CHATTANOOGA FIRE & POLICE PENSION FUND

A Defined *Benefit* Plan (DB Plan) obligates the City of Chattanooga to provide for an annuitized stream of income to Police Officers and Firefighters or their surviving spouses during their retirement years.

- Over the course of a career, both the City and the employee make regular contributions to the fund. Those contributions are pooled with those of other employees. The pooled assets are then invested to earn a sufficient amount of money to satisfy, in part, the payout to Police Officers and Firefighters during retirement. The DB Plan includes disability and death benefits in addition to retirement income, with retirement income typically constituting the largest benefit.

- An officer must serve 10 years to be "vested" in the pension fund. A Cost of Living Adjustment (COLA) for the retirement benefit is part of the plan. The long-term preservation of the plan is based on a combination of factors that include: a) City contributions at or above the actuarial requirement; b) realized investment returns at or above the actuarial return requirement; and c) the number of active participants exceed the number of beneficiaries.

- **With a DB Plan, each employee focuses on the benefits stream upon retirement.** If the participant believes a certain level of benefits are required to cover living expenses and other financial needs during retirement, the participant will likely determine his or her retirement date based on when that level will be achieved. That decision, of course, could be contingent upon limitations such as mandatory retirement ages or minimum/maximum years of service.

ADVANTAGES	DISADVANTAGES
• Retirement & disability income security	• Higher cost to administer
• Ability for City to more efficiently manage workforce needs through plan design	• Required Contributions are variable
• COLA provides some inflation protection	• Limited account portability

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A Defined *Contribution* Plan (DC Plan) is an alternate type of qualified retirement account to which the City of Chattanooga and Police Officers and Firefighters would both contribute.

- There are many types of DC Plans. A feature of the most common types of these plans is that contributions are not a fixed amount based on some actuarial requirement. Instead, these contributions are often flexible and discretionary. This type of plan is not designed to support a pre-determined amount of monthly retirement income. It does not have death benefits or disability benefits. Contributions and earnings accumulate over time to provide a lump sum of money that the beneficiary uses upon retirement.

- In many DC Plans, employees maintain separate, individual accounts and assets are not pooled. The investment returns for one participant have no impact on any other participant. The City would provide a broad selection of diverse investment options and employees would select how their money will be invested throughout their duration as participants. The City would also be required to help educate employees on options in their plans as well as general information about retirement planning.

- Employees are immediately vested in their contributions, but a vesting schedule is often applied to employer contributions. Upon retirement, most participants can transfer their money in a DC Plan to an Individual Retirement Account (IRA) without tax penalty. Retirees utilize their IRAs to help support living expenses and are no longer considered participants in a DC Plan. Money in the IRA is subject to a required distribution schedule that begins at age 70½. However, the retiree can draw against these funds immediately, subject to income taxes and early distribution penalties.

- **Employee participants of DC Plans seek to accumulate as large a balance as possible**. Because of the impact of earnings upon accumulated earnings and compound interest, DC Plan balances tend to grow by increasing **a)** length of service; **b)** contributions; and **c)** investment returns. Contributions to DC Plans are limited by Federal tax laws. Because of these variables, participants in DC Plans have an incentive to defer retirement for as long as possible.

ADVANTAGES	DISADVANTAGES
• Budgetary flexibility through fixed or discretionary contribution rates	• Incentive to extend career to accumulate larger plan balance
• Account portability	• Employee can outlive his or her money
• Lower administrative costs	• No guarantee as to investment returns or level of benefits
	• No disability benefits

An Example
Defined Benefit Plan vs. Defined Contribution Plan

Assumptions

- ✓ 6% contribution rate by the City
- ✓ 5% contribution rate by the employee
- ✓ Investment returns of 6% for the 401(k)
- ✓ 27-year-old that works 25 years + 3 year DROP period
- ✓ Pension estimates based on present-day value
- ✓ Death at 88
- ✓ Defined Benefit Plan has investment return of 7.75%

Under the Defined Benefit Plan, the present value -- upon retirement -- of the amount necessary to fund the monthly benefit until death is $560,991.

Under a Defined Contribution Plan, the projected balance available for retirement use would be $448,813, or a difference of $112,178.

To achieve the same amount of retirement funding as provided under the Defined Benefit Plan, a Police Officer or Firefighter would have to work an additional nine years, until age 63.

To be able to retire after 28 years at age 55 instead of age 63, the Police Officer or Firefighter could achieve the same amount of money as provided by the current pension plan by:

- ✓ **Earning an investment return over the 28 years of 9.125%, or**
- ✓ **Having the City contribute 14%, or**
- ✓ **Contributing 13.5% of pay to his retirement fund**

<u>Bottom line</u>:

To match the current Pension Plan, employees would have to work longer.

- **The Issue of Portability**

The importance of portability as it relates to a DC Plan or a DB Plan depends on one's perspective. **Portability refers to the ability of the employee to take his contributions to a plan and leave for another job.** Under the current pension plan, a Police Officer or Firefighter is vested in the Pension Plan after 10 years.

For example, if an officer decides to leave at 13 years, he or she will be eligible in the future for a 13-year pension benefit from the Pension Fund. If an officer decides to leave before 10 years, he or she receives back the pension contributions made. **The DB Plan is effectively an anchor with an incentive for officers to continue to serve.** Under a DC Plan, assuming the plan allows for immediate vesting, an officer may leave the force at any time and the total accumulated amount of money goes with him or her.

- **What's Best for Police Officers and Firefighters?**

While they are indeed members of the public sector, Police Officers and Firefighters need to be considered as a unique class of worker. For most public and private sector workers, the ability to work more than 40 years is quite common; "Job-related" disabilities are rather low, as is the probability of loss of life because of one's profession. **However, Police Officers and Firefighters are not afforded the luxury to work 35 – 40 years.**

Because of physical demands and other obvious restrictions, **most public safety personnel do not enjoy the career longevity of workers in the private sectors** and others in the public sector.

In many ways, Fire & Police belong to a separate, unique category. DC Plans have an inherent incentive on the part of the employee to work as long as possible. **For this reason, a DC Plan structure would be inappropriate for Police Officers and Firefighters.**

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