September 21, 2021

To: Mayor and Members of City Council

Copy: Paula Boggs Muething, City Manager

From: Cincinnati Retirement System Board of Trustees

Subject: State of CRS Pension Trust and Healthcare Trust as of December 31, 2020

This report is written to provide to the City Council with the state of the Cincinnati Retirement System (CRS) Pension Trust and Healthcare Trust, in accordance with the City's Administrative Code, based on the latest actuary report from December 31, 2020.

Given the current and projected funding positions of the Pension Trust, we recommend that the City Council take action to address the continued downward trajectory of the Pension Trust. In addition, we recommend that the City Council require the City Manager to develop a funding policy for the Healthcare Trust. The Cincinnati Municipal Code requires that the City get "input and recommendations" about the Healthcare Trust funding policy from the CRS Board.

Background

The purposes of the CRS Pension Trust and Healthcare Trust are to provide retirement benefits and healthcare benefits to eligible retired city employees. As of December 31, 2020, there were 2,631 full-time active members, 4,459 pensioners receiving pension payments, and 5,110 pensioners and spouses receiving healthcare benefits.

The CRS Board of Trustees serves as an independent fiduciary on behalf of active and retired members of the retirement system. The Board retains Marquette Associates, an independent investment consulting firm, and Cheiron, a pension and healthcare actuarial consulting firm, both of which specialize in public sector plans. Marquette and the Board have developed and follow a disciplined investment policy that can be found on the CRS website. Cheiron calculates the actuarial value of assets and liabilities and projects the funded status of the Trusts in future years based on professional actuarial standards and practices.

The assumed investment rate of return and discount rate for calculating liabilities is 7.5% per year as prescribed in the CSA. The annualized market rates of return for the past 5 and 10 years as of December 31, 2020 were 8.8% and 8.0%, respectively. As of June 30, 2021, the 5 and 10 year returns were 10.5% and 8.6% respectively. CRS investment performance is at or above the median with peer public defined benefit retirement plans.

The table below highlights the actuarial value of assets, liabilities, and funded ratios.

As of 12/31/20:	Assets	Liabilities	Funded Ratio
Pension Trust	$1.79 billion	$2.53 billion	70.5%
Healthcare Trust	$502 million	$398 million	126.3%

Pension Trust

The assumptions used in finalizing the CSA projected that the Pension Trust would be fully funded in 30 years if all of the assumptions played out exactly. The status of the annual contributions and distributions is described below:

- The active employees contribute 9% of covered payroll to the Pension Trust as required by the CSA;
- The City contributes only the minimum rate per the CSA of 16.25% of full-time covered payroll to the Pension Trust. (The General Fund represents 37.5% of covered payroll and other non-general funds represent 62.5% of covered payroll.);
- The Actuarially Determined Contribution (ADC) for the Pension Trust, as calculated by the actuary, is the annual employer contribution amount required to bring the Pension to a fully funded status in 30 years. **The ADC as of 12/31/2020 was 33.46% of covered payroll for FYE 6/30/2022 compared to the City's contribution rate of 16.25%, less than half of the ADC;**
- Benefit payments and expenses have exceeded employer and employee contributions for over a decade placing CRS in the bottom quartile among other public pension funds with negative cashflows. This means that CRS continues to liquidate a relatively large amount of assets to pay for benefits and expenses. This also means that CRS is more dependent on investment returns than most public pension plans.

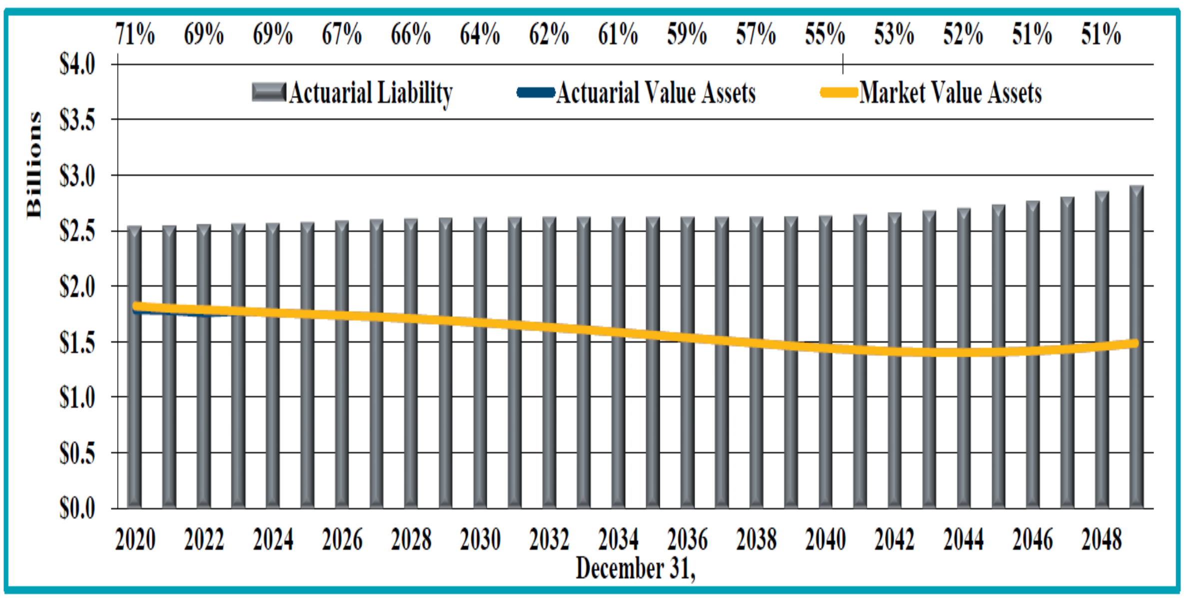
The following events occurred after the CSA was finalized:

- Ordinance 336, which reflects changes made in finalizing the CSA that increased liabilities, was approved by City Council in 2016;
- Revisions to actuarial assumptions (e.g., longer life span of retirees) occurred as recommended by the actuary and approved by the CRS Board;

- Annualized 5-year investment returns (2016 – 2020) were 8.8% as of December 31, 2020 (10.5% as of June 30, 2021) vs. the assumed 7.5%. However, CRS is especially sensitive to the timing of market swings since it continues to liquidate assets when the market drops. This requires more time for the remaining assets to recover from market volatility;
- The City offered an Early Retirement Incentive Plan (ERIP) in 2020 that provided two (2) additional years of service to eligible participants resulting in earlier retirements and higher benefits;
- The DROP is required to be cost neutral according to the CSA, but it has increased the liabilities of the Pension Trust according to the actuary.

The actuary's latest revised funding progress for the Pension Trust, which includes the impact of the DROP and the 2020 ERIP, projects an alarming decline in the funded ratio from 70.5% as of 12/31/2020 to 51% in 30 years, reaching a projected unfunded liability of $1.4 billion. The graph below reflects the City's minimum required contributions of 16.25% of covered payroll for 30 years. It also includes the recommended budget's $2.7 million contribution per year for the next 15 years to pay for the ERIP liabilities and assumes the CSA benchmark return of 7.5% investment return for all future years.

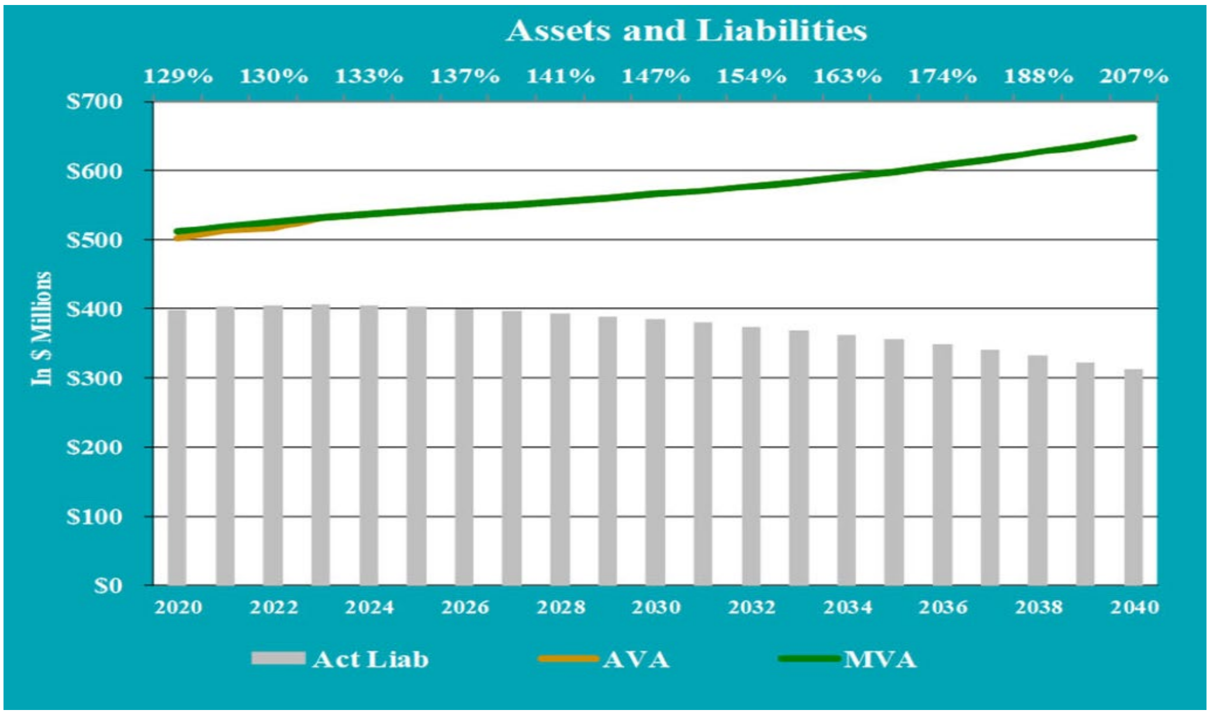
Pension Trust



Healthcare Trust

At the time of the CSA signing, the Healthcare Trust was fully funded, and the City was required per the CSA to establish a funding policy to keep the Trust fully funded over the lifetimes of current and future retirees. Implementation of a full funding policy will assure that the Healthcare Trust remains fully funded. The City has yet to adopt a Healthcare Trust funding policy as required by the CSA and there have been no City contributions to the Trust since the CSA was signed. In the graph below, the bars represent liabilities and the lines represent the actuarial value of assets (AVA) and the market value of assets (MVA) assets.

Healthcare Trust



Investment Performance

While the simple conclusion may be to achieve higher returns or "invest our way out of this," CRS' investment performance has been solid relative to what the capital markets have provided. At the current level of historically low interest rates and modest economic growth, a 7.5% annualized return is a high hurdle and an optimistic assumption based on the investment consultant's analysis. Our investment policy and portfolio allocation are already among the more aggressive pension systems in our effort to achieve the 7.5% target with an acceptable level of risk, given the high negative cash flow.

Our portfolio is well diversified across asset class, sector, investment managers and securities. The Board has recently changed the asset allocation as shown below with the goal of full implementation in 2021. The change in allocation is expected to maintain the projected rate of return with less volatility.

Asset Class	Policy %
Total Fixed Income	17.0%
Total U.S. Equity	27.5%
Total Non-U.S. Equity	23.0%
Risk Parity	5.0%
Real Estate	7.5%
Infrastructure	10.0%
Private Equity	10.0%

Conclusion

The CRS Pension Trust and Healthcare Trust are undoubtedly challenged in providing promised retirement benefits. When the Collaborative Settlement Agreement was implemented, the Pension Trust and Healthcare Trust were projected to be fully funded in 30 years.

The Pension Trust is on a downward trajectory toward a 50% funded position in 30 years. The future of the Health Care Trust is also uncertain due to the lack of a funding policy as required by the CSA.

Following are possible solutions to avert these outcomes:

1. Increase City contributions to the Pension Trust above the minimum required amount of 16.25%, as provided for in the CSA. This is less than one-half of the Actuarially Determined Contribution of 33.46% for FYE 2022. For the Healthcare Trust, establish a policy to ensure the trust remains fully funded as required by the CSA;
2. Increase investment performance by increasing risk. Generally, there are several strategies affecting increased investment return. These include using different investment managers, making a riskier asset allocation, and attempting to lower fees. There is little we can do regarding these factors because we believe we have the appropriate managers, the appropriate asset allocation, and fees are already on the low end. With regard to asset allocation, the only way to increase expected returns in the future is to lower the fixed income allocation and add more to stocks or other "riskier" assets. Investment performance has been solid over time and the risk level of the portfolio is already aggressive relative to our peers. We and our investment consultant believe that taking any more risk would be imprudent. Conversely, taking less risk would decrease our chances of achieving the 7.5% target;

3. Reduce benefits. While unpopular and considered the last resort, reducing benefits would require re-opening the CSA; and
4. As the City has done before, explore issuing judgement bonds to reduce the unfunded actuarial liability. As of 12/31/2020, the unfunded actuarial liability for the Pension Trust was $747 million.

<u>Recommendation</u>

At this time, we recommend the following:

- That City Council immediately increase the City's employer contributions to the Pension Trust;
- That the City Manager develop, and the City Council approve, a funding policy for the Healthcare Trust to ensure that the promises to CRS members will be met well into the future. The Healthcare Trust was well funded as of the 12/31/20 valuation and does not now require an ADC amount but may in the future;
- That the City Manager develop, and the City Council approve, a plan to consistently contribute the Pension Trust ADC in the future. The ADC for FYE 2022 is $70 million for the Pension Trust.

Immediate action is required. Further delays will result in higher contributions in future years.

cc: Paula Tilsley, Executive Director