February 9, 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, 2019

This report is written to provide to the Mayor and City Council the state of the Cincinnati Retirement System (CRS) Pension Trust and Healthcare Trust based on the latest actuary report from December 31, 2019, additional updated actuarial reports prepared due to the implementation of the Early Retirement Incentive Program (ERIP), the impact to date of the Deferred Retirement Option Program (DROP) and reports from our investment consultant.

Given the current and projected funding positions of the Pension Trust, we recommend that the Mayor and City Council take the immediate step of requiring the City Manager to address the downward trajectory of the Pension Trust. In addition, we recommend that the Mayor and 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, 2019, there were 2,903 full-time active members, 4,276 pensioners receiving pension payments, and 4,926 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 is not a party to the Collaborative Settlement Agreement (CSA). 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 funding 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 actual annualized market rate of return for the past 5 and 10 years as of December 31, 2020 was 8.8% and 8.0%, respectively.

As of December 31, 2019, the total combined actuarial value of assets for both Trusts was $2.25 billion. The table below highlights the actuarial value of assets, liabilities, and funded ratios. The actuary will use the annual rate of return for 2020 of approximately 8.9% to complete the December 31, 2020 valuation report expected to be presented to the Board in June 2021.

As of 12/31/19:	Assets	Liabilities	Funded Ratio
Pension Trust	$1.76 billion	$2.47 billion	71.2%
Healthcare Trust	$488.0 million	$376.6 million	129.6%

Pension Trust

The assumptions used in finalizing the CSA projected that the Pension Trust would be fully funded in 30 years. 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 contribution amount required to bring the Pension to a fully funded status in 30 years. The ADC as of 12/31/2019 was 30.67% of covered payroll for FYE 6/30/2021 compared to the City's contribution rate of 16.25%;
- Benefit payments and expenses have exceeded employer and employee contributions for several years placing CRS in the bottom quartile among other public pension funds with negative cashflows.

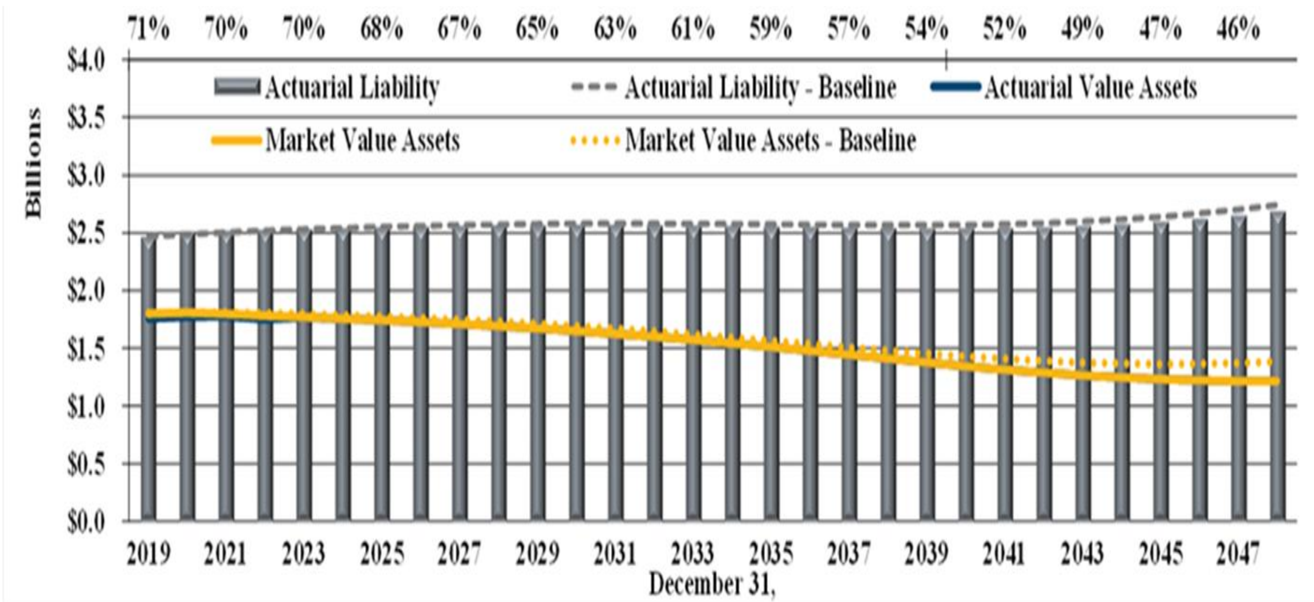
After the CSA was finalized the following events occurred:

- 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) were made as recommended by the actuary and approved by the CRS Board.
- Annualized 5-year investment returns (2016 – 2020) were 8.8% vs. the assumed 7.5%.
- The City offered an ERIP in 2020 that provided two (2) additional years of service to participants.

- The DROP has added cost to CRS according to the actuary.

The actuary's latest revised funding progress for the Pension Trust, which includes the impact of the 2020 ERIP and DROP, projects an alarming decline in the funded ratio from 71% as of 12/31/2019 to 46% in 30 years, reaching a projected unfunded liability of $1.5 billion. The graph reflects the City's minimum contributions of 16.25% of covered payroll for 30 years, in addition to $2.7 million per year for the next 15 years to pay for the ERIP liabilities and assumes a 7.5% investment return for all future years.

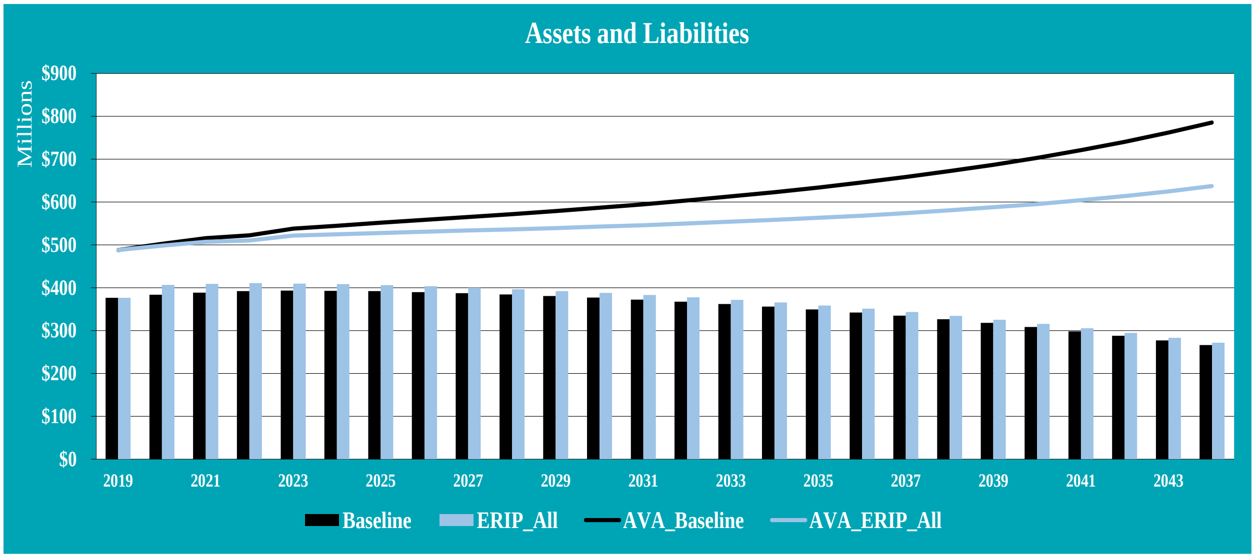
Pension Trust



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 its members. 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 assets before and after the ERIP.

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.

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. At the time of the CSA, the Pension Trust and Healthcare Trust, based on assumptions at the time, were projected to be fully funded in 30 years.

Now we are headed toward less than 50% funding in 30 years on a downward trajectory for the Pension Trust. 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 still far below the Actuarially Determined Contribution of 30.67% for FYE 2021. For the Healthcare Trust, establish a policy to ensure the fund 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 12/31/2019, the unfunded actuarial liability for the Pension Trust was $710 million.

Recommendation

At this time, we recommend that City Council increase the City's employer contributions to the Pension Trust and develop and implement a funding policy for the Health Care Trust to ensure that the promises to CRS members will be met well into the future. City Council should devise a plan to consistently contribute the ADC. The ADC for FYE 2021 is $63.4 million for the Pension Trust. The Healthcare Trust was well funded as of the 12/31/19 valuation and did not require an ADC amount. Immediate action is required. Further delays will result in higher contributions in future years.

cc: Paula Tilsley, Executive Director