



# FIRE AND POLICE PENSION FUND



April 18, 2011

The Honorable Mayor Ron Littlefield  
The Honorable Pam Ladd, Chair, Chattanooga City Council  
The Honorable Carol Berz, Chair, Budget and Finance Committee  
The Honorable Members of the Chattanooga City Council  
City of Chattanooga  
1000 Lindsay Street  
Chattanooga, TN 37402-4233

In the past few weeks, some members of City Council have gone on record expressing a desire to change the retirement benefits for Firefighters and Police Officers. As a result, the Pension Board has received numerous inquiries from active and retired members about these public statements and what effect they would have on the Chattanooga Fire and Police Pension Fund and their retirement benefits. In general, there seems to be a fair amount of confusion among our members, the City Administration, City Council and the general public as to the purpose and structure of the plan's benefits.

In response to these inquiries from our members, the Board of the Chattanooga Fire and Police Pension Fund developed the enclosed Fact Sheets to educate and inform our members and other interested parties about our retirement benefits. We wanted to share these Fact Sheets with all of you as well. Here is a brief summary of each fact sheet:

- The *Chattanooga Fire and Police Pension Fund Fact Sheet* provides an overview of the Pension Fund, its history and an explanation of how the pension benefit is determined for Firefighters and Police Officers.
- The *Deferred Retirement Option Provision (DROP) Fact Sheet* was developed to support our March 30 report on the actuarial analysis of the financial impact of the DROP to the Fund. It also provides an important history, as well as comparisons of the DROP and pension benefits, while correcting general misinformation about this plan feature that seems to be pervasive.
- The *Fire and Police Data Fact Sheet* provides a comparison of relevant fire and police data from 1999 and 2010. It is apparent from this information that our fire & police departments face greater challenges with fewer resources. We believe strongly that the current benefit structure is an important tool for recruitment and retention in both forces. Modification of those benefits could damage the ability to recruit, train and retain valued personnel and, consequently, exacerbate the growing public safety problem.

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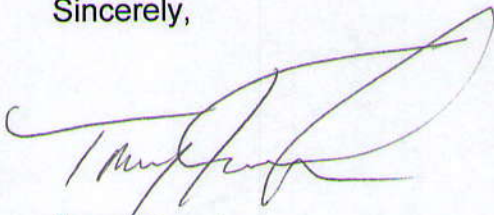
- The Defined Benefit versus Defined Contribution Fact Sheet was developed to address questions and concerns raised by our members after City leaders made public comments about moving non-vested Firefighters and Police Officers and all new hires from a Defined Benefit (DB) retirement plan to a Defined Contribution (DC) retirement plan. While a DC plan could offer some cost savings to the City, we believe strongly that DC plans are inappropriate for Firefighters and Police Officers. We believe DC plans will force fire & police personnel to work much longer than desired, and we further believe that DC plans will hurt both recruitment and retention. Interestingly, the Governor of Wisconsin agrees with this position as he exempted Firefighters and Police Officers from his plan to restructure public pensions.

The Board understands the need to work together with the City to manage benefit costs. Approximately nine months ago, the Board formed a committee to explore adjustments to its investment mix to boost current income in a low interest rate environment. This adjustment should help defray some of the cash flow pressures on the Fund. This work was completed in January, and the portfolio adjustments were completed during the First Quarter of 2011. The Board considers this to be an important first step to mitigating the impact of the Fund's contribution requirements.

The next step is to examine the cost impact of various benefit features. The Board is hopeful the City will allow us sufficient time to properly gather information and study this matter. These are important issues, and the Board looks forward to making formal recommendations to the City Council once our comprehensive review and analysis is completed.

In the coming days, we will call you to schedule a one-on-one meeting to discuss the recent actuarial analysis of the DROP benefit and the enclosed Fact Sheets.

Sincerely,



Terry Knowles  
Chairman of the Board



Frank Hamilton  
Fund Administrator

CC: Members of the Chattanooga Fire and Police Pension Board of Directors  
Chattanooga Police Chief Bobby Dodd  
Chattanooga Fire Chief Randy Parker



# CHATTANOOGA FIRE & POLICE PENSION FUND



PENSION  
APRIL 2011

## WHO WE ARE:

The Chattanooga Fire & Police Pension Fund (CFPPF) was established in 1949 as a defined benefit plan to provide Police Officers and Firefighters with a secure, pre-defined monthly benefit upon retirement. The Fund also provides a safeguard for the immediate family in the event the Firefighter or Police Officer becomes disabled or dies.

Research shows Police Officers and Firefighters typically have a shorter career and life expectancy than other City employees or others in the private sector. For this reason, the CFPPF helps ensure Police Officers and Firefighters have a secure, lifetime retirement benefit.

## WHO WE SERVE:

The CFPPF represents 790 current Firefighters and Police Officers along with 540 retired members and 152 beneficiaries.

## OUR BOARD:

The CFPPF is governed by an eight-person Board: three active Firefighters, three active Police Officers, a City general employee appointed by the Mayor and a citizen appointed by the City Council. Current members of the board:

- Fire Lieutenant Terry Knowles, Board President
- Fire Captain Chris Willmore, Vice President
- Police Sergeant Scott Fulgham, Secretary
- Police Lieutenant Corliss Cooper
- Fire Lieutenant Ivan Hicks
- Police Officer Phillip McClain
- Stan Sewell, Mayor Appointee
- Ray Ryan, City Council Appointee

## INVESTMENT PERFORMANCE:

Since December 1983, the Fund has earned a 9.3% annualized rate of return.

## PENSION CONTRIBUTIONS:

The CFPPF receives contributions from multiple sources:

- Members annually contribute 8-9% of their base salary.
- City contributes the amount recommended by the actuary but no less than 10% of the gross salaries of the Fire and Police Departments.
- Revenue from investments accounts for more than 70% of the Fund's growth.
- \$5 from every City Court fee paid.
- Revenue generated by the sale of surplus property.

## PENSION PAYMENTS:

Payments to members are calculated based on a formula that takes into account years of service and pay. At 25 years of service, the formula provides for a benefit of 68.75% of the average base salary from the 3 highest paid years of service. For each service year after 25 years until the member reaches 30 years of service, the formula provides an additional 1.25% of the average base salary from the 3 highest paid years of service.

## DROP PAYMENTS:

When members serve more than 25 years but no more than 30 years, they can elect a Deferred Retirement Option Plan (DROP) benefit upon retirement. The DROP is an optional form of an earned benefit that allows Firefighters and Police Officers to receive a portion of their accrued retirement benefit earned during the DROP period up front, in exchange for working longer than required. If the member declines the option to take the DROP benefit, the pension benefit is based on the total years of service rather than the typical 25 years of service.



# CHATTANOOGA FIRE & POLICE PENSION FUND



DROP  
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- **The Deferred Retirement Option Provision (DROP) was created jointly in 1999 by Mayor Kinsey, City administrators and the Pension Board as part of an effort to reduce the number of Firefighters and Police Officers working longer than 30 years.**
- **Since implementing the DROP benefit in 2000, the City has seen:**
  - The number of **active disability cases drop by 25%.**
  - **A significant reduction in Police Officers and Firefighters working more than 30 years.**
  - The number of **Police Officers and Firefighters retiring in the first year of eligibility drop by 40%.**
  - **Fire/Police personnel are generally retiring between 25 and 30 years; the primary objective of the DROP.**
- **The DROP benefit makes a positive difference for Police Officers and Firefighters as they transition to retirement.**
  - Police Officers and Firefighters **do not enjoy the career longevity** afforded other City employees and employees in the private sector.
  - Considerable research demonstrates Firefighters and Police Officers tend to **have shorter life expectancies than the rest of us.**
  - For these reasons, the DROP and other benefits of the Pension Fund are **vitaly important to current members** and **essential to the recruitment and retention efforts of the City.**
- **The DROP is an optional form of an earned benefit that provides Police Officers and Firefighters with the ability to receive a portion of the accrued retirement benefit earned during the DROP period up front, in exchange for working longer than required.**
  - **The DROP benefit is the member's money and part of their accrued pension benefit!**
  - To qualify, the member must **continue to work for the City and contribute to the Pension Plan** for up to three years (the DROP Period) past the member's typical retirement at 25 years of service.
  - At retirement, the member has the option to receive the **retirement benefit accrued during the DROP Period** as a lump sum payment and receive a pension benefit typically based on 25 years of service.
  - If the member **declines the option to take the DROP benefit**, the **pension benefit is based on the total years of service** rather than the typical 25 years of service.
- **Today, the average salary for a Firefighter or Police Officer is \$43,471. Under the current pension plan adopted in 2008, the average Police Officer and Firefighter, at retirement, has two options:**
  - Retire with a **28-year pension benefit of \$31,093 annually.**
  - Retire with a **25-year pension benefit of \$29,485 annually** and exercise the DROP benefit to **receive the accrued pension benefit for the three extra years of service** in a lump sum payment of \$83,449.
- **The DROP is not a bonus or golden parachute.**
  - A **BONUS** is additional compensation given to an employee **above** his/her normal salary.
  - A **GOLDEN PARACHUTE** is a lucrative benefit given to top executives when they leave their job.
- **To address the impact of the DROP benefit to the Pension Fund, the Pension Fund Board worked proactively the past two years, and adjusted its investment strategy to include allocations to certain investments.** The original DROP has a finite number of participants and as these officers retire, along with the investment strategy change made this January, **the impact of the DROP will move steadily towards cost neutrality** to the Fund.



# CHATTANOOGA FIRE & POLICE PENSION FUND



F&P DATA  
APRIL 2011

	1999	2010	Change	Pct
Chattanooga Population	152,000	167,000	15,000	9.9%
Number of Police Officers	449	408	-41	-9.1%
Number of Calls for Service	169,913	200,015	30,102	17.7%
Calls per Officer	378.4	490.2	111.8	29.5%

The Ochs Center 2010 State of the Region Report on Public Safety ranks Chattanooga with 11<sup>th</sup> highest crime rate in the United States among cities with a population of 100,000 or more.

	2000	2010	Change	Pct
Number of Firefighters	382	382	0	0.0%
Number of Fire Stations	20	18	-2	-10.0%
Number of Fire Dept. Responses	22,057	34,402	12,345	56.0%
Number of Calls per Firefighter	57.7	90.1	32.4	56.0%
Number of Calls per Fire Station	1102.9	1911.2	808.4	73.3%

The National Fire Protection Association standard 1710, Chapter 5 states that {t}he fire department shall have the capability to deploy an initial full alarm assignment with a 480-second (8-minute) travel time to 90 percent of the incidents". A September 2009 study indicates that the Chattanooga Fire Department is capable to provide such a response in 44% of incidents within 8 minutes.



# CHATTANOOGA FIRE & POLICE PENSION FUND



DB vs. DC  
Plan  
APRIL 2011

**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
<ul style="list-style-type: none"> <li>• Retirement &amp; disability income security</li> </ul>	<ul style="list-style-type: none"> <li>• Higher cost to administer</li> </ul>
<ul style="list-style-type: none"> <li>• Ability for City to more efficiently manage workforce needs through plan design</li> </ul>	<ul style="list-style-type: none"> <li>• Required Contributions are variable</li> </ul>
<ul style="list-style-type: none"> <li>• COLA provides some inflation protection</li> </ul>	<ul style="list-style-type: none"> <li>• Limited account portability</li> </ul>



# CHATTANOOGA FIRE & POLICE PENSION FUND



DB vs. DC  
Plan  
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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
<ul style="list-style-type: none"> <li>• Budgetary flexibility through fixed or discretionary contribution rates</li> </ul>	<ul style="list-style-type: none"> <li>• Incentive to extend career to accumulate larger plan balance</li> </ul>
<ul style="list-style-type: none"> <li>• Account portability</li> </ul>	<ul style="list-style-type: none"> <li>• Employee can outlive his or her money</li> </ul>
<ul style="list-style-type: none"> <li>• Lower administrative costs</li> </ul>	<ul style="list-style-type: none"> <li>• No guarantee as to investment returns or level of benefits</li> </ul>
	<ul style="list-style-type: none"> <li>• No disability benefits</li> </ul>



# CHATTANOOGA FIRE & POLICE PENSION FUND



DB vs. DC  
Plan  
APRIL 2011

## 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

### Bottom line:

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





# CHATTANOOGA FIRE & POLICE PENSION FUND



DB vs. DC  
Plan  
APRIL 2011

- **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.**