June 12, 2024

To:	Mayor and Members of City Council
From:	Cincinnati Retirement System Board of Trustees
Copy:	Sheryl Long, City Manager
Subject:	Cincinnati Retirement System CY2023 Annual Report

Summary

This report is from the Cincinnati Retirement System (CRS) Board of Trustees (Board) and provides the City Council with the state of the CRS Pension Trust and Healthcare Trust. This summary report is intended to provide a comprehensive summary of the status of the Cincinnati Retirement System, in compliance with the CRS Board's reporting requirements as set out in the City's Administrative Code and Board Rules. The report is as of December 31, 2023. For additional status information, please see the City's Annual Comprehensive Financial Report, Actuarial Valuations of the Pension and Healthcare Trusts, and Investment Results on the CRS website. (https://www.cincinnati-oh.gov/retirement/crs-financial-information/)

The CRS is governed by the Collaborative Settlement Agreement (CSA) and CMC chapter 203. Under the CSA, the CRS Pension Trust is to be 100% funded by 2045. Under the CSA, the Healthcare Trust is to be 100% funded through 2045.

Given the current and projected funding position of the Pension Trust, we recommend that the City Council continue to take action to increase employer contributions thus improving the funding of the Pension Trust (currently funded at 68.8%); that the CRS Board be engaged in any analysis and recommendations regarding the Futures Commission report; and that the City Administration work with the CRS Board to implement Fiduciary Audit recommendations.

Background

The purposes of the CRS Pension Trust and Healthcare Trust are to provide promised retirement benefits and healthcare benefits to eligible retired City employees. CRS is a defined benefit plan that was established in 1931. The Collaborative Settlement Agreement (CSA) was approved in 2015 to settle litigation and provide a comprehensive strategy to stabilize CRS while securing sustainable and competitive retirement benefits for both current and future retirees.

As of December 31, 2023, there were 2,966 full-time active members (which includes 143 members in the DROP plan who are still working), 4,120 pensioners receiving pension payments, and 4,628 pensioners and spouses receiving healthcare benefits. The CRS Board 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 retirement 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 (for both Pension and Healthcare Trust). The CRS annualized rate of return for the past 1, 5 and 10 years as of December 31, 2023, were 11.7%, 8.9% and 6.9%, respectively, which rank above the median investment returns relative to peers of public defined benefit retirement plans.

The table below highlights the actuarial value of assets, liabilities, and funded ratios as of 12/31/23:

	Assets	Liabilities	Funded Ratio
Pension			
Actuarial Value	$ 1,819,308,605	$ 2,643,382,463	68.8%
Market Value	$ 1,763,884,000	$ 2,643,382,463	66.7%
Health			
Actuarial Value	$ 549,871,265	$ 393,177,787	139.9%
Market Value	$ 533,879,000	$ 393,177,787	135.8%

Pension Trust

A goal of the CSA is to establish a projected 100% funding ratio in 30 years (i.e., by 12/31/2045). The assumptions used in finalizing the CSA projected that the Pension Trust would be fully funded in 30 years if all the assumptions played out exactly. The status of the annual contributions and distributions is described below:

- The active employees contribute 9% of the covered payroll to the Pension Trust as required by the CSA and CMC 203.
- The City in CY2023 increased their contribution from the CSA minimum rate of 16.25% to 17.00% of full-time covered payroll to the Pension Trust. (The General Fund represents approximately 35% of covered payroll and approximately other non-general funds represent 65% of covered payroll.).
- In CY2023, the City contributed a payment of $2.7 million as result of the continued payments toward the cost of the 2020 Early Retirement Incentive Plan (ERIP). There are now 12 annual payments remaining. Cheiron estimates that payment at 1.26% of payroll for this additional benefit, bringing the City's contribution rate for CY2023 to 18.26%.
- In CY2023, the City also contributed a lump sum payment of $2.0 million dollars from the General Fund fiscal year-end surplus. Cheiron estimates that payment at 0.91% of payroll for this additional benefit, bringing the City's contribution rate for CY2023 to 19.17%.
- 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 for FY2024 was 34.02% of covered payroll (as set by the CY2022 actuarial valuation). The actual contribution of 19.17% means the City contributed 56.35% of the actuarial recommendation.**
- Benefit payments and expenses have significantly exceeded employer and employee contributions for over a decade. This dynamic put strain on the system and relative to peers

CRS ranks in the bottom quartile of net cashflows. This means that CRS continues to liquidate a relatively large amount of assets to pay for benefits and expenses (each month regardless of market conditions) because contributions to the Pension Trust are relatively low. This also means that CRS is much more dependent on investment returns than most public pension plans and lacks the same flexibility to take advantage of dislocations in the market when outsized return opportunities are present.

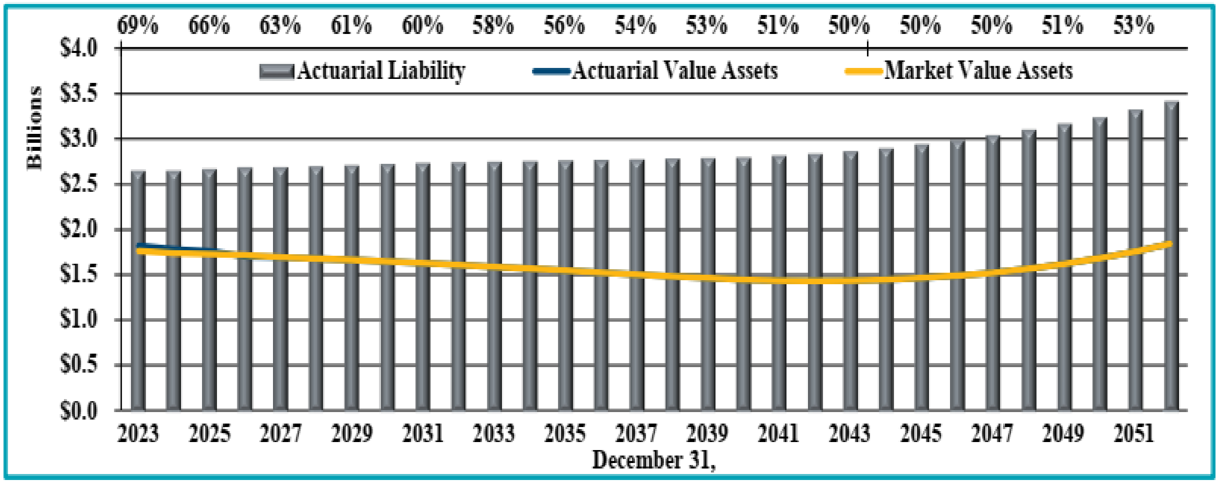
The following events occurred after the CSA was finalized:

- Ordinance 336 - 2016, 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.
- CRS is especially sensitive to the timing of capital market swings because it continues to liquidate assets to pay benefits when the capital market drops. This requires more time and a significantly higher rate of return for the remaining assets to recover from capital market volatility.
- The City offered the ERIP in 2020 that provided two (2) additional years of service to eligible participants resulting in earlier retirements, additional benefits, and an increase in liabilities.
- The Deferred Retirement Option Plan (DROP) established in the CSA is required to be cost neutral; however, DROP has had a net increase in liabilities to the Pension Trust of $16.9 million.

The actuary's latest revised funding progress for the Pension Trust, which includes the impact of the DROP and the ERIP, projects the funded ratio on an Actuarial Value of Assets basis is projected to decrease over the next 30 years and will not reach 100% by 2045 in accordance with the CSA.

The graph below reflects the City's status quo scenario where contributions of 17.00% of covered payroll continue for 30 years. It also includes the recommended budget's $2.7 million contribution per year for the next 12 years to pay for the ERIP liabilities and assumes the CSA benchmark return of 7.5% investment return for all future years. The plan will be fully funded by 2073. The funding ratio on an Actuarial Value of Assets basis is expected to be 50% by 2045.

Pension Trust



The following table highlights the elevated funding volatility for CRS, and the overall sensitivity of the system to fluctuations in experienced returns versus the assumed rate of return. While the above chart shows doing the same thing eventually gets the plan fully funded in 2073, doing the status quo leaves the plan extremely susceptible to market fluctuations, which generally occur doing fiscally challenging times for the City. For example, the chart below shows that if the investment return was negative -7.5% for just one year in 2024, insolvency is projected in 2050.

Assumed 2024 Investment Return*	Projected Insolvency Year	Projected Year to be 100% Funded
15.0%	None	2058
7.5%	None	2073
0.0%	None	2103
(7.5%)	2050	None
(15.0%)	2043	None

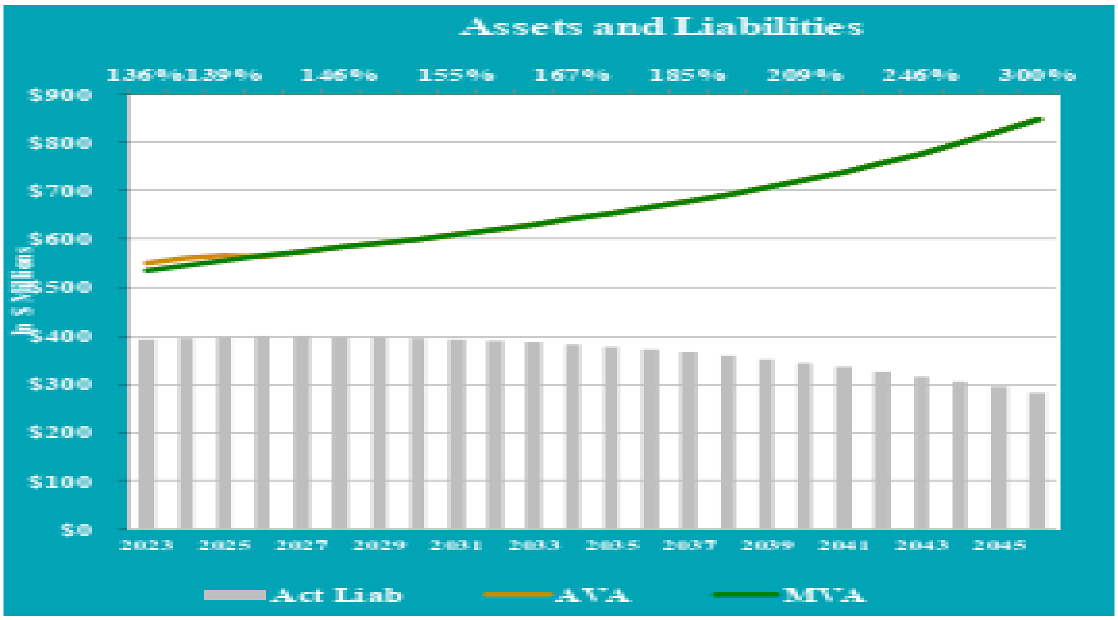
** Assumed 7.5% per year for 2025 and thereafter and annual contributions based on 17.00% of Full Time payroll.*

Healthcare Trust

In 2023, the City adopted a Healthcare Trust funding policy as required by the CSA. At the time of the CSA signing in 2015, the Healthcare Trust was fully funded, and the City was required per the CSA to develop and present a proper funding policy to fully fund the healthcare trust at actuarially appropriate levels. The funding policy would keep the Trust fully funded over the lifetimes of current and future retirees and their beneficiaries covered by the CSA. The Healthcare Trust is irrevocable, and its assets must be used exclusively for healthcare benefits for CRS retirees and their beneficiaries. The funding policy was approved by the Federal Court on March 28, 2024, nine years after the CSA signing. The funding policy provides for employer contribution triggers at a 90% funding ratio.

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. The graph shows that the Healthcare Trust is fully funded in 2023 and beyond. This is based on current assumptions being fully met.

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 return opportunity in the market, the assumed risk and peer group. With that said, the 7.5% annualized return assumption remains a high hurdle. The median investment return assumption of U.S. public retirement systems has steadily decreased over the past decade and is currently 6.9%. CRS will be challenged to achieve the 7.5% rate of return with an acceptable level of risk. CRS, given the mature membership (older retirees relative to younger active members), has a high asset liquidation each year to pay benefits while not taking in enough funds through employee and employer contributions. Coupling the high return assumption and large net cash outflow creates a difficult environment to manage liquidity and "investment your way out of this."

The following chart reflects the annual rates of return including 5-year & 10-year annualized returns. CRS has achieved the 7.5% CSA assumption over the 5-year period with 2018 rolling off. While the 4 years under the 7.5% assumed rate in '14, '15, '18 and '22 has pushed the 10-year annualized return to less than the 7.5% CSA assumption.

Annual CRS Rates of Investment Return

Plan Year	Investment Return Assumption	Market Return
2014	7.5%	6.5%
2015	7.5%	-0.1%
2016	7.5%	8.9%
2017	7.5%	14.9%
2018	7.5%	-4.3%
2019	7.5%	16.8%
2020	7.5%	10.3%
2021	7.5%	17.4%
2022	7.5%	-9.3%
2023	7.5%	11.8%
10-Year compound Average		**6.9%**
5-Year Compound Average		**8.9%**

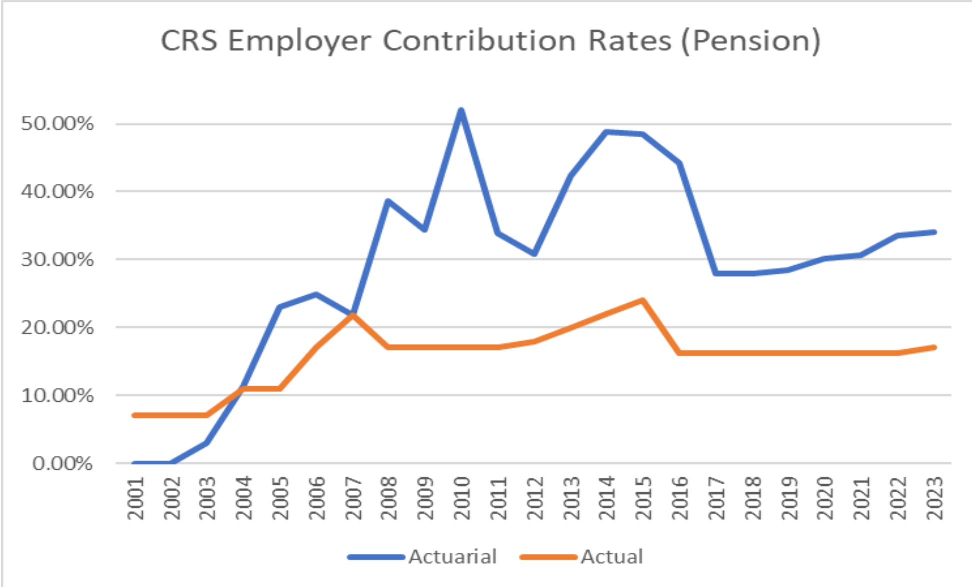
The Board's Investment Policy provides for a well-diversified portfolio across asset class, sector, investment managers and securities. The chart below is designed to achieve the 7.5% return over time with an acceptable level of risk. The Board was able to take advantage of the inflection point in last year's interest rate cycle by derisking the overall plan and maintaining our long-term 7.5% return target by increasing the Fixed Income allocation from 15% to 22.5%.

CRS Asset Allocation

Fixed Income	22.5%
Domestic Equity	28.5%
Non-US Equity	16.0%
Volatility Risk Prem	2.5%
Real Estate	6.0%
Infrastructure	10.0%
Private Credit	6.5%
Private Equity	8.0%
Total	100.0%

Employer Contributions

In a defined benefit retirement plan such as CRS, the employer (plan sponsor) is responsible for providing benefits (as opposed to a defined contribution plan). The Actuarially Determined Contribution (ADC) is the actuary recommended employer contribution to achieve full funding in 30 years. The chart below reflects the Pension Trust ADC and the City employer contribution for the last 20+ years. By not contributing to the ADC the unfunded liability increases over time meaning that the actuarial liability exceeds the value of assets.



Fiduciary Audit (Governance Report)

In accordance with its fiduciary duty, the Cincinnati Retirement System Board of Trustees engaged Funston Advisory Services to complete a fiduciary audit, entitled Cincinnati Retirement System Governance Review. The Funston report is available on the CRS website. https://www.cincinnati-oh.gov/retirement/

The purpose of the engagement is to review Cincinnati Retirement System (CRS) standards and practices and compare them to peer systems and system benchmarks. The six areas of focus are:

1. Legal and Regulatory
2. Governance Framework
3. Investment Program and Operations
4. Pension Operations
5. Administrative Operations, and
6. Compliance.

Overall, the report concludes that the CRS Board of Trustees has been functioning effectively, the Director and the staff have been effectively providing services to active and retired members, and relations among the Board, CRS staff and other City departments have been collaborative and cordial.

There are opportunities for improvement and the report provides thirty-seven recommendations which the Board is in the process of reviewing and acting upon.

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 by 2045. For the Pension Trust this is no longer the case.

At the close of 2023, the Pension Trust experienced a return of 11.7%, above the assumed rate of return of 7.5%. The demographics improved from an actuarial perspective in that the City had a material increase in active employees (i.e. more employee contribution). And with the strong performance and improved demographics, the funded ratio of the plan still decreased, albeit marginally, from 69.3% to 68.8%. Funding vigilance therefore remains a priority for the Board.

CRS Pension Funded Ratio

2015*	2016**	2017**	2018	2019	2020	2021	2022	2023
77.1%	76.9%	75.5%	72.6%	71.2%	70.5%	71.6%	69.3%	68.8%

* CSA

** Realized Wage Growth Rates larger than planned for by Actuary

The following are possible solutions:

1. Continued increases to City contributions to the Pension Trust above the minimum required amount of 16.25%, as provided for in the CSA. The Board has formally **recommended an increase in rates by 1.1% each year** until the actuarial projections reflect anticipated full funding by 2045. The Board also recommends that the City adopt the multi-year incremental increase funding methodology to achieve full funding by 2045, update the methodology annually, and budget accordingly. The Board acknowledges and appreciates the 0.75% increase in the contribution rate and the use of variable General Fund carryover to reduce unfunded pension obligations. Nonetheless, a more stable and predictable path to full funding is necessary. Failure to increase the City's annual contribution rate will result in the CRS Pension Funded Ratio steadily decreasing until it reaches 50% in 2045; alternatively, incremental increases in the rate are required to achieve 100% funding by 2045 based on the most recent projection:

Incremental Increase Plan

Schedule of funded Ratios	Earnings Assumption of 7.50			
	Flat E'r Rate of 17%		Increase E'r Rate by 1.1%/year	
	E'r Contr Rate	Funded Ratio	E'r Contr Rate	Funded Ratio
12/31/2023	17.0%	68.8%	17.0%	68.8%
12/31/2024	17.0%	67.5%	18.1%	67.6%
12/31/2025	17.0%	66.2%	19.2%	66.4%
12/31/2026	17.0%	63.4%	20.3%	63.9%
12/31/2027	17.0%	62.9%	21.4%	63.8%
12/31/2028	17.0%	61.9%	22.5%	63.4%
12/31/2029	17.0%	60.9%	23.6%	63.2%
12/31/2030	17.0%	59.9%	24.7%	63.0%
12/31/2031	17.0%	58.8%	25.8%	63.1%
12/31/2032	17.0%	57.6%	26.9%	63.4%
12/31/2033	17.0%	56.4%	28.0%	63.8%
12/31/2034	17.0%	55.2%	29.1%	64.6%
12/31/2035	17.0%	53.9%	30.2%	65.6%
12/31/2036	17.0%	52.6%	31.3%	67.0%
12/31/2037	17.0%	51.2%	32.4%	68.6%
12/31/2038	17.0%	49.7%	33.5%	70.8%
12/31/2039	17.0%	48.3%	34.6%	73.4%
12/31/2040	17.0%	46.9%	35.7%	76.5%
12/31/2041	17.0%	45.5%	36.8%	80.2%
12/31/2042	17.0%	44.3%	37.9%	84.6%
12/31/2043	17.0%	43.1%	39.0%	89.7%
12/31/2044	17.0%	42.0%	40.1%	95.4%
12/31/2045	17.0%	41.1%	41.2%	102.0%

2. Increase investment performance by increasing risk. 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 at the low end. Regarding asset allocation, the only way to increase expected returns in the future is to increase allocation to more volatility and illiquid parts of the market such as private equity. The Board and the investment consultant believe that taking any more risk would be imprudent. Conversely, as stated earlier in the report, the Board has looked to derisk the portfolio while maintaining asset allocation that based on market assumptions hits a target return of 7.5%.

3. Reduce benefits. While unpopular and considered the last resort, reducing benefits would require re-opening the CSA for a prolonged negotiation. Pension benefits have already been reduced significantly for current and future retirees as a result of the CSA. The compound COLA was eliminated and replaced with a simple COLA resulting in thousands of dollars in reduced benefits during retirement years. For example, an average annual pension amount over a twenty-five-year period is reduced by $64,000 on a net present value basis.
4. As the City has done before, explore issuing judgment bonds to reduce the unfunded actuarial liability. As of 12/31/2023, the unfunded actuarial liability for the Pension Trust was $824.1mm.
5. As suggested in the Future Commission report, the City could sell an asset to fund the Pension Trust, thus reducing unfunded volatility and providing more stability to the City finances.

Recommendation

At this time, we recommend the following:

1. That City Council adopt a plan to continue increasing the Pension Trust employer contribution incrementally on an annual basis to assure full funding in 2045 (see page 8, #1 of this report)
2. That the Incremental Annual Increase Plan be updated every two years in anticipation of the City's fiscal year biennial budget.
3. That the City Council approve and appropriate the Pension Trust employer contribution in accordance with each updated Incremental Annual Increase Plan.
4. That the City Manager engage with the CRS Trustees on the Futures Commission analysis and recommendations regarding the future of CRS and funding of the Trusts.
5. That the City works with the CRS Board of Trustees to fulfill the recommendations from the Fiduciary Audit (Governance Report) completed by outside consultants.

Immediate action is requested. Further delays will result in significantly increased vulnerability for CRS benefits.