FREQUENTLY ASKED QUESTIONS (FAQ)
TUCSON SUPPLEMENTAL RETIREMENT SYSTEM (TSRS)
November 2013

The purpose of this FAQ sheet is to respond to questions submitted to the TSRS Board of Trustees (Board) in the September 2013 meeting. Responses were prepared by the Board's education committee.

How is the pension funding level determined?

In simplest form, pension funding level is determined by expressing the ratio of "valuation" assets divided by the accrued actuarial liabilities at the plan year end. Both components used for this ratio are calculated by the plan's independent actuary. Based on the most recent actuarial valuation completed for June 30, 2013, the actuary indicates assets are $600.3 million; liabilities are $948.6 million; so the funded ratio is 600.3 / 948.6, or 63.3%. The funded ratio represents the degree to which a pension plan can fulfill its obligations to future and current retirees. The *American Academy of Actuaries* offers the following key points about a pension plan's funding ratio in their *July 2012 Issue Brief*:

- It is a point-in-time reference.
- No single level of funding should be identified as a defining line between "healthy" and an "unhealthy" pension plan.
- The movement or trend of the funded ratio is as important as the absolute level.
- The financial health of a pension plan depends on many factors in addition to funded status.

It is important to note that the funding ratio calculation is based upon actuarial assumptions. Because these assumptions differ from plan to plan, it is difficult to compare one pension plan to another based upon funded ratio status alone.

The TSRS actuary uses a funding method that has a built-in mechanism for moving the plan to a targeted funding level of 100% using the following parameters:

- Contributions will remain approximately level from year to year and thereby minimize inter-generational cost transfers. What that means is the costs of pension benefits accrued today are paid today, rather than leaving an unpaid liability to be paid by a subsequent generation.
- There will be reasonable management and control of employer and employee contribution volatility.
- As required by the charter, the City will pay 100% of the annual required contribution each year which is comprised both of normal annual cost of benefits plus the amortization of the unfunded liability over a twenty year period (Mike – can you add the section of the charter for reference in parenthesis).

How often is the funding level determined?

Annually, TSRS completes an actuarial valuation to determine the asset values and actuarial liability owed to members for the value of the benefit earned from the year of service completed. In addition, the valuation predicts the amount of benefit that will eventually be payable to the member and/or the member's beneficiaries when they become eligible to retire, expressing the present value of asset values required to pay the benefit over their expected lifetimes.

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Is there an industry standard for rating pension plans by their funding level?

No. There is no industry standard. Recommended ranges may vary from 80% to 120%, if you were to Google the topic. The *American Academy of Actuaries* in the *July Issue Brief* states: "No single level of funding should be identified as a defining line between a healthy pension plan and an unhealthy pension plan. The financial health of a pension plan depends on many factors in addition to funded status. " It is important to note that the funding ratio calculation is based upon actuarial assumptions. Because these assumptions differ from plan to plan, it is difficult to compare one pension plan to another based upon funded ratio status alone.

How much City funds are paid into the public safety system?

Based on rates shown in the June 30, 2013 Actuarial valuation reports from the Arizona Public Safety Retirement System, Employer contributions to the plan for FY15 are estimated at $28,736,312 for Police and $18,566,774 for Fire on annual active member payrolls of $59,140,383 and $36,298,678 respectively. For comparison, TSRS Employer contributions estimated for FY15 are $35,714,929 on a payroll of $132,522,928 (note: actuarial projections of FY15 payrolls include assumptions that forecast age based pay increases which may not occur).

Is PSPRS costing more than TSRS?

During FY13, employer (only) contributions expressed as a percentage of active member covered payroll for PSPRS for Police were 41.44% and 42.61% for Fire. The weighted average employer contributions for TSRS in FY13 were 28.77%. Employee contributions for these two plans during FY13 were 9.55% (Police & Fire) for PSPRS and 6.17% (weighted average rate) for TSRS members. Combining employee and employer rates for FY14 puts the total contribution rates for these plans at 50.99% for Police, 52.16% for Fire and 32.32% for TSRS.

How many members are in PSPRS?

At June 30, 20912, there were 811 active employees from the Police and 494 from the Fire Department.

What is the ratio of retirees vs. active employees in PSPRS?

At June 30, 2012, there we 1,305 actives, compared to 1,295 retirees in PSPRS, the ratio would be 1.007; there were 2,718 actives and 2,704 retirees in TSRS a ratio of 1.005.

Are the out-of-towners targeting larger cities like Phoenix?...county and state?

There have been similar initiatives seen in San Diego and San Jose. In addition, the City of Phoenix ballot initiative, filed by the group *Citizens for Pension Reform,* has recently begun distributing signature petitions. The initiative will ask Phoenix voters to change the City of Phoenix Employees Retirement System by adding a 401(k) style defined contribution plan and have the City make set contributions to it. In addition, the initiative seeks to stop pension spiking by implementing limits on the pension benefits available to current employees.

What are other cities doing to make their plans solid?

The City of Phoenix recently adopted changes to their pension plan design approved by voters during the Spring of 2013. These changes added new terms of participation for the City of Phoenix Employees' Retirement Plan for all employees hired by the City of Phoenix on or after July 1, 2013: For new employees only, the following changes apply: (1) the member's contribution rate to the Retirement Plan for each year will shared equally with the City (50/50); (2) the current *Rule of 80* for retirement eligibility is eliminated and replaced with a *Rule of 87*; (3) the pension multiplier factor applied to years of service for the calculation of a member's retirement benefits is changed to a multiplier that increases over time; 0-14.99 years of service have a benefit factor of 1.85% per year of service, 15.00-19.99 have a factor of 1.90%, 20.00-24.99 = 1.95%, 25.00-29.99 = 2.00% and for 30 years of service and over, the factor is 2.10%); (4) the member would not be eligible to receive a month of service credit for any month in which the member had less than 20 days of service; and 5) any minimum pension obligation is eliminated.

Generally speaking, many retirement plans adopt best practices as policy to help “make their plans more solid”. According to the Government Finance Officers Association, sustainable funding practices of Defined Benefit Pension Plans include the following:

1. Adopt a funding policy targeting a 100 percent or more funded ratio (full funding). The funding policy should provide for a stable amortization period over time, with parameters provided for making changes that are based on specific circumstances. Establish a period for amortization of unfunded actuarial accrued liabilities that does not exceed the parameters established by GAAP and that is consistent with the funding policy of the plan.

2. The funding policy should stipulate that employer and employee contributions are to be made at regular intervals, with the contribution amount determined by the results of a recent actuarial valuation of the system. To ensure that this objective can be achieved, the funding policy should be integrated with investment and asset allocation policies. Reductions or postponements in collecting the ARC would typically be inconsistent with the assumptions made in computing the ARC. When contributions fall below the ARC, the board of trustees should prepare a report that analyzes what effect the underfunding has on the system and distribute the report to all stakeholders.

3. Have an actuarial valuation prepared at least biennially by a qualified actuary in accordance with generally accepted actuarial principles applied in a manner consistent with Generally Acceptable Accounting Practices. Each valuation should include a gain/loss analysis that identifies the magnitude of actuarial gains and losses, based on variations between actual and assumed experience for each major assumption. Have a comprehensive audit of the plan’s actuarial valuations performed by an independent actuary at least once every five to eight years. The purpose of such a review is to provide an independent critique of the reasonableness of the actuarial methods and assumptions in use and the validity of the resulting actuarially computed contributions and liabilities.

4. Actuarial assumptions should be carefully reviewed by retirement system staff, discussed with outside experts (including investment advisors), and explicitly approved by trustees. Assumptions that should be

carefully reviewed include the long-term return on assets, salary growth, inflation, mortality tables, age eligibility, and any anticipated changes in the covered population of plan participants. Have an actuarial experience study performed at least once every five years, and update actuarial assumptions as needed.

5. Prepare and widely distribute a comprehensive annual financial report (CAFR) covering retirement system activity, and distribute summary information to all plan participants. The CAFR should be prepared following the guidance provided by the GFOA for the preparation of a public employee retirement system CAFR.

Can we get a list of all people receiving TSRS pensions?

This information can be provided upon request.

Who is the point person for distributing information to retired and active employees?

The Pension Retirement Office is responsible for distributing information to plan members. Their phone number is 520-791-4598, and their email address is tsrs@tucsonaz.gov. In addition, all plan members may address the TSRS Board and request information directly. The schedule for Board meetings is posted at: http://hr.tucsonaz.gov/retirement/tsrs-board-information.

What is the projected number of active employees believed to be retiring in the next 5 years?

Our database shows 807 employees will become eligible to retire in five years, if they continue to work full-time through December 31, 2018.

How do these people retiring affect the pension fund's sustainability?

In the case of TSRS, the ratio of active employees to retirees has been shrinking steadily since 2005 due to workforce reductions deployed to solve the City's budget shortfalls. As a result, cash flow from payroll contributions to the plan have decreased and benefit payments to retirees have increased. Both of these factors are considered by the actuary, and they put upward pressure on contribution rates.

What does the City plan on doing to make the pension fund more sustainable 5 yrs. from now? 10 yrs? 20yrs? 30 yrs?

The Board is charged with the responsibility for the plan's sustainability and will continue to consider and offer solutions to make TSR more sustainable or reduce risk to the plan. While the TSRS Board is responsible for the plan, the Mayor and Council have authority to adopt or modify changes to the Board's recommendations. Sustainability will involve a three-pronged approach: asset management, liability management and 100% funding of the annual required contribution.

Asset Management:
The Board engages the services of Callan Associates, Inc., an investment consultant with a long history of providing consulting services for government and private industry defined benefit plans. Prudent management of the TSRS

portfolio requires an understanding of the plan's investment policies, the level of performance that can be expected from each investment manager, and how those projections affect the plan's ability to pay benefits in the future. The investment consultant will track quarterly performance on the plan's 15 investment managers against appropriate benchmarks, reporting on changes in personnel or on the investment process utilized by each manager, based on priorities and objectives stated in the Board's investment policies. If an investment manager fails to meet performance objectives for the plan's investment policies, a manager can be placed on a watch list for replacement consideration. If the manager is selected for replacement, the investment consultant will conduct a manager search and recommend a replacement manager for consideration by the Board. The consultant also completes an asset-liability study every five years, to determine appropriate asset allocation targets for the TSRS portfolio, when it completes a predictive modeling process to indicate how the investment policy will perform in the financial markets.

Liability Management:
In order to ensure that benefits are truly affordable long-term, the Board has made a concerted effort to actively manage the plan's liabilities. An example of what has been done recently occurred in the spring of 2011. The TSRS Board commissioned its actuary to study a variety of different plan designs, including 401(k) like options, with a goal of providing a reasonable retirement benefit to employees that would offer more sustainability than the plan design in use at the time. The Board ultimately recommended restructuring the plan design by reducing the benefit formula and requiring longer service before the member could become eligible to receive benefit payments. The recommendation resulted in the adoption of a new Tier II benefit plan for new employees hired after June 30, 2011. The TSRS Board recommended the TSRS benefits factor be reduced from 2.25% to 1.75% and a number of other changes to the benefit calculation affected by leave balances and retirement eligibility. Ultimately, the Mayor and Council adopted the following changes:

- A reduction in the benefit factor from 2.25% to 2.00% for each year of service
- The elimination of the inclusion of sick and vacation leave from the member service credits accumulated toward retirement and for the computation of average final salary
- A determination of average salary over a 5 year period, instead of over a 3 year period
- A requirement that each member attain 85 points (age plus years of service) plus a minimum age 60 for retirement eligibility, instead of 80 points

100% Required Contribution:
The Tucson City Code requires 100% funding of the annual required contribution. The funding objective of TSRS is to establish and receive contributions, expressed as percent's of active member payroll, which will remain approximately level from year to year and thereby minimize intergenerational cost transfers.

What is the number of people eligible to retire each year for the next 5 years? 10 yrs?

The number of active employee's eligible to retire are in the coming years are: 2013 – 376; 2014 – 112; 2015 – 91; 2016 – 111; 2017 – 117; 2023 – 93

What are these figures based on?

Normal eligibility is determined on the basis of the member's age plus accumulated years of service in the pension plan. For Tier I, the member must have 80 points, or the member must have attained age 62 with a minimum five years of service. For Tier II, normal eligibility is reached when the member has attained 85 points and has attained a minimum age of 60 years.

How does TSRS determine the rate of return? Are GASB principles followed?

TSRS considers a long term rate of return on pension plan assets based upon recommendations from the plan's actuarial firm and the investment consultant. The actuary recommends an investment return assumption by conducting an experience investigation of the plan's investment returns achieved over a five year period. The plan's investment consultant conducts an asset liability study every five years and the two firms collaborate to seek agreement in what the recommended investment return assumption should be for the plan. The investment consultant determines the level of investment returns possible by applying the plans investment policy to the asset base and running simulations of allocating those investments and applying Monte Carlo simulations and statistical methods designed evaluate possible outcomes and the range of possibilities that might occur. Both the Actuary and the Investment consultant collaborate in the process and the result is the recommendation of a rate of return that is consistent with expected returns.

Amounts calculated under GASB pension accounting rules are completely different than amounts calculated under pension funding rules. One must be careful not to mix the two topics. GASB principles are applied to determine what the required liability disclosures for the Plan's financial statements are They do not determine the assumed rate of return for the Plan.

Can we provide TSRS an email address to give to retirees?

The TSRS email address is: TSRS@tucsonaz.gov

Who is on the education committee? What is their role?

Currently, the education committee is comprised of Karen Tenace (TSRS Board Member – Employee Representative), Mike Hermanson (TSRS Administrator), Doris Rentschler (City Finance Department) and Marie Nemerguth (former TSRS Board member and TSRS Retiree). Their role will be to educate plan members and to support the City Managers Office in their efforts in educating the public, the elected officials and the media. Objectives include:

- FAQ Sheet – Answer all questions submitted by retirees in the September TSRS Board Meeting in the format of a "Frequently Ased Question" (FAQ) sheet.
- Holding two townhall meetings in the fall to educate plan members and provide a forum for questions.
- Request the Board to adopt a policy that will require annual education to all plan members. This may take the form of an annual newsletter that provides an executive summary on actions taken by the Board as well as key metrics of the plan.
- Post educational materials on the TSRS website in one place and notify plan members of location.