

THE CITY EMPLOYEES' RETIREMENT SYSTEM (SCERS)

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INTRODUCTION

This paper describes the Seattle City Employees' Retirement System (SCERS or "the System"), including the governance structure, the benefits provided and the funding status of the plan.

THE SEATTLE CITY EMPLOYEES' RETIREMENT SYSTEM

SCERS was created in 1929 to provide retirement benefits for City employees. Nearly all regular, benefits-eligible employees of the City and the Seattle Public Library may participate in SCERS. Fire fighters and law enforcement officers are covered by the State-administered Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF) rather than SCERS. Regular (classified) employees who are eligible for SCERS membership are required to join; however, SCERS membership is optional for exempt employees, such as certain managers and strategic advisors.

As of January 1, 2015, there are 8,746 active SCERS members who are currently working and contributing to the system (out of a City workforce of nearly 10,000). There are also 6,019 retired members collecting an average monthly benefit payment of \$2,154 and 1,188 inactive vested members who have separated from City service and are no longer contributing to the system but are entitled to collect a retirement allowance at a later date.

SCERS is administered by a Board of Administration (Board) that has seven members:

- The Chair of the City Council's finance committee;
- The City's Finance Director;
- The City's Personnel Director;
- Two representatives of active (contributing) SCERS members, elected by System members;
- One representative of retired SCERS members, elected by System members; and
- One member not meeting any of the criteria above and with no personal vested interest in SCERS, selected by the other Board members.

The Board is responsible for:

- overseeing the daily operations of the system, such as the enrollment of new members and the provision of benefit estimates to members approaching retirement;
- approving applications for retirement; and
- managing SCERS' portfolio of investments.

The Board has a fiduciary responsibility to manage the System and its assets solely in the best financial interests of SCERS members. This means that Board members must put the financial

health of the plan and the beneficiaries (members) ahead of other personal or political considerations.

Certain Board actions, such as changes in plan benefits and contribution rates, are subject to City Council approval. The interest rate that will be credited to members' SCERS contributions each year (a factor in both of the SCERS benefit formulas and in the refund of contribution given to members who leave the system early) is also endorsed by the Council via a resolution. Furthermore, benefit changes and employee contribution rate increases are also subject to labor negotiations.

BENEFITS

SCERS is a defined benefit pension plan, meaning that a member who vests in a benefit (typically after at least five years of credited service) is promised a specified monthly benefit upon retirement. The value of the benefit is predetermined by a standard formula based on the employee's earnings history, years of service, and age, rather than on the performance of investments made with the funds contributed to the plan. Members of SCERS are eligible for full (unreduced) retirement:

- At any age with at least 30 years of service credit;
- From age 52 with at least 20 but fewer than 30 years of service credit;
- From age 57 with at least 10 but fewer than 20 years of service credit; or
- From age 62 with at least 5 but fewer than 10 years of service credit.

A member who is eligible to retire may receive either a standard benefit calculated according to a set formula or a benefit based on the annuitized value of the member's contributions and earnings (the "alternative benefit formula" discussed below), whichever is greater.

The standard retirement benefit of a member who has reached full retirement eligibility is equal to 2 percent of the member's salary for each year of service, up to a maximum of 6 percent. A member who retires with fewer than 30 years of service may be eligible for a benefit that is less than 2 percent per year of service, depending on the member's age. A member's salary for the purpose of these benefit calculations is defined as the average annual salary over the member's highest-compensated 24 consecutive months of employment with the City.

The alternative benefit formula calculates the value of an annuity that could be purchased using the member's accumulated contributions, the City's matching contributions, and the interest earnings on both amounts. Historically, most retired SCERS members have received benefits based on the standard 2 percent per year formula; however, in some cases the annuity formula provides a larger retirement payment than the standard formula.

A member's actual retirement allowance may be reduced from the maximum possible benefit under either formula if the member elects to provide a survivor benefit to a spouse or other beneficiary, or elects to receive a payout of a portion of his or her account balance (there are a number of options) in a lump sum at the time of retirement. Whatever option is selected, a member's monthly pension payment from SCERS is guaranteed for life and is increased by 1.5

percent each year to help offset the effects of inflation on a retiree's income. Additionally, the purchasing power of a SCERS benefit is guaranteed not to be reduced to less than 65 percent of its value at the time of retirement. If a member's retirement allowance is determined to have fallen below this level, then the member will receive a cost of living adjustment (COLA) equal to the rate of inflation, ensuring that the purchasing power of the benefit does not erode further. This floor, which was applied retroactively beginning in 2001, currently benefits long-term retirees who retired prior to the periods of high inflation in the late 1970s and early 1980s.

Although the retirement allowance paid from SCERS replaces only a portion of a retiree's prior working income, it is not subject to the federal payroll taxes (7.65 percent of pay) that fund Social Security and Medicare. Additionally, unlike active City employees, retirees no longer contribute 10 percent of their pay to fund the pension plan. Therefore a member who retires with a benefit equal to 60 percent of her or his pre-retirement salary will not actually see a 40 percent reduction in take-home pay. Furthermore, the income that is lost may be replaced by Social Security payments. In some cases a retiree may actually see a net increase in take-home pay.

State law provides for certain "portability" benefits (such as the ability to combine years of service to qualify for retirement) for members of SCERS who also have service credit in one of the retirement systems administered by Washington State (such as the Public Employees' Retirement System or the Teachers' Retirement System) or the retirement systems of Spokane or Tacoma. A SCERS member who separates from City employment without meeting the five-year vesting requirement (five years of service) may withdraw their accumulated contributions (not the City contributions) and interest. If the withdrawn contributions aren't rolled over to a tax-privileged account such as an Individual Retirement Account (IRA) they are subject to federal income tax.

FUNDING

The retirement allowances that are paid to retired SCERS members are funded through a combination of member contributions, City contributions, and returns on the investments made with plan funds. Over the long term, the most important funding source for SCERS is returns on the investment of accumulated contributions. SCERS funds are invested in a range of instruments, including U.S. and foreign public equity (stocks), private equity, bonds and real estate. The investment earnings of well-managed defined benefit plans typically cover about three-fourths of the cost of retirement allowances that the plans pay out.

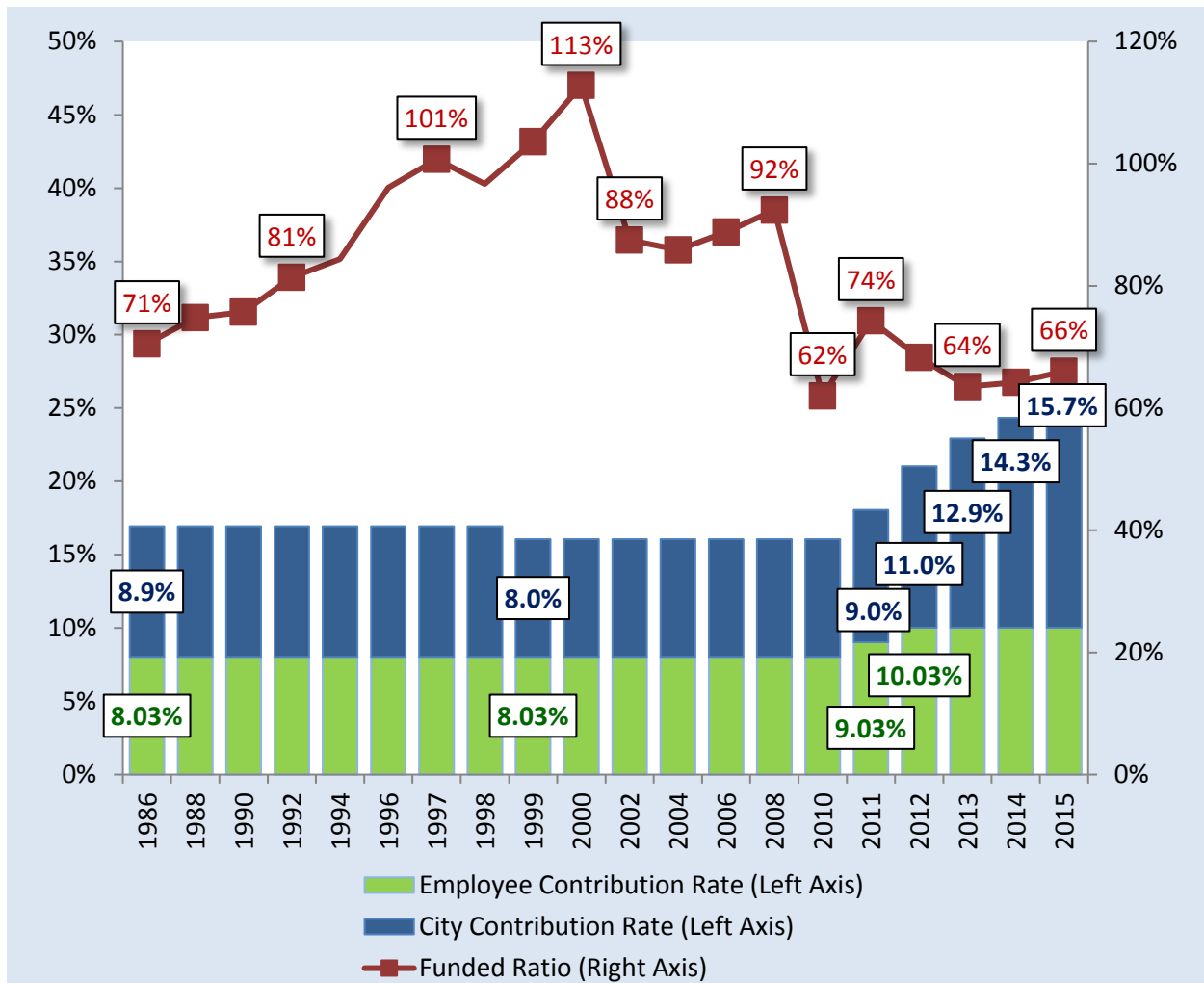
SCERS contribution rates are based on the actuarially determined funding needs of the system and are defined as a percentage of active members' salary. The funding needs of the system include both the "normal cost," which is the value of additional benefits that members accrue in a given year, and the cost to address any unfunded liability.

The funded status of the system is calculated as part of an annual actuarial valuation study that compares the value of the plan's monetary assets to the plan's liabilities, which are the present value of the benefits earned by members at the time of valuation. A pension plan that is 100

percent funded has exactly enough assets to pay for the benefits earned by members as of the valuation date - provided that all of the actuarial assumptions about investment returns, member life expectancy, and other factors are correct. If the funded status is less than 100 percent, then an unfunded liability has developed. It is important to note that even a plan with a 100 percent funded ratio will continue to require contributions, as the fully funded status means only that the liabilities already incurred are funded. As long as there are active members continuing to accrue service credits, plan liabilities will continue to grow.

In the early 1970s, when the funded status for SCERS was above 80 percent, the member and the City each contributed 6 percent of an employee's pay towards funding the system for a total contribution rate of 12 percent. Due to a deterioration of the plan's funded status the total contribution rate was increased steadily in order to fully fund the plan. This effort was successful in achieving 100 percent funded status for the system by 1997. However, market losses in the wake of the dot-com collapse of 2000 and the 2007 financial crisis, combined with the cost of benefit improvements introduced by the City in 2001, reduced the plan's funded status to approximately 62 percent as of the January 2010 actuarial valuation. Since then, City management and employee groups have agreed to steady increases in contribution rates in order to address the funding problem. The recent history of SCERS funding is illustrated in the chart below.

SCERS Funded Status and Contribution Rates, 1986-2015



As of January 1, 2015, the system had actuarial present values of about \$2.26 billion worth of assets and \$3.43 billion worth of accrued liabilities. The unfunded liability is approximately \$1.17 billion, and the funded ratio has increased from 62 percent in 2010 to 66 percent as a result of higher contribution rates and improving returns on the investment of SCERS funds.

The current total contribution rate is 25.76 percent of pay. Under current labor agreements, the City contributes 15.73 percent and members contribute 10.03 percent. Of these contributions, normal costs (including cash outs to members leaving the system) consume approximately 15.2 percent of pay, while administrative expenses amount to 0.6 percent of pay, and the remaining 9.96 percent of pay goes towards “paying off” the unfunded liabilities of the system. The Board’s current funding policy includes a target date for reaching 100 percent funded status by 2042.