



May 15, 2014

Members of the Court of Common Council
City of Hartford
550 Main Street
Hartford, CT 06103

RE: Final Report of Task Force on Healthcare, OPEB, and Pension Benefits

Dear Council Members:

Attached for your consideration is the final report of the Task Force on Healthcare Benefits, OPEB and Pension Benefits.

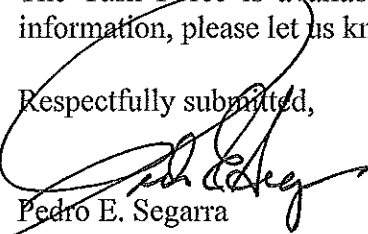
The Task Force initially convened in November of 2013 and met weekly for four months. Two subcommittees were formed and members carried out extensive research on a variety of topics. They carefully reviewed the City's current systems and explored options for improvement and cost savings. An initial report was completed in early April and shared with Council Members and others.

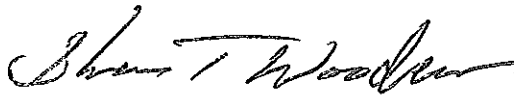
Since that time, the Task Force has continued its consideration of the City's pension program and, assisted by staff at Milliman actuarial firm, have developed an Addendum to the report, which begins on page 34. We specifically direct your attention to this Addendum as it provides options for calculating the Actuarially Determined Contribution (ADC) to the pension fund which you may wish to consider during your budget deliberations.

We want to express our sincere thanks to the nine members of the Task Force for their hard work and innovative ideas and, especially, to William Cibes, who chaired the task force so effectively. Thanks are also due to Richard Pokorski, the City's Benefits Administrator, City Treasurer Adam Cloud and his staff, and staff of Management & Budget, Human Resources, Corporation Counsel, and the Mayor's Office, all of whom provided information and assistance to the Task Force.

The Task Force is available to consult with you at your convenience. If you need further information, please let us know.

Respectfully submitted,


Pedro E. Segarra
Mayor


Shawn T. Wooden
Council President

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REPORT OF THE TASK FORCE ON HEALTHCARE BENEFITS, OPEB, AND PENSION BENEFITS

**Submitted to the Mayor and Court of Common Council
City of Hartford**

**April 16, 2014
Addendum Added May 14, 2014**

Task Force Members

**William Cibes, Chair
Nicholas Carbone
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APPENDICES *(in separate document)*

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Report of the Task Force on Healthcare Benefits, OPEB and Pension Benefits

to Mayor Pedro Segarra and Court of Common Council, City of Hartford

April 16, 2014 (plus Addendum of May 14, 2014)

Introduction

The Task Force was charged by Mayor Segarra and City Council President Wooden to:

- study the City's healthcare and pension benefits structure, and
- recommend changes that balance the City's fiscal demands with the need to treat City employees fairly and equitably

We were specifically asked to complete the following tasks:

- Analyze the structure of healthcare and pension benefits
- Recommend a course of action or options for modifying the structure of benefits
- Detail existing legal and contractual obligations
- Outline changes necessary to implement recommendation or options

The Task Force has found that the costs of current healthcare benefits, as well as pension benefits and other post-employment benefits (OPEB), have in recent years risen significantly.¹ This increase in budgeted costs is due to a number of factors:

- While the City has funded the Pension Fund's Actuarially Required Contribution (ARC) every year, and the pension fund was 100% funded as recently as 2008, the stock market slump in 2008-09 reduced the funding level considerably. Since then, as these losses – as well as the impact of past early retirement incentives (which were not pre-funded) – were factored into the calculation of the ARC (using the City's policy of asset smoothing and a 15 year amortization of unfunded liability), the annual funding cost to the City budget has grown from approximately \$9.6 million in FY 2009-10 to approximately \$47.8 million in FY 2014-15²

¹ To cite one example, the actuarially required contribution (ARC) to fund the City's pension benefits has increased almost 5-fold from FY 2009-10 to approximately \$48 million for FY 2014-15, and the ARC is anticipated to remain above \$40M per year in subsequent years.

² These costs include funding for Board of Education and Library employees who are in City bargaining units.

- While the City always funded the ARC for pension obligations, the City has never funded its annual obligations for Other Post Employment Benefits (OPEB). It has always paid these on a “pay as you go” basis. This has resulted in a \$273M unfunded OPEB obligation.
- Health care costs continue to rise nationally, and the City has provided good health care benefits to its employees with comparatively low employee contributions and co-pays.

Moreover, if these practices and benefits continue to be structured as they are now, their cost will continue to rise, both in absolute terms and as a share of the City's budget. Such expenditures will increasingly crowd out the City's investment in city services and other priorities, as well as dramatically increase the risk that at some future date the City would not be able to meet its commitment to pay those benefits. It is not an overstatement to say that the situation has already reached a critical stage, which urgently requires corrective action.

The context in which these employee benefit costs increase exacerbates the seriousness of the problem. As with other cities in Connecticut, the City of Hartford's budget depends upon the property tax as its primary life blood. With businesses and residents relocating to suburban communities with lower mill rates, property tax revenue in central cities is eroding. But Hartford's property tax crunch is especially great. Even during the best of times, the City's budget faced stress because so much property in the city is tax exempt: state government offices, hospitals, and colleges that serve the state and region, placing an inequitable burden on the residents and businesses in Hartford compared to cities and towns with a lower percentage of exempt properties. The state's programs to make payments for state property and tax-exempt colleges and hospitals (PILOTs) have provided some relief, but that support is not fully funded. Other state aid to municipalities with high service needs because of the poverty of their residents has also not been fully funded.

Moreover, two global trends have had a radical impact on Hartford's property tax revenue woes. First, the crash of the housing market especially affected working families, trapped in loans they couldn't repay, leading to a tremendous increase in foreclosures and abandoned property. Second, the increasing use of technology in the global economy has increased telecommuting and shifted jobs offshore, reducing the number of workers who used to come into Hartford and occupy offices. The consequences include downward pressure on the value of commercial office space and decreased revenue to small businesses that formerly served workers in those offices.

The Task Force has accordingly explored ways to reduce the costs of employee benefits. Although we have found no silver bullet, we recommend a number of changes which in our view can, if adopted, fairly “balance the City's fiscal demands with the need to treat City employees fairly and equitably” over time.

We have kept in mind the precept that, in order to accomplish the recommended changes, there must be a common interest on the part of both the City and the City's employees that the new structure:

- must be one that can remain in place for many years after changes are made, not requiring additional concessions by employees for the foreseeable future, and must be sustainable – to ensure that promised benefits will in fact be there when promised, not whisked away by a City bankruptcy or inability to pay.³ (If benefits are too rich, and accordingly too costly for the City, the probability rises that they will not be there when needed.)
- must continue to offer benefits such that total compensation is competitive with other jurisdictions and the private sector, in order to attract and retain well-qualified persons into city employment
- of health benefits should aim to make employees healthier, at the same time as it lowers costs
- of OPEB and pension benefits should continue to aim to avoid shifting costs to other governmental assistance programs (such as SNAP, Medicaid), by maintaining a viable “income replacement rate”
- should not shift all risk from City to employee, nor from employee to City
- must take into account the liabilities from increasing life expectancies of retirees.

We recognize that changes to benefits and pensions such as we recommend will not take place unless the City leaders and the employees work closely together. The changes must be negotiated and mutually agreed to in a coordinated coalition negotiation or, alternatively, won by one party or the other in long, complicated and divisive arbitrations with one bargaining unit after another. A negotiation that takes place with the city and a coalition of bargaining units would be a much faster and direct way to address these issues since healthcare coverage and retirement security are common concerns. But whether they are in coalition or not, the negotiations must be comprehensive and, if possible, friendly and non-confrontational, something which we recognize will be very hard to accomplish, but necessary.

³ As in Detroit.

Executive Summary

Health Benefits

- I. Convene a meeting with the City's collective bargaining agents to discuss the mutual interests of the City and the Unions to improve the health of employees.
- II. Explore plan design changes and related incentives to encourage the use of the most valuable health care services in the plans.
- III. Discuss further incentives to promote participation in patient-centered medical homes and Accountable Care Organizations that incorporate data-driven, evidence-based care into their delivery systems.
- IV. Additional specific initiatives are summarized below:
 - Establish a "Healthy Hartford" set of health screening initiatives that will emphasize prevention rather than treatment.
 - Establish an aggressive outreach and incentive program, based on current data, designed to engage employees and their families, especially those with chronic conditions, in more robust preventive management of their health.
 - Monitor implementation and utilization of patient centered medical homes (PCMH) and accountable care organizations (ACO) to ensure best practices.
 - Evaluate health plan options, including the potentially wider use of the HMO option and Health Savings Accounts
 - Create a single health plan design to reduce administrative costs and increase employees' knowledge of the health plan.
 - Change existing plan design to coordinate with the Health Enhancement Program in the first bullet above.
 - Ensure that chronic conditions are effectively managed through PCMHs and ACOs

Other Post-Employment Benefits (OPEB)

- Immediately create an OPEB Trust Fund, and transfer the assets available (currently set aside in City cash accounts) to this fund.
- The City Ordinance that creates the Trust Fund should commit the City to funding as described below
- The City should initially annually pay into the Trust Fund an amount equal to the pay as you go amount plus the Normal Cost (attributable to the annual growth in obligations from the work of current employees) as determined by the OPEB actuaries.
- The City should begin immediately to phase in additional payments to the Trust Fund toward the unfunded liability by creating and funding a budget line for the OPEB unfunded liability and, for example, increasing that budget line by \$1

million each year (i.e. \$1 million year one, \$2 million year two, etc.) until the City's share of the budgeted amount equals the ARC.

- The costs of administering the OPEB Trust Fund – including costs relating to investment of the funds – should be paid out of earnings of the Trust Fund (after initial set up costs are paid from the City's General Fund).
- The City should review its obligations under the Fire Fighters VEBA agreement. Once the OPEB Trust Fund is created and funded the City and Fire Fighters Union should discuss whether it makes sense to implement the VEBA, or whether the funded OPEB Trust Fund can meet the same goals as the VEBA, and therefore replace it.
- Consider policy changes that could reduce the future cost of providing benefits which would reduce the unfunded liability, such as
 - a) require current employees who will be receiving these benefits to contribute part of their salary toward those future benefits
 - b) Increase the retirement age
 - c) Increase the years of service necessary to retire and receive benefits
 - d) have retirees contribute a larger portion of the annual "premium" cost
 - e) annually update the amount of the retiree contribution to reflect changing costs of coverage
 - f) reduce benefits in additional ways, such as eliminating the 100% health coverage for those retirees who receive these benefits between the ages of 62 and 65, increasing deductibles, and making plan design and plan option changes in health care benefits for retirees as well as for active employees (as recommended in the Health Benefits section of this report)

The Task Force acknowledges that these changes are subject to the collective bargaining process.

- If the ARC for the Pension Fund decreases in any year (which could happen after the entire 2008 losses are recognized, assuming no further drop in asset value due to market losses), allocate the difference to the OPEB trust fund.

Pension Benefits

I. Continue to use the long-term expected rate of return on assets in the investment portfolio to determine the annual funding requirements (the Actuarially Determined Contribution (ADC)) for the City's defined benefit pension plan. Acknowledge that financial reporting requirements may incorporate a financial economics based discount rate (sometimes called a "risk-less" discount rate).

II. Do not pursue the replacement of the existing Defined Benefit plan by a Defined Contribution plan for newly hired employees.⁴

⁴ This recommendation is contrary to the recommendation of the 2010 Budget Fiscal Analysis Task Force.

III. Investigate the possibility of creating a new pension plan option of "stacking" a DC plan on top of the DB plan, which would be retained for all employees for the portion of their earnings less than a determined amount (such as the state median household income).

IV. Make additional adjustments to the existing DB plan to reduce the annual Actuarially Determined Contribution and the Normal Cost to a reasonable lower level.

- A. Increase the full retirement age to 65 for non-public safety employees.
- B. Make the adjustment for early retirement actuarially sound.
- C. Reduce the accrual rate (benefit rate) for all employees to no more than 2%.
- D. Restrict the exchange of accumulated sick leave for pension service time.
- E. In calculating final average earnings, use the average earnings for the last five years of employment, instead of the highest two or three years of the last five.
- F. Adopt additional anti-spiking provisions: exclude overtime pay and use of vacation and sick payout from the calculation of final average earnings.
- G. Use a closed amortization period of 25 years, instead of the current assumption of an open amortization period of 15 years.

The Task Force acknowledges that items A-F are subject to the collective bargaining process, while item G is in the purview of the Pension Commission.

V. In negotiations with collective bargaining agents, the City should never make or accept proposals without full consideration of the actuarial analysis of the impact of those proposals on pension plan cost.

Healthcare Benefits

Introduction

Similar to other public and private sector employers, the City of Hartford's healthcare budget has increased throughout the years due to the rising cost of health care in this country. These increases, however, have been moderate.⁵ The total City cost in FY 2010 was \$25,215,261; the total City cost in FY 13 was \$28,486,722. The average annual increase was 4.15%.

One reason for moderate growth is that the City has implemented various cost containment measures over the 2009-2013 time span that have saved approximately \$12 million, including

- a 2013 Pharmacy Benefit Pricing Restructure;
- a competitive bid process for both Medical Services (2012) and a Pharmacy Benefits Manager (2011);
- a 2011 Stop Loss RFP; and
- renewal negotiations in both 2009 and 2010.⁶

Documents presented to the Task Force also show that the benefit design of the two plan offerings (the PPO and the HMO⁷) and the employee premium cost sharing arrangements are not out of line or overly generous when compared to other employers, especially to employers in the public sector.⁸ This general observation is not meant to suggest that there are no specific current benefit design features that should be reviewed or revised. Steps should be taken to address these benefit variations in the next round of bargaining with the various units. It is also important to acknowledge that some of the variations in health plan benefit designs between the City and other municipalities are tied to other provisions of an overall bargaining agreement. In other words, a low co-pay on a medical service may have been in consideration of a lesser wage or a higher pension contribution. With this understanding, this report will list certain current plan provisions that bear examination in the future.

Moreover, both plan designs (PPO and HMO) should be revisited now with all the unions to see whether a more value based set of benefits can be instituted to insure

⁵ See Appendix A "City of Hartford Health Review," presented to the Task Force on December 18, 2013, p. 11.

⁶ Appendix A "City of Hartford Health Review," at pp. 13-14.

⁷ The City currently offers two options for health care plans for its employees: a Century Preferred PPO self-insured plan for which Anthem provides administrative services only, and a BlueCare HMO which is an insurance plan offered by Anthem.

⁸ Appendix A "City of Hartford Health Review" at p. 4; compare to CCM Report on Employee Health Insurance and Pension Contributions, three pages.

utilization of what experts have deemed the most valuable set of services in terms of ensuring the health of the employees. Such an approach is outlined below as well.

One other concern is the incidence of chronic conditions and the treatment of same. Task Force members received information detailing the rate at which those employees with certain chronic conditions were adhering to the filling of prescriptions prescribed by their physicians. Except for asthma, compliance was within Anthem's book of business. However, it appears that there are a substantial number of employees with at least one chronic condition who could, but do not, utilize the existing Condition Care program offered by Anthem.

One of the keys to controlling costs in the future seems to lie in plan administration that focuses on treating those with chronic conditions in a more coordinated and effective manner and in keeping healthy workers healthy. Encouraging participation in positive prevention programs to treat and prevent such conditions may yield significant savings based on better health of employees. The recommendation for the institution of a Healthy Hartford Program stems from this perceived opportunity. It should be noted that there are presently a host of voluntary programs available from Anthem, some of which are in place, some not. Without in any way passing judgment on these programs, it is helpful to reexamine the current carrier's offerings⁹ and determine which should be continued, discontinued, or added.

Just as important, however, is determining whether there can be a set of incentives (carrots or sticks) that can increase participation in such existing programs and in new pilot programs, as well as incenting higher utilization of current benefits in the plan which have been shown to promote better health management by and for employees.

To sum up: the City and its employee unions have been working during the past few years to make changes in health benefit plans that have kept cost increases to a moderate level. The recommendations of the Task Force recognize that constructive changes have been negotiated, but that additional efforts must be made to educate employees about the opportunities that already exist to achieve healthier lives at the same time as expenses are reduced, and to provide additional incentives to take advantage of those opportunities. Moreover, a balanced approach should be undertaken to introduce some additional changes that will ensure that health benefits are sustainable in the long run.

Accordingly, the Task Force urges the City to convene a meeting with the City's collective bargaining agents to discuss the mutual interests of the City and the Unions to improve the health of employees. Explore plan design changes and related incentives to encourage the use of the most valuable health care services in the plans. Discuss

⁹ Detailed in Appendix B.

further incentives to promote participation in patient-centered medical homes and Accountable Care Organizations that incorporate data-driven, evidence-based care into their delivery systems. Specific recommendations follow.

Task Force Recommendations:

1. Create a Healthy Hartford Prevention Screening program

Copayments, coinsurance, deductibles, and other benefit structures are widely used to contain health care spending by encouraging patients to consider the cost of health care services before deciding to purchase them. Cost sharing helps address the overconsumption that may result from too generous coverage. However, it may also lead patients to reduce their use of high-value services. A value based insurance design seeks to avoid this problem by setting cost-sharing amounts in inverse relationship to the clinical benefit that an intervention offers.

The peer-reviewed literature supports the ability of co-pay reductions and other incentives to increase the use of higher value services and the use of essential medications which improve clinical outcomes without increasing overall health care spending. As a result, such value based design plans have been adopted by many employers and health plans throughout the United States.¹⁰ In addition, the Affordable Care Act calls for the creation of guidelines to facilitate the broader use of such plans.

The City's health advisors should undertake a review of the Health Enhancement program for Connecticut State employees,¹¹ as well as the national experience surrounding value based insurance design, and seek to initiate a similar model.

City employees, as should all persons, ought to be accountable for their own health care. The current delivery system often makes this difficult. The goal of any employer should be to align all participants in a health care delivery system to promote quality care.

It is beyond question that age appropriate preventive screenings are vital to the health and productivity of the City's workforce. Early identification, diagnosis, treatment, and management will lead to improved clinical outcomes resulting in

¹⁰ See "Assessing the evidence for value based insurance design," *Health Affairs*, Vol. 29, No. 11 (2010), pp. 1988-94. <http://content.healthaffairs.org/content/29/11/1988.full>

¹¹ See Office of the State Comptroller's website for details:
<https://www.connect2yourhealth.com/ParticipantPortal/Default.aspx?PageID=179>

healthcare cost containment. Undiagnosed chronic health conditions lead to untimely clinical interventions and higher costs. Early intervention reduces the potential for large claims utilization, and, in turn, significantly reduces healthcare expenses.

As noted above, the claims data shows a high incidence of chronic conditions. While screenings are at acceptable levels as are the levels of prescription drug adherence, there is room to improve.

The City should engage in a thorough review of its claims data to determine the incidence of chronic conditions and then act to modify its health care program to incent employees into receiving the treatment they need. At the same time, incentives should be installed to make sure that a full range of evidence-based screenings is utilized by all plan participants. Data provided to the City and to the Task Force by the current insurer, Anthem, demonstrate that not enough employees are using health care covered services to identify potential health care issues. This contributes to a higher level of expenses. Participants need a plan that incents early intervention and promotes engagement with their primary care provider and medical home. An enhanced personal care model should be supported by the City.

A review of the State of Connecticut's program as well as a review of other value-based programs should be undertaken and a Hartford specific program should be devised. Unions should be invited to review the data in detail and to engage in non-binding discussions over possible incentives that benefit health and cost containment.¹²

2. Chronic Condition Management

The costs related to the treatment of chronic diseases account for more than 75 percent of our nation's health expenditures. Between 1998 and 2008, the number of working-age adults with a chronic condition increased by 25 percent.¹³

Focusing on the city's high cost claimants provides an opportunity to lower hospital admission rates and reduce healthcare costs. Disease management programs should identify members by chronic condition and severity of risk. For instance, it is

¹² As a starting place, see the February, 2011, report entitled "Synergies at Work: Realizing the full Value of Health Investments," available through the website of the Center for Value-Based Insurance Design of the University of Michigan: http://www.sph.umich.edu/vbidcenter/research/center_publications.html See also "Value Based Cost Sharing in the United States and Elsewhere can Increase Patients' Use of High-Value Goods and Services," *Health Affairs*, Vol. 32, No.4 (2013), pp.704-712. <http://content.healthaffairs.org/content/32/4/704.full>

¹³ Centers for Disease Control and Prevention, Chronic Disease Overview, 2010 (<http://www.cdc.gov/chronicdisease/overview/index.htm>)

important to establish a baseline for the number of employees identified with chronic conditions and the levels of on-going disease management by condition including tracking primary care physician visits. While it is typically true that a relatively small number of the highest utilizers of healthcare represent the majority of the dollars spent, there are opportunities for the City to influence all categories of risk. The utilization of preventive screenings for the entire population is essential.

However, data mining and analysis of the data are only a piece of the solution. The rest involves using the results to create goals. Goals need to stretch beyond the health plan design and cost sharing strategies to include creating a culture around better health for City employees. This will involve partnering together with the employees and the unions to create a shared vision as to achieving good health and its importance to the city workforce and their families.

3. Patient Centered Medical Home (PCMH) and Accountable Care Organizations (ACO)

Patient centered primary care is an emerging provider payment methodology introduced by most carriers, including Anthem in Connecticut. Such a program was implemented in the City on August 1, 2013 as to certain primary care provider groups. A PCMH is designed to incent quality of care, enhance coordination of care and to drive improved outcomes in patient care – all of which translate to financial savings through better use of health care dollars.

Anthem previously introduced this provider payment methodology in other states to positive results and we anticipate the same results in Connecticut where Anthem is now actively contracting with primary care practices. Based on the results of Anthem's pilots and published literature, we project that providers will generate savings for attributed members of 1-2% lower than projected costs in their first year of participation increasing in each of the next two years. Savings are driven by reduced hospital admissions and readmissions and fewer emergency room visits, the improved management of chronic conditions, the closing of gaps in care, and increased generic substitution of prescription drugs.

Approximately 68% of the City's employees visit a Primary Care provider participating in the program now. This should be carefully tracked and further incented.

It is important to note that there has been recent research published on the value of medical homes. While care coordination will undoubtedly serve as a waste reduction

tool as to healthcare costs, each medical home must operate on best practices to achieve its promise.¹⁴

The City should make sure that its health insurance carrier and its local provider networks, such as hospitals, seek to enhance current programs and to design specific pilot programs for City employees – such as preferred pricing arrangements for certain procedures such as hip replacements to ensure lowest price for recurring surgical procedures.

4. Investigate Plan Options

Make the current BlueCare HMO option more attractive

The City's primary health program is the Anthem Century Preferred self-insured plan, elected by most City employees. While another Anthem "BlueCare" insured HMO exists, the HMO product has an annual capitation amount on prescription drugs and is an in-state only plan which significantly reduces employee participation.

However, the difference in plan price may warrant providing incentives to employees that transition to the HMO product. In addition, through the HMO product, the City may have the ability to enhance additional plan "tightening" in benefit design that would further reduce the product's cost. Additional plan design edits should be considered and implemented as collectively bargained contracts allow. However, the Task Force recognizes that any substantial increase in HMO enrollment will, in and of itself, lead to a reconsideration of the underlying premium, since this is currently an insured offering.¹⁵

Explore the Introduction of Health Savings Accounts (HSA)

Health Savings Accounts are thought to promote employee accountability in healthcare expenditures. An HSA is a tax advantaged medical savings account that is owned by the individual. It is designed to be used in conjunction with a High Deductible Health Insurance Plan (HDHP), which means the money the City saves on lowering insurance premiums can help to partially fund the employee's HSA. The money contributed to an employee's account is not subject to federal tax at the time of deposit, so it is pre-tax dollars for employees.

¹⁴ See AHRQ report on "Early Evidence on the Patient Centered Medical Home," February, 2012, available at <http://pcmh.ahrq.gov/page/early-evidence-patient-centered-medical-home> . But see the recent RAND study, February, 2014, referred to at <http://www.rand.org/news/press/2014/02/25.html> , which found only limited quality improvement and no cost containment.

¹⁵ A delicate balance exists: the current price differential between the PPO plan and the HMO plan may be diminished if employees with high medical costs transition to the HMO plan. The cost of the HMO plan may increase, and the PPO plan could become less expensive.

The funds in a Health Savings Account can be used to pay all eligible medical related expenses that are not covered by the employee's health insurance plan. The City should investigate pricing an HSA product in two ways: (1) A full replacement for all employees, or, (2) provide an option for current employees and mandate an HSA product for all new employees as of a given date, as the Board of Education did.

However, the City should also carefully review the literature from foundations such as the Kaiser Family Foundation regarding the efficacy of Health Savings Accounts, especially for low to middle income workers.¹⁶ The City should not implement an Health Savings Account that encourages persons to forego needed care because of a high annual deductible.

Explore the Implementation of a Single Plan Design

The City has an administratively complex health program. Currently all Unions have their own specific plan design and benefit levels. As active employees retire, these new retirees are placed into retiree plan divisions specifically created to mirror the plan designs employees were afforded as active employees. This "snowball" affect has created numerous plan divisions that has increasingly become complex and costly. These plan designs represent very "rich benefits" no longer considered industry standard and therefore probably drive up utilization (cost) dramatically. An agreed upon plan design for all Unions would ease administration, and increase employees' plan knowledge through plan uniformity.

It is the understanding of the Task Force that prior RFP requests have received limited competitive responses from health insurance carriers other than Anthem. A lack of response to a City RFP may be a direct result of the complexity of plans, and the sheer number of plans requiring claims payment and administrative oversight. It is our suggestion that the City's Health Plan consultant explore this issue to determine if this has indeed been a hindrance to receiving alternative proposals.

5. Plan Design Considerations

The following are suggestions for plan design changes. Any changes to the existing design (s) should be aligned with changes tied to the implementation of a Health Enhancement Program as referenced in section 1. The Task Force acknowledges that there may be a perceived tension between some of the recommendations in

¹⁶ See the critical review of "Health Savings Accounts and High Deductible Health Plans: Are they an option for Low- Income Families," October, 2006, Kaiser Family Foundation (to be found at <http://kff.org/health-costs/issue-brief/health-savings-accounts-and-high-deductible-health/> . See also "Lowering the Barriers to Consumer-Directed Care: Responding to Concerns," *Health Affairs*, Vol. 26 No.5 (September, 2007), pp. 1328-1332. <http://content.healthaffairs.org/content/26/5/1328.full>

Section 1 and this section. Our recommendations for higher co-pays for some low-value services are intended to incent participants to use high-value services. Lower co-pays for high-value services are also intended to provide a similar incentive.

PPO (Century Preferred)

- *Outpatient Surgery/Ambulatory Services.* Copays across the various unions range from \$0 to \$150. While in most cases performing procedures outside of the hospital setting is a more cost effective option, having copays at \$0 or something less than \$100 serve to disassociate the employee and their families from the actual cost of care and can drive up utilization. Recommendation: set reimbursement as a % of total cost (90%) or at a copay level such as \$150.00
- *High Cost OutPatient Diagnostic (MRI, CAT, PET Scans).* Presently a \$0 copay is associated with these high cost diagnostic procedures. Recommendation: implement a copay at least equal to the copay for an office visit or urgent care visit.
- *Durable Medical Equipment.* Presently these services have a copay of \$0. Recommendation: implement a copay no lower than that for an office visit (\$20).
- *Medical Supplies /Prosthetics.* Presently these services have a copay of \$0. Recommendation: implement a copay no lower than that for an office visit (\$20).
- *RX-Caremark-Retail Copayments.*
 - A. RX costs continue to increase at a rate that far outpaces that of medical trends. It is critical that the City evaluate RX co-pays in light of escalating cost inflation and the financial impact to the City. Additionally, specialty drugs targeting cancer, cystic fibrosis, MS, etc. are growing even faster and represent a large portion of pharmacy spend. Cost management strategies offered by the City's pharmacy carrier can reduce cost and provide clinical support. Recommendation: implement a minimum \$10 copay for generics, and a multiple of the minimum copay for brand-name drugs reflective of the incentive to purchase generics. In subsequent years, increase copays consistent with standard plans offered by Caremark. Implement the Special Drug program developed by Caremark.
 - B. The cost of generic drugs is far lower than that of comparable brand-name drugs, although generic drugs are identical or within an acceptable bioequivalent range in dose, strength, route of administration, safety, efficacy, and intended use to the brand-name counterpart. The cost differential to the

City is substantial.¹⁷ Therefore it is important to incent members to purchase generics whenever a choice is available.

Recommendation: if the minimum co-pay for generic drugs is \$10, as recommended, the brand copay payment should be \$25.

C. Certain prescription drugs have been shown to be highly effective in treating and preventing chronic conditions.

Recommendation: reduce or eliminate co-pays for these highly effective drugs to increase adherence rates.¹⁸ Work with the City's carrier to implement.

D. Maintenance drugs are priced less when using mail order. Adherence to taking medications is improved with access to 90day fills. Copays are less than retail and are also available at certain retail pharmacies.

Recommendation: mandate the use of mail order for maintenance drugs (as long as there is an option for certain retail pharmacies, as provided in programs developed by the City's carrier.)

HMO (Blue Care)

- *Office Visit Copayment.* Presently each union has a co-pay of \$5.
Recommendation: increase copay to minimum of \$10-\$15 (assumes desire to keep this co-pay lower than that of PPO (Century Preferred))
- *Inpatient Copayment .* Presently \$0.
Recommendation: implement a minimum copayment of \$150.
- *ER Copayment .* Presently the copayment of \$50 is not viewed as enough of a deterrent to limit unnecessary ER usage.
Recommendation: increase the ER copay to \$100 or \$150 (if not admitted). Must align with increased Urgent Care Center availability with an attached co-pay which is similar to or slightly higher than the (proposed revised) office visit copay.
- *Outpatient Surgery/Ambulatory Services .* Presently the copay is \$0. While in most cases performing procedures outside of the hospital setting is a more cost effective option, having co pays at \$0 or something less than \$100 serve to disassociate the employee and their families from the actual cost of care and can drive up utilization.

¹⁷ For example:

Nexium (brand name ulcer/acid reflux drug) = \$8.52 gross cost/day (\$255.60 monthly) compared to omeprazole (generic alternative) = \$0.26 gross cost/day (\$7.80 monthly).
Crestor (brand name cholesterol lowering drug) = \$5.28 gross cost/day (\$158.40 monthly) compared to atorvastatin (generic alternative) = \$1.14 gross cost/day (\$34.20 monthly).

¹⁸ See "Value-Based Insurance Design and Medication Adherence," Health Affairs, Vol. 33, No. 3 (2014), p. 493. <http://content.healthaffairs.org/content/33/3/493.full>

Recommendation: set reimbursement as a % of total cost (90%) or at a copay level such as \$100.

- *Outpatient Mental Health/Substance Abuse Visits.* Presently \$5 copayment.
Recommendation: Align with proposed revised office visit copayment.

- *High Cost OP Diagnostic (MRI, CAT, PET Scans).* Presently \$0 copay.
Recommendation: implement a copay at least equal to office visit or urgent care visit for these high cost diagnostic procedures.

- *Skilled Nursing Care.*
Recommendation: introduce a copay equal to proposed revised Inpatient co-pay of \$150.

- *RX-Caremark-Retail Copayments.*

A. RX costs continue to increase at a rate that far outpaces that of medical trends. It is critical that the City evaluate RX co-pays in light of escalating cost inflation and the financial impact to the City. Additionally, specialty drugs targeting cancer, cystic fibrosis, MS, etc. are growing even faster and represent a large portion of pharmacy spend. Cost management strategies offered by the City's pharmacy carrier can reduce cost and provide clinical support.

Recommendation: implement a minimum \$10 copay for generics, and a multiple of the minimum copay for brand-name drugs reflective of the incentive to purchase generics. In subsequent years, increase co-pays consistent with standard plans offered by Caremark. Implement the Special Drug program developed by Caremark.

B. The cost of generic drugs is far lower than that of comparable brand-name drugs, although generic drugs are identical or within an acceptable bioequivalent range in dose, strength, route of administration, safety, efficacy, and intended use to the brand-name counterpart. The cost differential to the City is substantial.¹⁹ Therefore it is important to incent members to purchase generics whenever a choice is available.

Recommendation: if the minimum co-pay for generic drugs is \$10, as recommended, the brand copay payment should be \$25.

C. Certain prescription drugs have been shown to be highly effective in treating and preventing chronic conditions.

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Recommendation: reduce or eliminate co-pays for these highly effective drugs to increase adherence rates.²⁰ Work with the City's carrier to implement.

D. Maintenance drugs are priced less when using mail order. Adherence to taking medications is improved with access to 90day fills. Co-pays are less than retail and are also available at certain retail pharmacies.

Recommendation: mandate the use of mail order for maintenance drugs (as long as there is an option for certain retail pharmacies, as provided in programs developed by the City's carrier.)

6. Focus Chronic Condition Management and Patient Centered Medical Home and Accountable Care Organizations on "Hotspots"

During the most recent policy period 0.5% or 22 of the 3,674 participants accounted for 23% of total medical expenses. Each claimant averaged \$153,000 in expenses. As a rule of thumb, 5% or the equivalent of 183 plan participants will account for 50% of total annual claims expenses. Given the magnitude of the expenses and the impact said medical expenses have on the overall financial health of the City's plan it is critical that at least these plan participants actively engage in programs such as Chronic Condition Management, Patient Centered Medical Homes and Accountable Care Organizations. We believe that the first step is to determine which of these plan participants were enrolled in chronic condition management and PCMHs or ACOs during the prior period,²¹ and for those not enrolled, plan aggressive engagement strategies for the future.

Strategies should include:

- more aggressive outreach to participants with chronic conditions including PCP phone outreach and mailings
- Promote the 24/7 Nurseline as a physician extender.
- Expand the outreach described above to include the 5% of plan participants with the highest medical expenses.
- auto-enroll plan participants with high dollar chronic conditions into the health care facilitation/management programs described above
- provide positive incentives to employees to remain in the programs once enrolled rather than relying on the current voluntary enrollment
- introduce tailored or value-based plan designs specific to the health care needs of plan participants with high dollar chronic conditions

²⁰ See "Value-Based Insurance Design and Medication Adherence," Health Affairs, Vol. 33, No. 3 (2014), p. 493. <http://content.healthaffairs.org/content/33/3/493.full>

²¹ The Task Force understands that 68% of the current plan participants have a PCMH. It is important to increase participation to 100%.

Many employers are beginning to utilize the concept of "hot spotting". This strategy means targeting efforts to ensure that efficient and coordinated care is brought to the high cost cases through outreach initiatives. The City should engage the wider health care community in designing such a strategy for its employees -- which should include seeking the help of community organizations, foundations, and medical schools.

SUMMARY OF RECOMMENDATIONS

Convene the unions to discuss the mutual interests of the City and the Unions to improve the health of employees. Explore plan design changes and related incentives to encourage the use of the most valuable health care services in the plans. Discuss further incentives to promote participation in patient-centered medical homes and Accountable Care Organizations that incorporate data-driven, evidence-based care into their delivery systems. Specific initiatives are summarized below:

- Establish a "Healthy Hartford" set of health screening initiatives that will emphasize prevention rather than treatment.
- Examine current data on high cost conditions and establish an aggressive, expanded outreach to those employees and family members that have experienced high dollar medical expenses. The data can be used to engage in more robust management of the healthcare of these participants; the top 5% of utilizers should be contacted to insure each one is enrolled in a Patient Centered Medical Home and/or is an active participant in an Accountable Care Organization;
- Monitor implementation and utilization of patient centered medical homes and Accountable Care Organizations to ensure best practices and active participation. Participate in Anthem sponsored pilots for those with chronic conditions when those pilots are designed to positively impact the health of the City's employees and their dependents.
- Evaluate plan options, including wider use of the BlueCare HMO as modified to introduce additional medical expense savings provisions and the option of introducing a Health Savings Account plan. However, the Task Force cautions against the implementation of a Health Savings Account option unless it can be demonstrated that the implementation will not adversely affect the lesser paid job classifications and deter the utilization of valuable benefits;
- Review current plan designs and revise those provisions that are no longer in keeping with other public sector benefit plans so as to better manage costs within the plan.

Note: Changes were made to the City's Blue Care HMO plan during the Task Force's work. The changes may be found in Appendix C..

Other Post Employment Benefits (OPEB)

Statement of the Problem

The City of Hartford is committed by contracts to pay current and future retirees Other Post Employment Benefits (OPEB). Like pensions, these benefits are earned during an employee's career, and as each eligible employee works, the City creates a liability to pay these benefits in the future when they retire. Good fiscal practice requires that the employer – the City and the Board of Education – pay into a trust fund each year an actuarially calculated amount to cover these future payments. This annual calculated amount is called the Normal Cost.

The City has essentially never done this. The City has paid these benefits to retirees on a "pay as you go basis" – paying these benefits as they are due to be paid, rather than recognizing the cost when they are earned. This practice has created a large unfunded liability for the City - \$273.3 million.²²

The annual Actuarial Required Contribution (ARC) – to (a) fund Normal Cost and (b) make payments toward the unfunded liability (amortized over 30 years) – is approximately \$19 million (for the City and the Board of Education). The City has been budgeting and paying essentially only the pay as you go amount – about \$9.9 million in FY 2012-13.²³ Because of this annual underfunding and the lack of invested assets, the Unfunded Liability has been growing – by about \$12 million in the most recent year.

Calculation of the unfunded liability and the ARC are actually a bit more complicated than this – see more details below.

In summary, the City needs to address these issues by (a) creating and funding an OPEB Trust Fund (b) creating and annually increasing a budget allocation toward the unfunded liability and (c) looking for ways to decrease the overall OPEB liability.

These issues are more fully discussed below.

What is OPEB and who is eligible to receive these benefits

Other Post Employment Benefits (OPEB) are retirement benefits that are paid on behalf of retirees and their eligible dependants in addition to pensions. The amount the City pays, the amount the retiree must contribute toward these benefits, and the age of

²² See the Aon-Hewett Actuarial Valuation Report – page 2. This report – dated November 13, 2013 - was distributed to the Task Force at one of our initial meetings. It is for the period ending June 30, 2013. The OPEB Unfunded Liability is also reported in the City's Comprehensive Annual Financial Report (CAFR) for the fiscal year July 1, 2012 – June 30, 2013 – page 71.

²³ See CAFR page 106. This amount differs somewhat from the initial estimate in the Aon-Hewitt actuarial report – page 2 – which was \$10.4 million. See further details below.

eligibility for these benefits are based on the negotiated union contracts that were in effect at the time of retirement. Because changes in OPEB benefits have been negotiated in recent years, there are different benefits paid on behalf of different retirees.

For retired police and firemen these payments are made between the time the employee retires and when the retiree reaches age 65 when they are eligible for Medicare. For many other City retirees the City pays for retiree benefits between the ages of 62 and 65. An employee who retires before age 62 pays the full cost of health care coverage prior to age 62. For some retirees there is also supplemental coverage to Medicare provided by the City. For some retirees there is no OPEB benefit. All retirees who have medical coverage pay a portion of the cost of their coverage.²⁴

For the City of Hartford OPEB benefits include

- Medical Benefits
- Drug Benefits
- Dental Benefits
- Life Insurance

The AON-Hewitt Actuarial Valuation Report (hereafter referenced as AH), lists the **Plan Provisions** and which City of Hartford and Board of Education retirees (and dependents) are eligible to receive benefits, and under what conditions (including paying a portion of the cost) on pages 15-19. See Appendix D. Also attached is a summary sheet on these benefits (Appendix E).

Because police and fire retirees are eligible to retire at a much younger age than other employees, and they receive coverage immediately upon retirement, the largest OPEB costs to the City are for these retirees. The City's new actuaries have been asked to provide a breakdown of OPEB obligations by bargaining unit – but will not have this information available until after the Task Force completes its work. City Officials should look at this information for a perspective of where the major OPEB costs are – which would also be the areas of greatest potential savings (see recommendations below).

Potential additional OPEB financial risks for the City

Unlike pension payments – which are known when a person retires – OPEB benefits depend on the cost of these benefits during the years that the retiree (and if applicable his or her dependents) is eligible to receive benefits. Future medical costs are difficult

²⁴ Coverage for eligible spouses continues until the spouse reaches 65, and for eligible dependents until they reach age 26.

to calculate very far into the future. If the assumptions used by the actuaries for growth in medical costs are too low, the unfunded liability could increase.

Also, as with the pension program, there is an assumed rate of return on assets in the pension fund. Because there are currently no assets in an OPEB trust fund, the actual current OPEB rate of return is 0%. When there are assets in a Trust Fund there is the risk similar to that of the Pension Fund that actual earnings may not meet the assumptions.

OPEB Unfunded Liability

Sources for data are Aon Hewitt actuarial study (AH) and the City's Comprehensive Annual Financial Report (CAFR).

- The OPEB unfunded liability (as of June 30, 2013) is \$273.3 million (AH p2, and CAFR p71)
- Of this \$224.8 million (AH p7) is attributable to the City, and \$48.5 million to the Board of Education (BOE) (AH p9).
- There are funds that have been set aside against this liability – which are currently in City cash accounts. Because they are not in an OPEB trust fund, they do not show as assets against this liability. When an OPEB Trust Fund is established, and assuming these assets are transferred to the Trust Fund, they will show as assets against this liability – reducing the unfunded liability. The amount available is \$2.6 million for the City, and \$34.6 million for the BOE (CAFR p 105).²⁵
- Therefore if and when these funds are deposited in an OPEB Trust Fund, the actual unfunded liability will be reduced by \$37.2 million to \$236.1 million.
- The BOE is essentially 70% funded, while the City is less than 2% funded.
- The City used to have about \$15 million in this account (CAFR p 107 – net position beginning of year), but this is an account from which approximately \$13 million was transferred to the General Fund to balance the FY 2012-13 budget.
- These funds are included on the balance sheet (Statement of Net Position - CAFR p5 and p11) and annual activity tables in the Business Type Activities columns – and therefore do not roll up into the General Fund - Fund Balance (or Fund Deficit). Because they are combined with other funds, they are not identifiable on these tables.
- The "Net OPEB Obligation" of \$64.4 million (CAFR p14 and p41) is less than the unfunded liability because the Net OPEB Obligation (which is required by GASB²⁶ to be part of the City's financial report) is defined as only the cumulative

²⁵ Note that the CAFR p 104 and 105 are one table and need to be read together, as with pages 106 and 107. The "New Hires" column is a combination of the City and BOE – and is divided \$1.1 million and \$0.5 million respectively. These numbers when added to the "Municipal Actives" and "BOE Actives" numbers add up to the numbers above.

²⁶ See Appendix G for a short description of GASB (the Government Accounting Standards Board) and the role of its accounting rules.

difference between the ARC and actual funding since the effective date of GASB 45 (see AH p30) which for the City was FY 2007-08 (AH p29).

- The Net OPEB Obligation has been reflected in the City's financials since the effective date of GASB 45. There will be no future additional impact on the City's financial reporting.
- The "Net OPEB Obligation" and the total OPEB Unfunded Liability will continue to grow each year that funding is less than the ARC. The amount of the change in the unfunded liability will be calculated by the actuaries and determined by a number of factors, including the amount contributed toward the unfunded liability, the assumed growth rate of assets in the trust fund, the actual growth (or decline) in the value of assets in the trust fund, the actual cost of benefits, and negotiated changes in future benefits.

OPEB ARC

- The ARC for FY 2013-14 is \$18.9 million (AH p3). This is comprised of \$14.9 million for the City (AH p7), and \$4.0 million for the BOE (AH p9).
- It is interesting to note that the BOE appears to have been putting in more than its ARC (CAFR p107 – showing a positive "change in net position of \$8.3 million in FY 2012-13.)
- The total "Pay As You Go" cost to the City for FY 2012-13 was projected by the actuaries to be \$10.4 million (AH p2.). The actual "Pay As You Go" cost to the City as reported in the City's year end financial report was \$9.9 million (CAFR p107).
- The City's year end financial report shows the total payments made for OPEB benefits – which are paid for both by the City and by retiree contributions. In FY 2012-13 total payments were \$21.7 million. Of these payments the City paid \$9.9 million, \$11.7 million came from retiree contributions toward the cost of these benefits, and \$0.2 million came from other sources (CAFR p107).
- Because (a) the City continues to underfund the ARC, and (b) the assets are not in a trust fund, and therefore have no earnings, the unfunded liability continues to grow. There was a reduction in the unfunded liability in FY 2008 and FY 2009 due to policy changes. It has grown annually since. (CAFR p71 – see below), and we can expect it will have grown over another \$10 million this year.²⁷

OPEB	
Valuation Date	Unfunded Liability (in Millions)
7/1/07	\$373.4
7/1/08	\$303.0
7/1/09	\$241.5
7/1/10	\$247.9
7/1/11	\$261.8
7/1/12	\$273.3

²⁷ The City's actuaries are currently working on the OPEB valuation, unfunded liability and ARC calculations. Their final report will not be available until after the Task Force issues its report. The City has a new OPEB actuary this year – Segal Consulting. See Appendix F for the Draft report.

Voluntary Employees' Beneficiary Association (VEBA)

The City and the Hartford Fire Fighters Association agreed in a contract effective July 1, 2007 to create a VEBA "for the sole purpose of providing funding for retiree health insurance benefits" for fire fighters hired after July 1, 2007 – which was to replace the current method of funding these post retirement benefits for these new employees. While the contract provision states that the VEBA will begin to be funded July 1, 2007, this provision has never been implemented or funded by the City.

The VEBA had specific contribution levels for both the City and covered employees. In addition, according to a Memorandum of Understanding between the City and the Fire Fighters Association dated December 12, 2007 the City must also pay 8% interest on unpaid contributions (both the City's contribution and the employees' contributions) for the period between July 2007 and when the VEBA is created and funded. Because these contributions have never been made, the City has an obligation to this program of approximately \$ 1.7 million.

Recommendations:

- Immediately create an OPEB Trust Fund, and transfer the assets available (currently set aside in City cash accounts) to this fund.
- The City Ordinance that creates the Trust Fund should commit the City to funding as described below
- The City should initially annually pay into the Trust Fund an amount equal to the pay as you go amount plus the Normal Cost (attributable to the annual growth in obligations from the work of current employees) as determined by the OPEB actuaries.
- The City should begin immediately to phase in additional payments to the Trust Fund toward the unfunded liability by creating and funding a budget line for the OPEB unfunded liability and, for example, increasing that budget line by \$1 million each year (i.e. \$1 million year one, \$2 million year two, etc.) until the City's share of the budgeted amount equals the ARC.
- The costs of administering the OPEB Trust Fund – including costs relating to investment of the funds – should be paid out of earnings of the Trust Fund. This would be similar to the funding of the administration of the Pension Fund. However, since there will be no earnings while the OPEB Trust Fund is being created, the set up costs of the fund should be paid for by an appropriation from the City's General Fund.
- The City should review its obligations under the Fire Fighters VEBA agreement. Once the OPEB Trust Fund is created and funded the City and Fire Fighters Union should discuss whether it makes sense to implement the VEBA, or whether the funded OPEB Trust Fund can meet the same goals as the VEBA, and therefore replace it.
- Consider policy changes that could reduce the future cost of providing benefits which would reduce the unfunded liability, such as

- a) require current employees who will be receiving these benefits to contribute part of their salary toward those future benefits
- b) Increase the retirement age
- c) Increase the years of service necessary to retire and receive benefits
- d) have retirees contribute a larger portion of the annual "premium" cost
- e) annually update the amount of the retiree contribution to reflect changing costs of coverage
- f) reduce benefits in additional ways, such as eliminating the 100% health coverage for those retirees who receive these benefits between the ages of 62 and 65, increasing deductibles, and making plan design and plan option changes in health care benefits for retirees as well as for active employees (as recommended in the Health Benefits section of this report)

The Task Force acknowledges that these changes are subject to the collective bargaining process.

- If the ARC for the Pension Fund decreases in any year (which could happen after the entire 2008 losses are recognized, assuming no further drop in asset value due to market losses), allocate the difference to the OPEB trust fund.

Pension Benefits

Introduction

Like the overwhelming majority of municipalities in the country, the City of Hartford provides a defined benefit pension plan for its employees – the Hartford Municipal Employees' Retirement Fund (MERF). In a defined benefit (DB) pension plan, an employer promises a specified monthly benefit on retirement that is predetermined by a formula based on the employee's earnings, tenure of service and age. Whether or not the promise is fulfilled depends on the adequacy of contributions made by the employer and sometimes, as in Hartford's case, by the employees. The annual amount of the contributions necessary to pay the specified benefits is determined by actuarial calculation, but occasionally governments fail to make the required contributions, with the potential consequence that the plan is unable to pay the benefits promised.

Hartford is not a government which has "behaved badly" with respect to funding its pension plan.²⁸ Unlike some government entities, including the State of Connecticut, which failed in early years to fund the annual required contribution (ARC) to pay for pension costs, or took ARC payment holidays, the City of Hartford has diligently funded the ARC. As a result, in the years leading up to the Great Recession, the City's pension obligations were 100% funded using traditional long-term actuarial assumptions.²⁹

Funding Status (using traditional long-term actuarial assumptions)	
Actuarial report on July 1	Percent funded
2004	99.6%
2005	101.7%
2006	101.9%
2007	100.1%
2008	102.2%
2009	96.6%
2010	88.6%
2011	83.5%
2012	79.0%
2013	76.6%

²⁸ In this respect, it is not unlike most cities across the country. In seeking to determine the causes of "city fiscal woes," a paper for the Center for State and Local Government Excellence concluded that pension funding problems appeared to be a major factor in less than 10% of the cities with fiscal difficulties which were reviewed. Munnell et.al, "Are City Fiscal Woes Widespread? Are Pensions the Cause?" December 2013, p. 6. (linked at <http://crr.bc.edu/briefs/are-city-fiscal-woes-widespread-are-pensions-the-cause/>)

²⁹ As noted below, for financial reporting purposes, using a financial economics based discount rate which reflects current market fixed income interest rates (a discount rate that is sometimes termed a "riskless rate,") the pension fund will appear to be funded at a much lower percentage of liability.

The reduction in the funding status in recent years is almost entirely the result of the 2008-2009 market slump.³⁰ Although it can be argued that the current funding level is still reasonably good (although not strong), there are important reasons to continue to fund the full annual required contribution (ARC) – in the future, the “Actuarially Determined Contribution (ADC)”– even though over the past 5 years the ARC has increased about 5-fold from roughly \$9.6 million in FY 2009-10 to approximately \$47.8 million for FY 2014-15³¹ and if no plan design or assumptions are changed, it is anticipated to remain above \$40M per year in subsequent years.

Contributions less than the full ARC will only undermine the financial health of the pension plan.³² (In turn, underfunded pension plans create long-term holes in a municipality’s fiscal budget, which exacerbate other sources of budgetary imbalance.) We acknowledge that many other factors also played a part in the decline of the financial health of the pension plans sponsored by other government entities, but non-payment of the full ARC was certainly one of the critical factors. Failure to continue to fully fund the ARC as recommended by the City’s actuary can possibly lead to a downgrade from rating agencies and more onerous financial reporting requirements. However, the City’s credit rating was recently upgraded and the rating agency cited the fact the City has continued to pay the full ARC as a factor in its decision.³³

³⁰ The actuarial value of assets in the pension plan and the actuarial accrued liability for the plan are shown in the following table, from the 2012 and 2013 Actuarial Studies by Hooker and Holcombe.

Actuarial Valuation Date	Actuarial Value of Assets (\$)	Actuarial Accrued Liability (AAL) (\$)	Funded Ratio
7/1/2007	1,092,128,000	1,090,715,000	100.1%
7/1/2008	1,123,379,000	1,099,441,000	102.2%
7/1/2009	1,089,184,000	1,126,965,000	96.6%
7/1/2010	1,041,572,000	1,175,040,000	88.6%
7/1/2011	1,017,602,000	1,218,900,000	83.5%
7/1/2012	977,146,000	1,237,136,000	79.0%
7/1/2013	963,269,000	1,258,182,000	76.6%

³¹ A detailed table of the Annual Required Contribution for each year from FY 2007-2008 through FY 2012-2013 is on p. 15 of the 2013 Actuarial Study by Hooker and Holcombe. (Appendix I)

³² As has occurred in some governmental entities, such as the states of Connecticut and Illinois, and the City of Detroit. The impact varies: while Connecticut has underfunded the ARC, and the pension funds are significantly underfunded, the situation is not as bad as either Detroit or Illinois. Connecticut is currently funding the ARC, and there is currently no threat of pension payments being reduced

³³ S&P rating report, March 5, 2014, at

http://www.hartford.gov/images/S&P_Rating_Report_March_2014_-_Upgrade_to_AA-.pdf

Recommendations:

I. Continue to use the long-term expected rate of return on assets in the investment portfolio to determine the annual funding requirements (Actuarially Determined Contribution (ADC)).

Acknowledge that financial reporting requirements are established by the Government Accounting Standards Board (GASB).³⁴ GASB requires use of a blended rate (the municipal bond rate and the long-term expected rate of return on assets) if the fund is ever projected to run out of money – which is not expected to occur in the City of Hartford.

Acknowledge that when assessing financial reports, bond rating agencies will make a conservative estimate of the pension liability and funded status based on the market rates of high quality bonds (referred to as a financial economics based discount rate³⁵).

A. Determining the amount of annual contributions to fund the reported financial liability should be based on the long-term expected rate of return on plan assets.

- Basing the annual contribution on a municipal bond rate or other current market discount rate means that there would never be investment in equities.
- This would require a high level of investment in low risk or risk-free bonds, which would guarantee a much lower return on investment, and hence rejecting higher rates of return possible with equities. In the long run, this would mean no possibility of reducing annual contributions through investment policy, since the return would never be expected to produce large investment gains.
- The high level of annual contributions required by a municipal bond or other current market discount rate would mean a lower wage level to offset the

³⁴ GASB is an organization whose main purpose is to improve and create accounting reporting standards or generally accepted accounting principles (GAAP). (See Appendix G.) These standards make it easier for users to understand and use the financial records of both state and local governments. "It is important to note that GASB Statements 67& 68 relate to *accounting and financial reporting* issues only—how pension costs and obligations are measured and reported in audited external financial reports. The Statements do not address how governments approach pension plan *funding*—a government's policy regarding how much money it will contribute to its pension plan each year. While there has been a close relationship between how governments fund pensions and how they account for and report information about them until now, the new guidance establishes a decided shift from the *funding-based* approach to an *accounting-based* approach. The Board crafted its new Statements with the fundamental belief that funding is squarely a policy decision for elected officials to make as part of the government budget approval process" – GASB 67/68 Plain Language Guide; June 2012. Last version: December 2013, at http://www.gasb.org/cs/ContentServer?site=GASB&c=Document_C&pagename=GASB%2FDocument_C%2FGASBDocumentPage&cid=1176160140567

³⁵ Laypersons frequently refer to this rate as a "riskless rate," because it does not depend on the vagaries of the stock market, but on the guaranteed interest rate on high quality bonds held to maturity – thus guaranteeing that the monies required to pay pension costs will be available.

higher pension contributions. A government sponsor has a finite amount of revenue and if contributions required for employee benefits rise, it is logical to conclude that wages or other public services would need to be cut to balance a budget. The high level of annual contributions would also mean less likelihood of increasing pension benefits. Both outcomes would ultimately make public employee compensation less competitive with the private sector, diminishing the quality of the public workforce.³⁶

B. Separating the discount rate used for financial reporting from the rate of return used to calculate contributions to the pension fund makes sense, and is supported in part by the new GASB accounting rules.³⁷ Financial disclosure under GASB 67/68 in some instances requires the use of a hybrid discount rate that potentially blends a municipal bond rate with the long-term expected return on plan investments.^{38, 39}

C. Objecting to the use of a rate of return based on the assets (including equities) in the portfolio of a DB plan is internally inconsistent. Proponents of DC plans in lieu of DB plans for government employees say that a riskless rate of return (the rate of return for a 30 year Treasury bond = ~ 4%) must be used for the calculation of DB plan liabilities; they say that assuming a rate of return of 8% for DB plans is unrealistically high, and will ultimately lead to underfunding and bankruptcy of DB plans. At the same time, however, DC plan proponents often argue that DC plan participants can earn a high rate of return on their DC investments, a rate comparable to the long-term historical rate of return in the equity markets, potentially in excess of 8%.⁴⁰ It is counter-intuitive to assume such a high rate of return on DC plan personal investments (when it is known that many participants do not invest wisely), and not on DB plan investments, which are

³⁶ Munnell, *State and Local Pensions: What Now?*, pp. 216-17.

³⁷ As the 2012 Valuation Study states, referring to the new GASB rules, "Under the prior standards, the ARC served as both the contribution policy and the accounting expense. . . . (T)he ARC is eliminated and replaced with the ADC (Actuarially Determined Contribution) with regard to the funding policy." (p. 6)

³⁸ Useful short summaries of new GASB rules may be found in "Pension Funding: A Guide for Elected Officials," Report from the Pension Funding Task Force 2013, downloadable at <http://slge.org/publications/pension-funding-a-guide-for-elected-officials>, and "Understanding New Pension Funding Guidelines and Calculations," National Association of State Legislatures, 2013, at <http://www.ncsl.org/research/fiscal-policy/new-public-pension-funding-guidelines.aspx>

³⁹ The City's actuary has stated to the Task Force that a blended rate would be required by GASB 68 only if the trust fund is expected to be unable to pay its benefits. A municipality having a funding policy, following that policy, and having a funding level above 70% should not need to use a blended rate. Accordingly, the actuary did not believe that the City of Hartford, under current circumstances, would be subject to a blended rate.

⁴⁰ The S&P 500, for the period 1928-2013, had a geometric average annual rate of return of 9.55%, for the period 1964-2013 a geometric average annual rate of return of 9.89%, and for 2004-2013, a geometric average annual rate of return of 7.34%. See NYU's table of returns at http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html. In Warren Buffet's 2014 letter to Berkshire Hathaway shareholders, he notes that his advice to the trustee of his estate is to invest in a low-cost S & P 500 index fund. (p. 20)

professionally managed and have a much longer investment horizon than any individual participant.

D. A financial economics based discount rate reflects current market fixed income interest rates. It makes sense to use this type of discount rate to internally evaluate pension liabilities (and to base financial reporting of pension liabilities on) because:

- It forestalls unwise benefit increases when the stock market soars
- It enhances pressure to increase funding
- Bond rating agencies will evaluate the pension liability on this basis
- New pension accounting rules require that if a pension fund is ever projected to run out of money, for financial reporting purposes the municipal bond rate must be blended with the expected rate of return on assets
- It avoids aggressive portfolio allocations to justify high discount rates

It is better practice for pension plan boards to determine how much risk they are willing to accept in the form of contribution volatility and benefit security, and then maximize the portfolio return for that level of risk. Actuaries would THEN recommend the expected discount rate based on the portfolio.⁴¹ Hartford is fortunate that the Pension Commission determines the acceptable risk level, the asset allocation, and the discount rate – so there is alignment of the factors involved.

To summarize this section, using the expected rate of return on invested assets to determine contributions to the pension fund should be a separate process from using the current market fixed income interest rate for financial reporting.

II. Do not pursue the replacement of the existing Defined Benefit plan by a Defined Contribution plan for newly hired employees (contrary to the recommendation of the 2010 Budget Fiscal Analysis Task Force).

A. Switching to a DC plan does not remove the employer's responsibility to pay for liabilities caused by past underfunding.

A new plan only addresses pension costs going forward – it does not address a current funding problem.

1. Must still cover cost of accrued benefits for past service⁴²
2. May actually increase short-term cost⁴³

⁴¹ Munnell, State and Local Pensions: What Now? p. 215.

⁴² Munnell, pp. 189, 208; "Final Report of the Connecticut Post-Employment Benefits Commission," October 28, 2010, (link available at www.ct.gov/opm/cwp/view.asp?a=2998&q=457846) p. 51

- a. Closed plans⁴⁴ using the level percent of payroll method for calculating the ARC must acknowledge that covered payroll is decreasing (GASB 25)
 - b. a level dollar funding method for a closed plan frontloads ARC compared to ARC under the ongoing plan
 - i. the cost increases because the period of time to spread the cost is continually shrinking without new younger employees joining the plan
3. Market gains from future new hire contributions that could have been used to offset unfunded liability in DB plan would now be sequestered in the new DC accounts
4. As the participants in the old DB "closed" plan grow older, funds invested in the closed plan would need to be shifted away from equities (more volatile) towards more fixed income (less volatile) to support a population of mostly retirees. So the government would have to increase contributions to the fund to make up for lower investment returns.⁴⁵
5. A DC plan would probably not save money for a given level of benefits⁴⁶
 - a) because a DC plan has higher administrative costs (~ 1% vs. ~ 0.4%)
 - b) to the extent that employees are currently making contributions to the old DB plan, the employer contribution for normal cost is already pretty low (and might be higher with DC plan – as with the CT Higher Education Alternative Retirement Plan)
 - c) the employer contribution in a DC design that is expected to deliver the same benefit at retirement as the current DB plan is likely to be significantly greater than the current normal cost in the DB plan, as a percent of payroll (currently 9.5%)⁴⁷

B. A DC plan essentially just shifts risk from the employer to the employee. These risks include investment risk, longevity risk and inflation risk. Most City employees are not prepared to manage these risks.

⁴³ Munnell, p. 190n.

⁴⁴ "Closed plans" here refers to plans which have been closed to new participants. The term does not refer to a closed amortization period used in calculating the ARC.

⁴⁵ CT PEB Study, p. 51. The Minnesota Retirement Plan Design Study (published June 1, 2011, available at <http://www.msrs.state.mn.us/pdf/Study6-1-2011web.pdf>) puts this a slightly different way: "Relative to an open ongoing DB plan, a closed DB requires higher cash outflow, meaning benefit payouts are high relative to contribution revenue. As a result, plan assets will be spent down and thus, must be invested in a lower risk investment allocation." (p. 3)

⁴⁶ Munnell, pp. 190-91.

⁴⁷ The reasons, according to a study by the National Institute on Retirement Security in 2008: 1) no longevity risk pooling, 2) less balanced portfolio, 3) higher management fees, 4) lower returns [individual investment choices usually less knowledgeable than those of a professionally managed pension plan]. Almeida and Fornia, "A Better Bang for the Buck," National Institute on Retirement Security, August 2008, linked at <http://www.nirsonline.org/index.php?option=content&task=view&id=121>

C. The supposed lower cost of DC plans is often just a result of cutting employer contributions to the DC plan, not greater economic efficiency.⁴⁸

III. Investigate⁴⁹ the possibility of “stacking” a DC plan on top of the DB plan, which would be retained for all employees for the portion of their earnings less than a determined amount (such as the state median household income).⁵⁰

This design would allow employees with modest earnings to receive the full protection of a DB plan. More highly paid employees (with earnings exceeding the predetermined amount) would still have the protection of a DB plan as a base, and would then rely on the DC plan for earnings replacement that exceeded the predetermined earnings threshold.

This type of benefit design would maintain risk protection to lower wage employees and allow some risk to be shared with employees deemed to be higher wage earners. The benefits could be designed to maintain meaningful benefits to all employees while reducing the cost and volatility of that cost to the City. The definition of “meaningful benefits” needs to be discussed amongst all stakeholders and would certainly be less than the current DB design provides. The current DB design was established at a time when employee mobility and life expectancy were much lower. The current DB plan was designed to be the sole provider of retirement income for a majority of its participants. The City needs to evaluate the role the retirement plan is to play in the recruitment and retention of its workers, so that it can continue to afford both competitive wages and meaningful retirement benefits.

Asking employees to participate in their retirement planning (via a stacked DC plan) may be appropriate because it helps build an understanding of the value of income in retirement and the sacrifices that must be made to accumulate the funds necessary to provide that income.

A change to the benefit design would need to be accompanied by employee education on the features of the new design, how the employee needs to participate, and how providing retirement benefits is a partnership between the City and the employee.

Such a design could provide secure benefits to those employees that need them most, while limiting the risk to taxpayers of covering large pension shortfalls. Because a stacked design will provide a smaller DB benefit to employees above the predetermined

⁴⁸ See National Institute on Retirement Security (2008), p. 13.

⁴⁹ First by conferring with a benefit consultant to determine the potential parameters of such a plan, and then by using an actuary to provide projections of the costs and benefits of such a plan.

⁵⁰ Munnell, pp. 206-208.

wage limit, there would be built in protection to taxpayers of significant liability shortfalls if pension plan assets underperform.

However, actuaries would need to calculate whether limiting the DB plan contribution from and for participants with income in excess of the determined amount would raise or lower the ARC or the Normal Cost. It may turn out that the cost to both employees and the City may be prohibitive.

Moreover, the transfer of some risk from the employer to the employee might affect an employer's ability to competitively attract managers and other highly compensated staff members.

IV. Make additional adjustments to the existing DB plan to reduce the annual Actuarially Determined Contribution and the Normal Cost to a reasonable lower level.

The retirement benefit for an individual employee is determined in a DB plan by a formula which takes into account the final pay of the employee, the age of the employee, the length of service, and the "benefit" or "accrual" rate assigned to each year of credited service, as modified or constrained by other factors. The aggregate amount of funding necessary to be set aside to pay the benefits for all employees is projected by actuaries based on assumptions about life expectancy of employees at retirement, the rate of return projected to be earned on funds set aside, and the length of the period used to amortize any shortfalls.

The accompanying table – attached ("Attachment 1" – page 38) as the integral final section of this report – provides a comprehensive summary of, and commentary on, factors that might be adjusted to reduce pension liabilities. Note that a number of potential adjustments have already been made by the City.

Based on analysis of the possible factors, the Task Force makes the following recommendations:

- A. Increase the full retirement age to 65.
- B. Make the adjustment for early retirement actuarially sound.
- C. Reduce the accrual rate (benefit rate) for all employees to no more than 2%.
- D. Restrict the exchange of accumulated sick leave for pension service time.
- E. In calculating final average earnings, use the average earnings for the last five years of employment, instead of the highest two or three years of the last five.

F. Adopt additional anti-spiking provisions: exclude overtime pay and use of vacation and sick payout from the calculation of final average earnings.

G. Use a closed amortization period of 25 years, instead of the current assumption of an open amortization period of 15 years.

The Task Force acknowledges that items A-F are subject to the collective bargaining process, while item G is in the purview of the Pension Commission.

V. In negotiations with collective bargaining agents, the City should never make or accept proposals without full consideration of the actuarial analysis of the impact of those proposals on pension plan cost.

The Task Force recognizes that even when actuarial analysis has occurred, the give and take of negotiations sometimes results in increased pension costs. But we strongly recommend that the impact on the fiscal health of the pension fund be one of the most important factors considered in the negotiations. It should be of great concern to both employees and the City, because it can ultimately determine whether expected benefits in fact are sustainable.

Addendum of May 14, 2014

Subsequent to the final meeting of the Task Force on April 16, 2014, the Task Force requested and received additional information from Milliman actuaries concerning the long-term impact of certain assumptions involved in the calculation of the Actuarially Determined Contribution (ADC) to the pension fund, which the City Charter requires to be made each year.

Specifically, the Task Force requested that various scenarios be projected for 25 years into the future (through 2040), using different assumptions about

1. the rate of return (discount rate) on assets
2. the length of the amortization period
3. whether the amortization period was closed⁵¹ or open,
4. whether the amortization would occur through "level dollar" payments (as with a home mortgage) or through "level percent" amortization, assuming 2%, and
5. whether the amortization would occur through "level dollar" payments (as with a home mortgage) or through "level percent" amortization, assuming 3%.

The various scenarios are included as **Appendices J and K. City of Hartford MERF – Long-Term Projection Based on July 1, 2013 Valuation, by Milliman.**

The following scenarios in Appendix G are of interest. Note that under all of the scenarios referred to here, the funded ratio at the end of the 25 year period is in excess of 92%, as opposed to the current funded ratio of about 75%.

Page 1. 8% rate of return, 15 year amortization period, open, level dollar

This scenario uses assumptions which the Pension Commission has been using in the past. The ADC for the 2014-2015 budget year would be \$47.761 million.

Page 3. 7.75% rate of return, 15 year amortization period, open, level dollar

This scenario uses assumptions which the Pension Commission had been considering for this year. The ADC for the 2014-2015 budget year would have been \$51.900 million.

Page 7. 8% rate of return, 25 year amortization period, closed, level dollar

⁵¹ Please note that the last 10 years of the "closed" amortization period, in the Milliman scenarios, reverts to an "open" schedule, in order to mitigate volatility in those years.

This scenario uses assumptions recommended by the Task Force as of April 16, 2014. See pages 4 and 5 of Attachment 1 of the Report, and recommendation G on page 33 of the Report. The ADC for the 2014-2015 budget year would have been \$41.192 million.

Page 9. 7.75% rate of return, 25 year amortization period, closed, level dollar

This scenario uses assumptions recommended by the Task Force for consideration beginning in the 2015-2016 budget year. See pages 4 and 5 of Attachment 1 of the Report, and recommendation G on page 33 of the Report. After discussions between the Mayor and the Treasurer, the Pension Commission adopted the assumption underlying this scenario as the basis for the ADC it decided to recommend for the 2014-15 budget year. The ADC for this budget year would be \$44.556 million – the amount included in the budget submitted by the Mayor.

Page 21. 7.75% rate of return, 25 year amortization period, closed, level 2% amortization

This scenario uses assumptions brought to the attention of the Task Force by Milliman actuaries: specifically, the use of “level 2% amortization” instead of level dollar. This was an alternative option that was considered, but not adopted by the Task Force (see page 5 of Attachment 1 of the Report), in large part because of a lack of information. After Milliman provided this scenario to the Task Force meeting of May 7, 2014, it appeared to the Task Force that this alternative might well be of interest to the Mayor and Council, for this year and in subsequent years. See commentary below. If adopted, the ADC for this budget year of 2014-2015 would be \$39.983 million. And the projected ADC would remain below that of the Scenario on Page 9 through budget year 2023-2024, when it would begin to exceed the Page 9 Scenario, ultimately by \$4 million annually in budget year 2039-40. In short, this Scenario would “backload” the pension contribution.

Page 33. 7.75% rate of return, 25 year amortization period, closed, level 3% amortization

This scenario uses assumptions brought to the attention of the Task Force by Milliman actuaries: specifically, the use of “level 3% amortization” instead of level dollar. This was an alternative option that was considered, but not adopted by the Task Force (see page 5 of Attachment 1 of the Report), in large part because of a lack of information. After Milliman provided this scenario to the Task Force meeting of May 7, 2014, it appeared to the Task Force that this alternative might well be of interest to the Mayor and Council in

future years as the state of the city's finances becomes clearer. See commentary below. If adopted, the ADC for this budget year of 2014-15 would be \$37.857 million. The projected ADC would remain below that of the Scenario on Page 9 through budget year 2023-2024, when it would begin to exceed the Page 9 Scenario, ultimately by \$6.4 million annually in budget year 2039-40. In short, this Scenario would "backload" the pension contribution.

Commentary

The Treasurer and the Pension Commission have observed that the anticipated rate of return on assets in the pension fund (the discount rate) – dependent as it is on the level of risk the Pension Commission is willing to accept (see page 29 of the Report) – is likely to be trending down in future years. Accordingly, as the members of the Task Force understand it, the Commission has been on the cusp of assuming a 7.75% rate of return, down from the previously assumed 8% of return. The result of the discussions between the Mayor and the Treasurer, which eventuated in the Pension Commission recommendation reflected in the Page 9 Scenario, combining a 7.75% rate of return assumption together with a 25 year closed amortization period assumption, using level dollar amortization, seems reasonable to the Task Force.

However, based on the various scenarios developed by Milliman actuaries, the Mayor and the Council may want to consider the use of "level % amortization," either this year or next. Using the assumptions of the Page 21 Scenario, the City could reduce by \$4.6 million its 2014-2015 contribution to the pension fund, on an actuarially sound basis. Using the Page 21 assumptions (level 2% amortization), rather than the Page 33 assumptions (level 3% amortization), is more conservative over the long term. The Task Force does not believe that the more aggressive assumption of a level 3% amortization, as embodied in the Page 33 Scenario, is appropriate.

Before any action to move away from the Page 9 Scenario is taken, however, the Mayor and Council should be aware of the following:

1. The out-year contributions, after 2023-24, are greater under the Page 21 Scenario than with the Page 9 Scenario, because the amortization is backloaded. (Although it should be observed that the additional out-year amortization contributions are a far lower share of the total ADC than are the annual Normal Cost contribution requirements).
2. The total cost of pension contributions over the 25 year period is greater with the Page 21 Scenario than with the Page 9 Scenario, because of backloading.
3. Under any scenario, the City must adhere to the amortization schedule as projected.

4. The projected costs in all of the Milliman scenarios are in nominal dollars, not in “real”, inflation-adjusted dollars. Further analysis is warranted.

5. Using a level % amortization method requires some realistic review of the City's future financial condition. As one of our Task Force members has pointed out,

A level % amortization method may be reasonable for a government sponsor if they anticipate that future revenue may also be increasing, thus aligning their future increasing pension payments with a similarly increasing revenue stream. This method should not be adopted if the government does not anticipate increasing revenue in the future.

To summarize this addendum:

The alternative scenarios, projected by Milliman actuaries for 25 years into the future, provide options that may be considered by the Mayor, the Council, the Treasurer and the Pension Commission, either now or in the near term. Task Force members are not in a position to make decisions that are delegated by the Charter to other bodies. By reviewing and presenting different options – along with potential downsides and upsides – for these bodies to consider, the Task Force believes that it has provided sound information for decision-making.

Attachment 1. An Integral Part of the Task Force Report

Analysis of Factors Affecting Pension Liabilities

The following two tables summarize the many factors that affect pension liabilities, and list potential adjustments that might be made. They also note that some actions have already been implemented. Others are being considered by the City's actuary, and/or by the Pension Commission. The final column in each table includes recommendations for the Mayor and the Common Council to consider implementing.

Note that, in the 2012 Actuarial Study, only \$14.4 million of the total \$43.2 million ARC was the Normal Cost; the other \$28.8 million was for the amortization of the Unfunded Actuarial Accrued Liability (over a 15 year open period), as adjusted for interest during the funding year. (See p. 9 of the 2012 Study) The 2013 Actuarial Study has updated this information.

Plan Design (subject to collective bargaining)

Options: Apply adjustments to new hires only, or to all employees for future service. Applying to new hires in the future limits potential reductions in the ARC. Applying to active employees for future service may reduce the ARC, but may affect the retirement income current employees expected, based on provisions in effect when they entered service. An actuary has been requested to provide estimates for a) increasing the retirement age, and b) using the average pay over the employee's last five years of service to calculate final pay, for two scenarios: 1. applying to new hires only, and 2. applying to current employees who are more than 15 years away from retirement at the age of 62.

Factor	Potential Action	Commentary	Action Already Taken	Recommendation
COLA percentage	Reduce COLA percentage	Per footnote #1 (pp. 2-3), reducing an automatic COLA from 2.5% to 0% reduces a hypothetical pension plan's Normal Cost by 23.5%.	City has set the nominal COLA = CPI%; but actual COLA is 0%, since it is discretionary and has not been provided since 2007	No further action.
COLA requirement	Make COLA discretionary, or eliminate COLA	Reduces costs to City, but eliminating a COLA threatens the retirement security of employee, although less so if the employee is also a participant in Social Security. (See footnote #2, p.6)	Discretionary. Not provided since 2007. Because the City has already limited COLAs to be discretionary, it retains the ability to provide inflation protection at times when it can afford to do so, but is not obligated to provide adjustments when it cannot afford to do so. This is a middle ground.	No further action.

Factor	Potential Action	Commentary	Action Already Taken	Recommendation
Normal retirement age	Raise retirement age for non-public safety participants to 65, and for public safety participants to 55.	Per footnote #1 (p.2-3), raising retirement age from 60 to 65 reduces the Normal Cost in a hypothetical pension plan by 25.3%. The City's actuary will be calculating the impact on Hartford's pension plan. * Would also reduce OPEB costs.	Age 55 added to service requirement for sworn police officers and age 60 increased to age 62 for some other groups (See p.39 of 2012 Study)	Raise retirement age for non-public safety participants to 65. (Actuaries can calculate impact on ADC for pension and OPEB.) Sunset ability to retire with unreduced pension at age 55 with 20 or 25 years of service, and 25 years and out.
Years of service	Increase years of service required for full pension	If age at retirement is less than 65, then retirement at that age with full pension when a specified length of service is attained nevertheless results in a longer period of pension payments – and under most current contracts, full health benefits from 62 to 65.	(See p. 39 of 2012 Study.)	If retirement age for non-public safety employees is raised to 65, require 10 years of service at 65 for unreduced benefits (currently 60 & 5 for many groups)
Vesting period	Increase period required for vesting	Would likely diminish turnover, & penalize mobility.		No further action.
Early retirement adjustment	Make adjustment actuarially sound (i.e. eliminate subsidy in current factor)	For most non-public safety employees, reduction of benefit is 4% per year short of retirement with a full pension. Reduction is fixed and less than would be actuarially required. (See p. 40 of 2012 Study) Per footnote #3 (p. 14), 6% is considered a roughly actuarially neutral reduction factor. Using a reduction factor less than 6% indicates that employers are subsidizing some of the early retirement benefits, thus providing an incentive to retire early.	Sworn police and fire are now actuarially reduced.	Make adjustment for early retirement actuarially sound.
Accrual rate (benefit rate)	Reduce accrual rate for non-public safety and those eligible for Social Security to 1.5%, and for public safety and those ineligible for Social Security to 2%.	A reasonable accrual rate is impacted by (a) whether employee contributes to pension and (b) whether employee is on Social Security. For comparison purposes, State of Connecticut SERS Tier II and IIA accrual rate is 1.33% for < ~\$40K, and 1.83% for > ~\$40K, but no employee contribution is required for these tiers.	Police: 2.8% up to 25 yrs; 2.5% after (Note that police rate increase was accompanied by retirement age requirement of 55 for full benefits.) Fire and Bd of Ed unions: 2.5% All others: most at 2.0%, with some non-bargaining at 1.75% (See pp.37-38 of 2012 Study)	Reduce accrual rate to no more than 2%.

Factor	Potential Action	Commentary	Action Already Taken	Recommendation
Maximum Benefit Percentage	Decrease percentage	A reasonable maximum benefit percentage is impacted by (a) whether employee contributes to pension and (b) whether employee is on Social Security. Currently most employees range from 70% to 85% of final average pay (See p. 37 of 2012 Study)		Explore the cost reduction to the City, and the impact on retirement income to employees, of lower maximum benefit percentages.
Service Purchase of sick days	Eliminate, or permit retirees to use accumulated sick leave to purchase additional service only on a 1 day for 1 day basis, either in total or capped at 50 days	Currently (see note 4 on p. 43 of 2012 Study), current employees who retire may purchase additional pension service time at the rate of 20 days of accumulated sick leave for one year of pension service time, up to a maximum of 4 years of pension service time. Recent bargaining agreements ended this provision for new hires after 2013, except for firefighters		End the current practice for current employees (as well as for new hires after 2013), and permit such purchase for only a day of sick leave for a day of pension service time. Cap the exchange of accumulated sick leave for pension service time at 50 days.
Service Purchase for other service	Make actuarially sound	Up to four years of other service (military, other govt.) can be purchased by paying employee contributions plus interest		To purchase, require full actuarial value to be purchased (i.e., employee must pay full employee cost plus employer cost plus interest)
Final earnings vs. career earnings	Use career earnings instead of final 2 or 3 or 5 years, OR increase the Final Average Earnings period for non-public safety participants to five years	Per footnote #1 (p.2-3), using average compensation over a career instead of final year's compensation level reduces the Normal Cost of a hypothetical pension plan by 32.8%. However, moving to career compensation fails to adequately account for inflation.	(See p. 37 of 2012 Study for current)	Move to 5-year average of final earnings for non-public safety participants
Anti-spiking provisions	Eliminate use of overtime or private duty pay, or inclusion of vacation and sick days payout		Fire: final year of base pay only Police: exclude private duty All others: Gross W-2 earning with vacation and sick days on a run-out basis	Exclude overtime and vacation and sick time payout in final average earnings.
Spousal benefits	If greater than 50% after participant death, reduce participant's benefit		Spousal benefit is 50%; can't be increased (For police, 25% of final 12 months of earnings)	No further action

Factor	Potential Action	Commentary	Action Already Taken	Recommendation
Employee contributions	Increase employee contribution		<p>Sworn police: 9.5% (new > 2012)</p> <p>Non-sworn police: 4% on SS earnings, 7% on excess</p> <p>Firefighters: 8%</p> <p>Bd of Ed units:</p> <p>4% on SS earnings, 7% on excess</p> <p>HESP, 9% & 12%</p> <p>HSSA, 9.25% & 12.25%</p> <p>HFSHP, 10.14% & 13.14%</p> <p>Non-bargaining: 4.5% & 7.5%</p> <p>Local 818, 7.1% & 10.1% (new > 2007)</p> <p>Muni & Library:</p> <p>Non-bargaining: 5% & 8%</p> <p>Library: 4% & 7%</p> <p>HMEA: 5% & 8% (new > 2003)</p> <p>CHPEA: 5% & 8% (new > 2003)</p> <p>SCGA: 4% & 7%</p> <p>(see p. 42 of 2012 actuarial study)</p>	Although the Task Force reviewed a change in this feature of the plan design, it believes that current employee contribution rates are high and further increases are not a viable alternative.

Assumptions and Methods (within the purview of the Pension Commission)

Factor	Potential Action	Commentary	Action Already Taken	Recommendation
Assumed rate of return on investments	The only reasonable action is to hold the existing assumption of 8% or to lower it; neither of which will reduce the ARC	Actuary had been exploring reducing the assumed rate to 7.75% in conjunction with increasing the length of the amortization period, and closing it.		The Pension Commission should continue to use an 8% assumed rate of return in conjunction with a closed 25 year amortization period.
Length of amortization period for unfunded liabilities	Increase from current 15 years to 20, 25, or 30 years.	<p>Actuary's most recent calculations concluded:</p> <p>a) lowering the assumed rate of return to 7.75%, using a 15-year open amortization period, would require a 14-15 ADC of \$51.9 million</p> <p>b) If length of amortization period extended to 25 years, with closed period, at 7.75% assumed rate of return, ADC for 2014-15 would be about \$44.6 million.</p> <p>c) Under current assumptions of 8% assumed rate of return and 15 year open amortization, ADC for 2014-15 would be \$47.8 million.</p> <p>d) Under assumption of 8% return and 25 year closed amortization, ADC for 2014-15 would be about \$41 million.</p>		<p>Recommendation:</p> <p>The Pension Commission should use an 8% assumed rate of return in conjunction with a closed 25 year amortization period, at least for 2014-15, as it considers using a 7.75% assumed rate of return in future years.</p> <p>The Pension Commission should</p>

Factor	Potential Action	Commentary	Action Already Taken	Recommendation
Length of amortization period for unfunded liabilities (continued)		Funded Status as of 7/1/2013 using an 8% assumed rate of return is 76.56% and using a 7.75% assumed rate of return is 74.73%. Length of period should be no longer than the length of an average employee's remaining work life. (See footnote #1, p. 5)		review the assumptions at regular intervals [e.g. every two years] to determine if there is a need to change the assumptions.
Open amortization period or closed amortization period	Assume closed amortization period.	A closed amortization period will initially increase costs, but over the long run will serve to reduce future costs. Changing from current open period to closed period would allow the existing unfunded liability to truly be retired by the end of the closed period.		The Pension Commission should use an 8% assumed rate of return in conjunction with a closed 25 year amortization period.
Smoothing method for losses of principal	Extend smoothing period of 5 years to longer than 5 years, but no longer than 10 years.			After consideration, the Task Force recommends retention of a smoothing period of 5 years.
Actuarial cost calculation: "entry age normal" vs. "projected unit credit"		Entry age normal is required for financial reporting (GASB) and is the current method for funding calculations (ARC). PUC will lower costs initially, but deliver increasing normal costs in future years as participants reach retirement.	Entry age normal	No further action.
Level dollar amortization vs. level percent of payroll		Level dollar is currently used; level percent of payroll will lower costs in the short term, but increase costs in future years without a growing workforce.		No further action.

References:

1. Hess, Healey and Nicholson, "Public Pension Reform: Benefit Design as the Key to Sustainability," Public Sector Inc., January 2014, available at <http://www.publicsectorinc.org/2014/01/public-pension-reform-benefit-design-as-the-key-to-sustainability/>.
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