anticipate that this summer, the SCERS board will recommend retirement contribution increases of 1% of payroll for employees in 2011 and another 1% in 2012. The City match would double these increases, taking the total contribution from 16.06% to

20.06% of payroll over the biennium.

Increasing the City's contributions to SCERS in 2011-2012 will be a new cost to the General Fund and the City's other funds (e.g. the utilities). The employee share is budget neutral since the overall payroll does not change, just the amount deducted from the employee's check. Each 1% of payroll the City contributes to SCERS costs about \$6 million citywide. Of this, about \$2 million is General Fund and the remainder is spread with payroll among the City's other funds, including Seattle City Light, and Seattle Public Utilities. All told, the increased contributions will generate an additional \$24 million per year or so to begin paying off the \$1 billion in unfunded liability. It's a down payment to begin to work on the problem.

**8. Will this add to Seattle's General Fund deficit?**

This cost was anticipated in the City Budget Office's deficit projections presented earlier this year, so the actuarial valuation does not increase the deficit projections that have been publicly discussed.

**9. How is the Seattle Employee Retirement System managed?**

The Retirement System is governed by a seven-member Board of Administration. The City Council Member who chairs the City Council's Finance & Budget Committee (currently Jean Godden) serves as chair of the SCERS Board. Other board members include the City's Finance Director and Personnel Director, two elected active employee members, one elected retired member, and one selected by the other Board members. Under state law, the Board is responsible for administering pension benefits, investing retirement funds (with the assistance of professional investment consultants), setting retirement policies (subject to Council approval), and making contribution rate recommendations to the City Council. The Board fulfills its duty by seeking out, obtaining, and evaluating expert financial advice with respect to the diversification of its portfolio and the soundness of individual investments. The Board currently relies on both an Investment Advisory Committee as required by state law, as well as professional consultants and outside legal counsel.

**10. Why can't we just wait to see if the market recovers? Do we have to increase contributions now?**

There is a significant risk that the shortfall will grow without action now. The actuary's study assumes SCERS' investments will earn a 7.75% average annual return going forward. If the fund earns less than that, the unfunded liabilities will be larger than \$1 billion. Even with the assumed market return, the actuary concluded that the retirement system will never "amortize," or catch up from, the unfunded liability at current contribution rates. The actuary recommended an even larger contribution increase, to about 25% of payroll (which might eventually be 12.5% from each the employee and the employer), to amortize the shortfall over 30 years. So, the proposed increase to 20.06% of payroll is a partial response that balances current budget woes with the need to begin paying off the City's unfunded pension liability in a responsible way.

**11. How does the study relate to the Memorandum of Understanding (MOU) reached by the City and its labor unions in December 2009?**

The City and its labor unions agreed last year to raise employee contributions under certain circumstances to protect the health of the retirement fund. Those circumstances are met by the 2010 Actuarial Valuation.

The MOU states that the City may increase employee contributions to a maximum of 10.03% if the actuarial valuation finds that "the amortization period for the System's unfunded actuarial liability exceeds thirty (30) years based on the current contribution rate of 8.03%." Indeed, the January 1, 2010 valuation concludes that "[t]he contribution rates currently in effect are not projected to amortize the UAAL over any period." Said another way, the system never catches up, which means the amortization exceeds 30 years per the terms of the MOU. The actuary calculates that the combined (employee + City) contribution would need to be considerably higher at 25.03% of payroll in order to amortize the unfunded liability over 30 years.

Council codified its authority to raise contributions for employees to 10.03% in the Seattle Municipal Code with Ordinance 123301, which they passed in May 2010. Further legislation will be considered with budget this fall to exercise that authority and raise the contributions for 2011-2012 and beyond.