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OPEN SESSION

NOTICE OF REGULAR BOARD MEETING
JOSEPH BRESS, CHAIRMAN

THURSDAY, MAY 15, 2014
1:00 PM

1:00 PM **ROLL CALL**

- **APPROVAL OF BOARD MEETING MINUTES FOR MARCH 20, 2014 [TAB 1]**

CHAIRMAN'S COMMENTS [TAB 2]
- WELCOME TRUSTEE LENDA WASHINGTON

EXECUTIVE DIRECTOR REPORT [TAB 2]
- FY 2015 BUDGET HEARING
- TREASURY LETTER REGARDING RECONCILIATION OF DISTRICT BENEFIT PAYMENTS

INVESTMENT COMMITTEE REPORT
- ACTION ITEMS

OPERATIONS COMMITTEE REPORT [TAB 3]
- FINANCIAL QUARTERLY REPORT-COMBINED (ANTHONY SHELBORNE, DCRB'S CONTROLLER)
- ACTION ITEMS

BENEFITS COMMITTEE REPORT

LEGISLATIVE COMMITTEE REPORT

OTHER BUSINESS

2:30 PM **ADJOURNMENT**

ADDITIONAL MEETING MATERIALS
- TRUSTEE MEMBERS LISTING
- DCRB ORGANIZATIONAL CHART
- TRAINING AND TRAVEL REPORT
- CONFERENCES & MEETINGS LISTING

LENDA PENN WASHINGTON

Ms. Washington began her career in securities brokerage in 1985 at Paine Webber Group Inc., (now UBS) as a registered representative. Tenures at major regional firms, including Ferris, Baker Watts, prepared her for successfully launching and managing the sales and operation of her own boutique broker-dealer/investment advisory firm, GRW Capital Corporation, founded in 1993 and registered in as many as 22 states. Ms. Washington holds Principal securities licenses as a General Securities Principal (S24), Financial and Operations Principal (S27), Municipal Bond Principal (S53) and an agent representative Registered Investment Advisor.

Over the course of her financial services career, Ms. Washington has hosted her own live call-in radio show, "Money Talks" (1994-1998) reporting on the day's stock market action, investment topics and financial advice and airing in the Washington, DC and Baltimore, MD markets on WOL AM/WMMJ FM Radio Stations. She has been widely quoted in national newspapers, been the subject of articles on investing, the stock market, women and investing and made guest appearances on national radio and television broadcasts over the course of her career.

Currently, Ms. Washington serves as the President of Washington Investment Advisors, LLC (WIA). WIA produces the *Personal Retirement View*, a quarterly report sold to Plan Sponsors for the benefit of defined contribution plan participants. *Personal Retirement View* provides employees with a specific goal, suggested contribution levels and investment guidance, empowering them to confidently achieve their retirement savings goal over a specified time period. An annual Plan Sponsor Report provides year-over-year comparative metrics of employees' savings and investing behavioral changes. The annual Report helps Plan Sponsors assesses the effectiveness of the Plan's investment options and educational programs to provide adequate retirement benefits to Plan participants.

After graduating from Howard University in the early 70s, Ms. Washington became a successful Madison Avenue sales executive for Metro TV Sales, a Metromedia Television company, and Post Newsweek's Top Market Television, an Advertising Representative firm, both in New York City. Afterwards, she was an important part of the team that branded "The Learning Channel" (now owned by Discovery Network) as the preeminent channel for "how-to" and professional and personal enrichment television.

Ms. Washington has been a member of Leadership Washington since 1997. As a former board member of the nonprofit Family Matters of Greater Washington, which delivers diversified social services and promotes and operates the Camp for Kids Fund for agency-owned Camp Moss Hollow, she served on the Finance and Governance committees and as 2nd Treasurer. Past industry committee participation includes serving on The District 9 Committee of the NASD (now FINRA) and serving as a NASD Hearing Officer, including representing the industry as a Small Firm FinOp expert. She was a DC Retirement Board Trustee from 1999 to 2003 and served as Chair of the Board's Operations Committee.

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EXECUTIVE DIRECTOR REPORT
May 15, 2014

Executive Updates	Update
Council FY 2015 Budget Hearing	The Committee of the Whole FY 2015 DCRB Budget Hearing occurred on April 14, 2014. Eric Stanchfield, along with other members of the Executive Leadership Team, and Ed Koebel from Cavanaugh MacDonald, attended the hearing. Trustee Gary Hankins delivered the Trustee statement. DCRB submitted a supplemental response to Chairman Mendelson's question regarding DCRB vacancies and hiring.
Office Move	The DCRB staff, along with the architect and project manager developed a "punch list" of contractor work to ensure minor repairs are completed. DCRB is reconciling outstanding invoices prior to the final sign-off on work order completion.
DCRB Communications	*Newsletter:* The Spring 2014 DCRB Newsletter was posted on our website and sent to all members via U.S. mail and email last week. The Newsletter included the FY 2013 Investment Update and a notice on the 2014 Cost of Living Increases. *Comprehensive Annual Financial Report (CAFR)*: The FY 2013 CAFR was submitted and is now posted on our website. I would like to applaud the hard work of the Finance and Investment staff who worked on this endeavor. *Logo Usage*: DCRB is gradually incorporating the new logo onto documents, the website, and stationery. *Office Space Signage*: DCRB staff are working with the project manager and vendors to design and install appropriate signage throughout the new office space.
Legal Updates:	Kessler Topaz Meltzer & Check, LLP (DCRB's securities litigation counsel) completed their audit of State Street relating to the proofs of claim they submitted on behalf of the DCRB from November 2011 through November 2013. We are pleased to report that based on their review of DCRB's transaction history, State Street identified and filed claim forms in all securities class action settlements for the audit period. Counsel will continue to audit State Street's filings on a quarterly basis going forward. Last month the Trustees' Confidential Financial Disclosure Statements were filed with the Mayor and Council. Most senior and mid-level DCRB staff are now required to file Public Financial Disclosure Statements with the Board of Ethics and Government Accountability. Other staff members file a Confidential Financial Disclosure Statement with DCRB's Ethics Counselor/General Counsel.

<table>
<tr><th>Executive Updates</th><th>Update</th></tr>
<tr><td>DCRB Human Resources</td><td>
New Hires

Finance Department –
Mr. Anthony Shelborne was hired as the Controller in the Finance Department on March 31, 2014. Anthony has many years of finance and accounting experience in both the private and public sectors, most recently as Vice-President of Finance and Operations for the Newspaper Association of America in Arlington, VA. Anthony also has public sector experience as a budget officer for the District Department of Public Works, and budget and financial analyst for Arlington County, VA. Anthony has an M.A. in Public Policy and Public Finance from the University of Chicago.

Benefits Department –

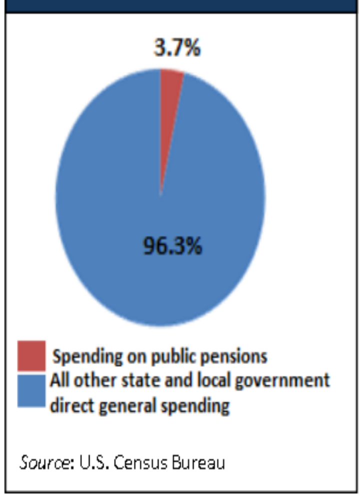
Quality, Compliance, & Projects Manager – Mr. John “Jack” Sahm joined the Benefits Department on April 21, 2014. Jack has over 30 years of defined benefit related administration experience with the Fairfax County Government, SEIU, the Writers Guild, National Electrical Benefit Fund, and the National Electrical Contractors Association. He holds an MBA and BS in Business Administration.
Quality, Compliance, & Projects Specialist – Mr. Thomas John joined the Benefits Department on April 21, 2014. Thomas was employed for over 22 years at the DC Office of Payroll and Retirement Services and has a wealth of experience in payroll processing and retirement adjustments in the plans we administer. His specialized expertise is in DC Teachers, Police, and Fire retirement reconciliation activities and working with various automated payroll systems. He holds an Associate’s Degree in Computer Information Systems.

Information Technology Department –

Security Administrator - Mr. Adu Poku has recently joined the Information Technology Department. Adu is a certified IT security professional who comes to us from an IT security auditing background, where he has performed compliance audits on numerous Federal agencies, including parts of the Department of the Treasury and the National Institute of Standards and Technology. The department is eager to have Adu join the staff as security, governance, and compliance become a larger part of its mission.

Congratulations!

Ms. Johniece Harris moved into a new role in the Executive Department as an Administrative Specialist. Johniece has served as a DCRB Retirement Specialist for over five years. In her new role, she will be assisting in office administration, handling travel & training arrangements, and performing other administrative duties.
</td></tr>
</table>

Executive Updates	Update
Financial Statements (As of 3/31/14)	DCRB’s Controller, Anthony Shelborne, will now present the Quarterly Financial Report for the period of October 1, 2013 through March 31, 2014, and financial initiatives that will improve processes and internal controls.
eCFM Implementation at DCRB	DCRB is in the process of implementing State Street’s eCFM (e-Cash Flow Module) system. This system allows users to securely and efficiently manage the workflow related to cash transactions, such as private equity calls or intra-fund transfers. **Why does the Board need eCFM?** The eCFM system would replace the Board’s current practice of faxing and emailing letters of direction to State Street, which is widely viewed as a less secure and reliable method of processing cash transactions. In addition, the eCFM system will help the Board keep a centralized record of all capital calls and intra-fund transfers, along with the supporting documentation, such as investment managers’ capital call notices. Many of State Street’s large pension clients have already implemented the system or are working to do so.
May 2014 National Association of State Retirement Administrators (NASRA) Brief – Government Spending	 Figure 1: State and local spending on public pensions as percentage of total government direct general spending, 2011 On a nationwide basis, pension contributions made by state and local governments account for roughly 3.7% of direct general spending. Current pension spending levels, however, vary widely and are sufficient for some entities and insufficient for others. In the wake of the 2008-09 market decline, nearly every state and many cities have taken steps to improve the financial condition of their retirement plans and to reduce costs although some lawmakers have considered closing existing pension plans to new hires, most determined that this would increase — rather than reduce — costs, particularly in the near-term. Instead, states and cities have made changes to the pension plan by adjusting employee and employer contribution levels, restructuring benefits, or both. Generally, adjustments to pension plans have been proportionate to the plan’s funding condition and the degree of change needed. The District of Columbia’s contributions to pensions as a percentage of all state and local government direct spending for 2011 was 2.11%. The NASRA May 2013 report found that on average state and local spending accounted for 3% on average, with DC listed as 2.8% You may download the entire brief at http://www.nasra.org/files/Issue%20Briefs/NASRACostsBrief.pdf.

Executive Updates	Update
PublicSectorInc. -"Pension Calculator	This Manhattan Institute's Center for State and Local Leadership project is intended to inform the pension debate, by allowing users to easily compare benefit levels across all 50 states. You may click on a state in their online map to estimate the pension that you would collect after a career in government. The calculator will also provide an estimate of the total annuity cost, or how much you would need to save to replicate that guaranteed income stream in retirement. To compare generosity of benefits between states, click on the "Compare States" tab. http://www.publicsectorinc.org/calculator/. According to NCTR, it appears flawed based on some examples they choose to run for the states of Mississippi and Oregon. Although, the District of Columbia plans are not included in the choices of comparable states, DCRB advises that you use this tool with caution.
Urban Institute – "Public Sector Report Card"	The Urban Institute, which has accepted $484,079 from the Laura and John Arnold Foundation to "expand access to information about public sector retirement systems," has recently rolled out a new "public pension report card," accompanied by an interactive map on their website, that purports to grade state and local government retirement systems based on how much retirement income they provide to both short- and long-term government employees, whether they "enhance the capacity of governments to recruit and retain a productive workforce," and whether they are setting aside enough funds to finance promised benefits. The website can be found at http://datatools.urban.org/features/SLEPP/index.html The Urban Institute concludes that "Alternative plan designs, such as cash balance plans and plans that include individual accounts, may better meet the needs of government and modern workers." According to NCTR, this is the same position that the Arnold Foundation strongly supports and aggressively advocates.

Budget Oversight Hearing

Statement of

Gary Hankins, Trustee
District of Columbia Retirement Board

Before the

Council of the District of Columbia
Committee of the Whole

April 14, 2014

Good morning Chairman Mendelson and members of the Council of the District of Columbia Committee of the Whole. I am Gary Hankins, the Elected Retired Police Officer Trustee of the District of Columbia Retirement Board (DCRB).

As a member of DCRB's Board of Trustees, I want to thank you, Chairman Mendelson, and this Committee for your continued support. We look forward to working with this Committee and the Council as DCRB works to fulfill its fiduciary and administrative responsibilities.

I am pleased to be here today to provide a brief overview of DCRB's fiscal year 2015 budget and to introduce DCRB's Executive Director, Mr. Eric Stanchfield, and the rest of his executive leadership team. Mr. Stanchfield will provide you with information of the activities we have planned for fiscal year 2015, and the team will provide you with details regarding any specific budget questions. Ed Koebel, our independent actuary, is also here to answer any questions you may have on the fiscal year 2015 Certified District Contribution to the District of Columbia Teachers' Retirement Fund and the District of Columbia Police Officers and Firefighters' Retirement Fund (collectively referred to as the Fund).

DCRB's budget is financed by the Fund, which includes the investment earnings and the employer and employee contributions. DCRB's fiscal year 2015 budget is $30.3 million.

I will now turn the testimony over to Mr. Stanchfield, who will discuss the specifics of the fiscal year 2015 budget and the initiatives to support DCRB's mission.

District of Columbia Retirement Board
Budget Oversight Hearing

Before the

Council of the District of Columbia
Committee of the Whole

April 14, 2014

Good morning Chairman Mendelson and members of the Council of the District of Columbia Committee of the Whole. I am Eric O. Stanchfield, Executive Director of the District of Columbia Retirement Board (DCRB). It is a pleasure to be here to testify on DCRB's FY 2015 budget.

I would like to thank Gary Hankins for his introduction and for taking the time to represent DCRB's Board of Trustees before this Committee. I also would like to thank the Council for assisting us as we continue to serve our members.

Joining me today to respond to questions are: Thomas Anderson, Chief Financial Officer; Sheila Morgan-Johnson, Chief Investment and Operations Officer; Peter Dewar, Director of Information Technology; and our independent actuary, Ed Koebel of Cavanaugh Macdonald.

DCRB is an independent agency of the District of Columbia government that was created by Congress in 1979 under the Retirement Reform Act. The agency has exclusive authority and discretion to manage the assets of the District of Columbia Teachers' Retirement Fund and the District of Columbia Police Officers and Firefighters' Retirement Fund (collectively referred to as the Fund) and to provide our members with comprehensive retirement services. Our mission is to provide these services to our members throughout their lifetime and their survivors' lifetime, and to safeguard the integrity of the Fund.

DCRB manages and controls the Fund, which is held in trust for the exclusive benefit of all Plan participants, and their eligible survivors and beneficiaries. The Fund assets can only be used to pay benefits to Plan members and the associated administrative expenses.

DCRB's Board of Trustees (Board) has 12 members, consisting of six (6) individuals who are elected by the participant groups, three (3) who are appointed by the Mayor, and three (3) who are appointed by this Council. In addition, the District's Chief Financial Officer (or his designee) serves on the Board as an ex-officio (non-voting) member. Trustees, who serve as fiduciaries, must act solely in the interest of all Plan members.

The District government, as the employer, is the plan sponsor and is responsible for the design of the Plan and for paying the required employer contributions into the Fund. DCRB, as plan administrator, is responsible for investing the assets and providing a range of administrative services to our members.

As of September 30, 2013, the Plan had 24,888 members. Of this number, 13,861 were retirees and survivors who receive monthly pension payments; 9,889 were active members. In addition, the Plan includes 1,138 terminated vested members.

As of September 30, 2013, the Fund was valued at $5.8 billion, an increase of approximately $600 million in the total asset value from the end of FY 2012. As of October 1, 2013, the Plan's funded ratio is 103.6%. For the individual Funds, the ratios are as follows: Teachers' at 90.2%, and Police Officers and Firefighters' at 110.1%. As of December 31, 2013, the Fund was valued at approximately $6.2 billion.

Our FY 2015 operating budget is $30.3 million, and includes a total of 57.6 authorized full-time equivalent (FTEs) positions.

From a strategic perspective, DCRB continues to move forward with a focus on achieving five overarching goals, which include:

1. Expand and improve benefits administration capabilities while assuring benefits are paid to our members timely and accurately.

2. Prudently invest Fund assets to provide long-term sustainable risk-adjusted returns.

3. Refine the organizational structure to meet agency responsibilities.

4. Foster member and stakeholder trust through enhanced communications.

5. Safeguard the integrity of the Fund.

With these five goals as a guide, I would like to briefly highlight the initiatives we have planned for FY 2015:

1. Expand and improve member benefits administration capabilities while assuring benefits are paid to our members timely and accurately.

DCRB's Retirement Modernization Program, a multi-year initiative to improve DCRB technology in all operational areas, will include two major projects: a data management project and a pension information management project. The data management project will ensure data accuracy and will allow DCRB to collect plan member information from multiple systems into a single source by gathering information from the District's PeopleSoft active member repository and the U.S.

Department of the Treasury's (Treasury) System to Administer Retirement (STAR). This project will improve member services by reducing the reliance on paper documents and minimizing the processing time currently required to provide members with their initial pension payments.

DCRB's goal in the benefits administration area is to provide a full range of retirement services for members—including annual benefits statements, member self-service, and the integration of data into other pension-related systems designed to produce pension payrolls. The pension information management system is a multi-year project that will transition DCRB's paper-based retirement processes into an information technology environment designed to provide these services.

2. **Prudently invest Fund assets to provide long-term sustainable risk adjusted returns.**

One of DCRB's ongoing goals is to prudently manage the Fund assets, with the goal of earning a return that meets or exceeds DCRB's actuarial investment return assumption of 6.5% over the long-term. To meet these objectives, we are continuing to move forward with several initiatives. These actions also will complement the significant progress previously mentioned in building a solid foundation for achieving long-term, sustainable risk-adjusted returns. These efforts include: periodically reviewing investment manager rosters for areas of improvement; rebalancing the portfolio when appropriate to maintain compliance with asset allocation ranges; and reviewing and adjusting cost saving measures.

3. **Refine the organizational structure to meet agency responsibilities.**

DCRB will continue the practice of filling vacant positions on an as-needed basis, and recruit more staff focused on financial and benefit administration, auditing, compliance, and IT system design/maintenance.

DCRB will make efforts to improve staff collaboration; implement document storage, sharing, and distribution; and enhance communication across the agency by providing greater accessibility to real-time data, including member records. This will be accomplished with the completion of the previously mentioned data management project and the integration of a DCRB intranet. In the future, authorized staff will be able to access information at off-site locations which will assist in disaster recovery and business continuity.

DCRB will continue to develop security capabilities to counter the threat of cyber-crime using industry best practices, current technology, and resources. Finally, DCRB will improve its business processes in the information technology area by continuing its efforts to obtain the International Organization for Standardization (ISO) certification.

4. **Foster member and stakeholder trust through enhanced communications.**

DCRB will continue its communication efforts with its members and the public by distributing a newsletter, exploring communications options using social media, and enhancing the functionality of the website. DCRB will also continue to increase access to necessary documents and forms and updates on Fund performance by providing them on its website, which contributes to a greater understanding of benefit provisions, and ultimately, improves the timeliness and accuracy of benefit transactions. As you know, we currently publish Board meeting minutes and materials, summary plan descriptions, brochures, and other relevant news items on our website.

5. **Safeguard the integrity of the Fund.**

DCRB will contract with an independent actuarial firm to audit the work of its consulting actuary. This is consistent with pension administration best practices. DCRB will continue its financial reporting by undergoing an independent financial audit and publishing the report in the Comprehensive Annual Financial Report. We will strive to continue to receive an unqualified audit opinion, the Government Finance Officers Association's Certificate of Achievement Award for Excellence in Financial Reporting, and the Public Pension Standards Award for plan design and administration as set forth by the Public Pension Coordinating Council.

I will now provide the details regarding DCRB's proposed FY 2015 operating budget.

As you know, the Fund is comprised of investment earnings, and employer and employee contributions. DCRB manages the assets of the Fund, receives contributions, and calculates and pays benefits for qualifying members upon retirement, termination, death, or disability. Pension fund assets can only be used for purposes consistent with this mission. The Fund also covers DCRB's administrative expenses, and any amount that is not expended remains invested in the Fund.

In addition, DCRB serves as the third-party plan administrator for the frozen plans covering members whose pension benefits are financed by U.S. Department of the Treasury (Treasury). The estimated Treasury reimbursement to DCRB for administrative services for FY 2015 is $3.6 million. The reimbursement amount varies annually based on the DCRB's expenditures associated with administering the frozen plans.

DCRB's budget is structured under Agency Management with eight budgetary activities: Investments, Benefits, Finance/Operations, Information Technology, Legal, Projects, Executive Office, and the Board of Trustees.

DCRB's FY 2015 budget is $30.3 million including 57.6 authorized FTEs. We will continue to fill positions as needed for the prudent management of investments, benefits administration, and effective internal control including legal, accounting and procurement functions.

In the proposed budget for FY 2015, there are two broad areas of change:

- The Personal Services budget is $7.2 million, reflecting an 8.9% increase over the FY 2014 amount. This includes the personnel costs associated with funding at full staffing levels, overtime, benefits, and other pay. The increase also includes an addition of 1.4 FTEs for agency operations. As we move forward with enhanced services and technology improvements, DCRB will gradually increase staffing levels.

- The Non-Personal Services budget is $23.1 million, reflecting a 2.5% decrease from the FY 2014 amount. The net decrease includes a reduction in investment management fees and the phasing of projects related to the Retirement Modernization Program.

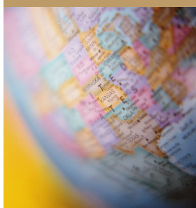
My next comments relate to the District's certified FY 2015 Annual Required Contribution (ARC) to the Fund. The District annually appropriates and pays the ARC to the Fund, which is an amount determined by DCRB's independent enrolled actuary. This is the amount an employer must contribute annually, based on an actuarial calculations, to fund current and future retirement benefits. The Board certifies this amount to the Mayor and the Council for inclusion in the District's approved budget for the ensuing fiscal year.

The District's certified ARC for FY 2015 is $142.9 million. As a general rule, employer contributions for all groups will rise as salaries increase assuming other actuarial assumptions are met. The City's contribution for FY 2015 remained relatively flat compared to FY 2014 contribution of $142.3 million primarily due to lower than projected salary increases. In general, the key drivers that could affect the ARC include the recognition of investment gains/losses, wages and general inflation, and changes in mortality assumptions. The Board's independent actuary is here to answer any questions you may have on the contribution rates and our funding status.

In summary, I am pleased to report that the Fund is in excellent shape. Our Board has maintained reasonable actuarial assumptions, the Plans are adequately funded, and we pay members timely. We have a skilled Board and team managing our strategic initiatives. We continue to make strides toward creating a comprehensive PIMS to serve the needs of our members.

I would like to thank the Committee and the Council for helping us carry out this vision. As we proceed, we may seek your assistance to help accomplish our goals. We look forward to working with you and your staff.

This concludes DCRB's testimony. Thank you for allowing us to provide this overview of DCRB's FY 2015 budget. We look forward to answering your questions.



CENTER *for* RETIREMENT RESEARCH *at* BOSTON COLLEGE

STATE AND LOCAL PENSION PLANS

NUMBER 38, MAY 2014

COLA CUTS IN STATE/LOCAL PENSIONS

*By Alicia H. Munnell, Jean-Pierre Aubry, and Mark Cafarelli**

Introduction

One of the more surprising responses of public plan sponsors to the financial crisis and the ensuing recession was their reduction, suspension, or elimination of cost-of-living adjustments (COLA) for current workers and, in a number of cases, current retirees. The response was surprising because it has often been assumed that public plan participants have greater benefit protections than their private sector counterparts. The Employee Retirement Income Security Act of 1974 (ERISA), which governs private pensions, protects accrued benefits, but it allows employers to change the terms going forward. In contrast, most states have legal provisions that constrain sponsors' ability to make changes to *future* benefits for current workers. Yet they were able to change the COLA for current workers and often for people already receiving it. This *brief* provides an overview of the COLA changes made to date, discusses the impact of eliminating COLAs on benefits, and explores the extent to which the courts view COLAs differently from 'core' benefits.

COLAs in 2009

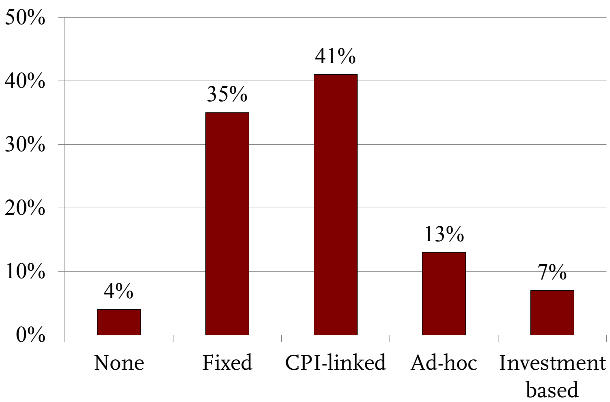
The defined benefit plans in the public sector generally calculate the initial benefit as a product of three elements: the plan's benefit factor, the number of years of employee service, and the employee's average earnings. In order to mitigate the effect of inflation on retirement income, most public plans provide retirees with a post-retirement COLA.

COLAs come in four main forms: 1) fixed rate – the increase is a constant percentage or dollar amount that is not tied to the Consumer Price Index (CPI); 2) CPI-linked – the increase is tied to the CPI; 3) ad-hoc – the increase is set by the legislature and revised on an ad-hoc basis; and 4) investment-based – the increase is tied to some financial metric, generally the plan's overall funded level or the level of assets in a special COLA fund. As of 2009, about 75 percent of public plans provided automatic increases – either fixed rate or CPI-linked (see Figure 1, on the next page). Roughly half of these were linked to the CPI, and these increases were generally capped at 3 percent; the other half applied automatic adjustments

Alicia H. Munnell is director of the Center for Retirement Research at Boston College (CRR) and the Peter F. Drucker Professor of Management Sciences at Boston College's Carroll School of Management. Jean-Pierre Aubry is assistant director of state and local research at the CRR. Mark Cafarelli is a research associate at the CRR.

at a fixed rate specified by the plan. The remaining plans provided increases either on an ad hoc basis or linked to investment returns.

Figure 1. Distribution of State and Local Plans, by COLA Type, 2009



Source: Public Plans Database (2009).

These COLAs warrant some comment. First, trying to maintain the real purchasing power of benefits in retirement is a laudable goal. It makes little sense to leave the well-being of retirees to the vagaries of the economy. Second, inflation protection is particularly important to the 25-30 percent of state and local workers who are not covered by Social Security, which provides full inflation protection. Third, providing full inflation protection is a risky undertaking for state and local governments because few states have economies that can ensure the revenues to cover this type of commitment. Thus, it is not surprising that many CPI-linked COLAs are capped. Finally, and importantly when thinking about the legal ramifications of cutting or eliminating COLAs, these arrangements do not exist in private sector defined benefit plans, where sponsors virtually never provide regular post-retirement adjustments.

Changes to COLAs, 2010-2013

Between 2010 and 2013, 17 states (with a total of 30 plans) enacted legislation that reduced, suspended, or eliminated COLAs for current workers and often for current retirees (see Figure 2).[1]

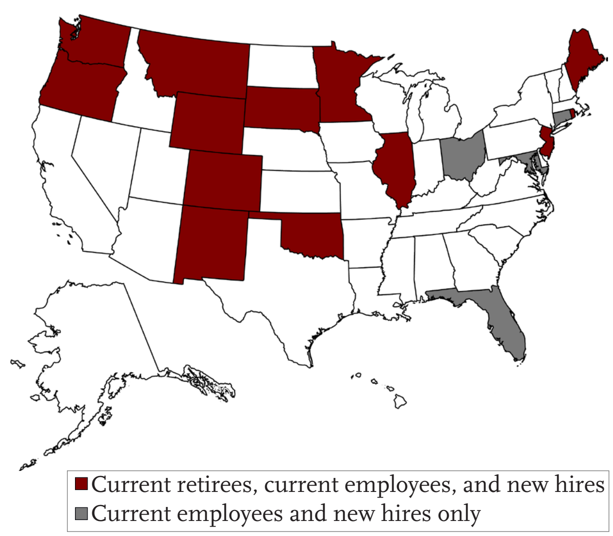
Cutting COLAs is an extremely attractive option to plan sponsors, because it is virtually the only way to make large reductions in a plan's unfunded liability. Reducing benefits for new hires or even future benefits for current employees – if legally possible – lowers future pension costs but has no effect on the existing liability. The existing liability represents benefits already earned, including promised COLAs. To the extent that the cost of future COLA payments is embedded in the liability estimate, cutting COLAs reduces the unfunded liability.

All the COLA changes represent a cut in benefits, but the magnitude of the cuts varies. They essentially fall into three groups: 1) virtually eliminating the COLA for the foreseeable future; 2) reducing guaranteed fixed amounts; and 3) reducing caps for CPI-linked COLAs.

Eliminated COLAs for Foreseeable Future

Three states with seriously underfunded plans – New Jersey, Rhode Island, and Oklahoma – essentially eliminated the COLA for the foreseeable future. New Jersey terminated all post-retirement COLAs for current and future retirees until the plans are 80 percent funded, at which point a committee will be formed to determine whether COLAs will be reactivated. Since the state has allowed funding to decline since the legislation, the prospect of 80 percent funding is very unlikely. In 2011, Rhode Island also suspended the

Figure 2. States Eliminating, Suspending, or Reducing COLAs for Current Workers and/or Retirees



Note: Washington state closed its plan.
Sources: National Association of State Retirement Administrators (2014); and National Conference of State Legislatures (1999-2014).

COLA until the plan is 80 percent funded and tied the COLA to the investment performance of the fund thereafter. Under a mediation agreement reached in February 2014, the COLA would have been linked to the CPI as well as investment performance. However, in April 2014, the mediation agreement was rejected by police union members, so the parties are headed back to court.[2] Oklahoma required that any COLA must be prefunded at the time of enactment, making future COLAs very unlikely.

Reduced Guarantees

Interestingly, the vast majority of states that changed their COLA had a fixed guarantee of 2.5-3.5 percent compounded annually, regardless of what was happening to inflation. These states include Colorado, Florida, Illinois, Minnesota, Montana, New Mexico, Ohio, and South Dakota. In the current low-inflation environment, such guaranteed adjustments more than compensate for increasing prices and therefore produce increasing real benefits after retirement. Three states (Colorado, Ohio, and South Dakota) abandoned the guarantee and linked future COLAs to changes in the CPI, with both Colorado and South Dakota including provisions that link the COLA to funded status as well. Two states (Minnesota, and Montana) reduced the guarantee and linked future increases to the funded status of the plan. Illinois and New Mexico simply reduced the amount of the guarantee. Florida suspended the COLA for several years, but plans to reinstate a 3-percent guaranteed increase in 2016.

Lowered Caps on CPI-Linked COLAs

Six states with CPI-linked COLAs cut their COLAs. Maine and Maryland reduced the cap on the CPI adjustment, with Maryland linking the cap to investment returns. Oregon moved away from CPI-linking entirely, providing instead fixed COLA guarantees that vary inversely with benefit levels.[3] Washington suspended the COLA indefinitely for PERS 1 (a closed plan), and Wyoming suspended the COLA until the plan is 100 percent funded. Since the plan is currently 84.5 percent funded, 100 percent is a feasible target. Connecticut lowered its minimum COLA from 2.5 percent to 2 percent.

Magnitude of COLA Cuts

A simple model suggests that eliminating a 2-percent compounded COLA reduces lifetime benefits by 15-17 percent (see Table 1). Eliminating a 3-percent COLA on the same initial benefit reduces lifetime benefits by 22-25 percent. The ranges reflect the impact of the assumed discount rate on the magnitude of the cut. With high discount rates, COLAs scheduled in the out years are not very valuable when discounted to the present; with low interest rates they are more valuable and the loss greater. Reductions in guarantees or lowered caps on CPI-linked COLAs have a lesser impact.

The seriousness of the effect on retirees depends critically on whether state and local workers are covered by Social Security. Social Security benefits are fully adjusted for price increases, so those with coverage are assured that at least their basic retirement income is inflation protected.

Four states that cut their COLA – Colorado, Illinois, Maine, and Ohio – have plans where workers are not covered by Social Security. It is worth taking a closer look at the cuts in these states.

- Colorado lowered the COLA from 3.5 percent to a modified 2 percent for those hired prior to 2007, and shifted to a CPI-linked COLA with a 2 percent cap for those hired during or after 2007.[4]
- Illinois, where participants in SURS and TRS are not covered by Social Security, reduced the COLA for those hired before 2010 from a guaranteed

Table 1. COLAs as a Percent of Total Lifetime Benefits by Discount Rate Assumption

COLA	Discount rate				
	7.75%	7.00%	6.00%	5.00%	4.00%
2.0 percent	14.7%	15.2%	15.9%	16.7%	17.4%
2.5 percent	18.2	18.9	19.7	20.6	21.5
3.0 percent	21.7	22.4	23.4	24.4	25.4

Note: Estimates assume a retirement age of 60 and an initial benefit of $35,000.
Source: Authors' calculations.

3 percent to 3 percent of the lesser of: 1) their current benefit; or 2) $1,000 multiplied by years of service.[5] Those who retire during or after July 2014 will receive COLAs only every other year for the next 10 years.[6]
- Maine froze its CPI-linked COLA for three years (2011-2013) and reduced the cap from 4 percent to 3 percent of the first $20,000 thereafter.
- Ohio changed its three major plans, all of which rely on a simple – rather than a compounded – COLA. Ohio PERS and Ohio Police and Fire moved from a 3-percent guarantee to a CPI-linked, with a 3-percent cap. Ohio STRS simply reduced the guarantee from 3 to 2 percent, but also suspended COLAS for existing retirees from July 1, 2013 to June 30, 2014.

If inflation remains low (less than 2 percent), most public employees in the four states will not be seriously hurt by the changes in the COLA. Even at low inflation rates, however, those with higher benefits in Illinois and Maine will be affected, as these states have targeted their COLAs to retirees with benefits below $30,000 and $20,000, respectively. If inflation rises to 3 or 4 percent, participants in all four states at all benefit levels will see the real value of their entire retirement income erode.

How Did the Courts React?

Before looking at how the courts reacted to lawsuits seeking to prevent the COLA cuts, it is useful to have a little background on the legal protections afforded benefits provided by state and local pension plans. Generally public pensions appear to be better protected than pensions provided in the private sector. In the private sector, ERISA protects benefits earned to date but permits the sponsor to adjust *future* benefits. In contrast, many states face legal constraints on the ability to change future benefits for current workers.

Most states protect pensions under a contracts-based approach. The federal Constitution's Contract Clause and similar provisions in state constitutions prohibit a state from passing any law that impairs existing public or private contracts.[7] A handful of states that protect pensions under the contract theory have state constitutional provisions that expressly prevent the state from amending the plan in any way that would produce benefits lower than participants expected at the time of employment. Illinois and New York have such a provision. Alaska has language that specifically applies only to accrued benefits, but the courts have interpreted the provision to protect all benefits from the time participants enroll.[8]

Table 2, which is based on an earlier study of legal protections, categorizes the states as of 2012 by the extent to which benefit accruals are protected and the legal basis for that protection.[9] States that appear in bold have cut their COLA. Interestingly, these states are not concentrated among those with the least protection, but rather are distributed evenly across all three groups.

Of the 17 states that changed their COLA, 12 have been challenged in court. The courts have ruled in nine states and in all but one case have upheld the cut. The Rhode Island proposals to cut the COLA withstood the mediation process with only minor changes but, as noted, police union members subsequently rejected the mediation agreement. Table 3 (on the next page) summarizes the status of these suits. Suits have been filed in Illinois and Oregon, but no decisions have been reached.

The main rationale for allowing the COLA cut is that COLAs are not considered to be a contractual right. For example, in Colorado, where the decision

Table 2. Legal Basis for Protection of Public Pension Rights under State Laws

Legal basis	Accruals protected			
	Past and future	Past and maybe future	Past only	None
State constitution	AK, **IL**, NY	AZ	HI, LA, MI	
Contract	AL, CA, GA, KS, MA, NE, NV, NH, ND, **OR** PA, TN, VT, **WA**, WV	**CO**, ID, **MD**, MS, **NJ** **RI**, SC	AR, DE, **FL**, IA, KY, MO, **MT** NC, **OK**, **SD**, UT, VA	
Property	**ME**, **WY**	**CT**, **NM**, **OH**	WI	
Promissory estoppel[a]	**MN**			
Gratuity				IN, TX

[a] Promissory estoppel is the protection of a promise even where no contract has been explicitly stated.
Source: Munnell and Quinby (2012).

is currently under appeal, the judge found that the plaintiffs had no vested contract right to a specific COLA amount for life without change and that the plaintiffs could have no reasonable expectation of a specific COLA amount for life given that the General Assembly has changed the COLA formula numerous times over the past 40 years. In Minnesota, the judge ruled both that the COLA was not a protected core benefit and that the COLA modification was necessary to prevent the long-term fiscal deterioration of the pension plan.[10] The courts clearly view COLAs very differently than core benefits. At this point, the legal hurdles to cutting COLAs appear to be quite low.

Conclusion

How state and local defined benefit promises have actually played out in the public sector in the wake of the financial crisis is an interesting story. Public plan participants were thought to have a higher degree of protection than their private sector counterparts. Whereas ERISA protects benefits earned to date, participants may end up with less than expected if their employer closes down the plan for reasons of economy or bankruptcy and the benefit formula is applied to today's earnings rather than to the higher earnings at retirement. In contrast, in many states the constitution prescribes, or the courts have ruled, that the public employer is prohibited from modifying the plan. This prohibition means that employees hired under a public retirement plan have the right to earn benefits as long as their employment continues. Thus if the employer wants to reduce the future accruals of benefits, such a change usually applies only to new hires.

On the other hand, in the wake of the financial crisis, in many instances the "pension wealth" of both current employees and retirees has been reduced through reductions in the COLA. Courts apparently do not view COLAs as a core benefit protected under the laws of the state. One wonders how COLAs would be treated under ERISA in the private sector. Of course, almost no private sector defined benefit plans have COLAs, so a direct comparison is not possible.

The key point is that defined benefit promises in the public sector are not as secure as one would have thought before the financial crisis. It was the belief that they were guaranteed that led economists to argue that the liabilities should be discounted by the riskless rate for valuation purposes. But when the stock market collapsed, benefit promises were in many cases reduced.

Table 3. Responses to COLA Cuts, 2010-14

State	COLA cut upheld	Rationale	Court/ process	Date	On appeal
CO	Yes	COLA not a contractual right	State District	2011	Yes
FL	Yes	COLA not protected under applicable state law	State Supreme	2013	
ME	Yes	COLA not a contractual right	US District	2013	
MN	Yes	COLA not a contractual right	State District	2011	
MT	Yes	Complaint dismissed*	State District	2013	
NJ	NA	Complaint dismissed for lack of jurisdiction	US District	2012	
NJ	Yes	Complaint dismissed**	State Superior	2012	Yes
NM	Yes	COLA not a contractual right	State Supreme	2013	
RI	Yes	NA	Mediation	2014	Mediation rejected
SD	Yes	COLA not a contractual right	State Circuit	2012	
WA	No	Illegal impairment of contract	State Superior	2011	Yes

* The court refused to issue a preliminary injunction, finding it was not clear that plaintiffs would be successful in proving that the COLA was protected as a contractual right.
** No written opinion.
Sources: National Association of State Retirement Administrators (2014); National Conference of State Legislatures (1999-2014); Buck (2011 and 2013); and various court cases.

Endnotes

1 South Carolina also passed legislation to change its COLA, but the goal was to increase, not reduce, the COLA.

2 As part of the mediation process, the agreement had to be approved by six groups representing state and local employees. Of the six groups, the Police MERS bargaining unit was the only one to reject the agreement.

3 The COLA for those who have earned an annual benefit under $20,000 is 2 percent; between $20,001 and $40,000 is $400 plus 1.5 percent; between $40,001 and $60,000 is $700 plus 1 percent; and over $60,000 is $900 plus 0.25 percent.

4 Both the modified COLA and the COLA cap increase by 0.25 percent if the funded status reaches more than 103 percent, but decrease by 0.25 percent if the fund reaches at least 103 percent funded and then drops below 90 percent funded. If the plan experiences negative investment returns in any year, all COLAs become CPI-linked for the next three years. At no point can the COLA be less than 0 percent.

5 For example, for a retiree with 30 years of service and a benefit of $40,000, the COLA will be the lesser of: 1) 3 percent of $40,000 or $1,200; or 2) 3 percent of $30,000 (30 years of service x $1,000) or $900. The alternative formulation serves as a cap.

6 The period of intermittent COLA payments is phased in based upon a member's age as of June 1, 2014. The younger the employee, the longer the period. For those age 50 or over, COLA payments will be skipped in the second year of retirement only. For those age 47-50, no COLAs will be paid in the 4th and 6th years of retirement. For those age 44-47, no COLAs will be paid in the 2nd, 4th, 6th, and 8th years of retirement. And finally, for those age 43 and under, no COLAs will be paid in the 2nd, 4th, 6th, 8th, and 10th years of retirement.

7 To determine whether a state action is unconstitutional under the Contract Clause, the courts undertake a three-part test. First, they determine whether a contract exists. This part of the test involves determining when the contract is formed and what the contract protects. Second, the courts determine whether the state action constitutes a substantial impairment. If the impairment is substantial, then the court must determine whether the action is justified by an important public purpose and if the action taken in the public interest is reasonable and necessary. This approach sets a high bar for changing future benefits.

8 Arizona's language is less clear, but prior court rulings suggest that the protection extends to future as well as accrued benefits. In these states, changing benefits for existing employees is virtually impossible. The only real option is to amend the state constitution. In contrast, Hawaii, Louisiana, and Michigan have constitutional provisions that have been interpreted as protecting only benefits earned to date.

9 Munnell and Quinby (2012).

10 The judge deciding the case made an additional point about Minnesota TRS, which not only reduced COLAs but cut other benefits for actives and raised contributions for both active teachers and school districts: "In exercising its authority here, the legislative change to the statutory adjustment formula was a comprehensive package of amendments that spread the burden and sacrifice of stabilizing the Plans across all members, the State, and the taxpayers..."

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The mission of the Center for Retirement Research at Boston College is to produce first-class research and educational tools and forge a strong link between the academic community and decision-makers in the public and private sectors around an issue of critical importance to the nation's future. To achieve this mission, the Center sponsors a wide variety of research projects, transmits new findings to a broad audience, trains new scholars, and broadens access to valuable data sources. Since its inception in 1998, the Center has established a reputation as an authoritative source of information on all major aspects of the retirement income debate.

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TO: BOARD OF TRUSTEES

FROM: EDWARD SMITH, CHAIRMAN

DATE: MAY 15, 2014

SUBJECT: BENEFITS COMMITTEE REPORT

The Benefits Committee did not meet in April. The following report reflects Benefits Department activities that have occurred since the March 20, 2014 Board meeting.

DISABILITY INCOME REVIEW PROJECT 2014

The Benefits Department mailed letters to 168 disability annuitants under the Police Officers and Firefighters Plan requesting earned income for the calendar year 2013. The initial deadline for submission of the completed income report and supporting tax documents is May 15, 2014. This review will determine whether annuitants have been restored to earning capacity and whether their annuities should be terminated or reduced. The 2013 project resulted in the termination of benefits to 11 annuitants whose income had been restored to earnings capacity and 41 annuitants whose income met the requirement for reductions.

COLA LOOK-BACK ERROR AND 80% MAXIMUM BENEFIT PUBLICATION ERROR

The Office of DC Pensions (ODCP) notified DCRB that contractors have been procured and they will soon begin the review of approximately 435 police and firefighter cases impacted by the COLA look-back error and approximately 30 cases impacted by the Max 80 error. The contractors will complete their review in 4 months

CHARTER SCHOOL COMMUNICATIONS

DCRB Benefits , the OCFO Office of Finance & Treasury, and the DC Charter School Board (PCSB) have been working together to improve the communication to charter schools regarding the eligibility and reporting requirements for former DCPS employees. This communication will assist in a smooth transition for continued participation in the DC Teachers Retirement Plan by DCPS employees who terminate or take a leave-of-absence to work in a DC charter school (*D. C. Code § 38-1802.07).* Brochures, applications, and Question and Answers will be finalized in a few weeks for presentation at a meeting of charter school local education agencies, hosted by PCSB, tentatively scheduled for June 9, 2014.

POLICE AND FIRE MANDATORY RETIREMENT

Under the Plan, the Mayor may require Members who are over age 60 to retire under optional retirement regardless if they are completely vested. Members who are mandatorily retired receive an annuity calculated under the optional retirement formula. These Members are considered retired under the Comprehensive Merit Personnel Act and may be eligible for post-employment benefits as determined by the District of Columbia Department of Human Resources.

COMMUNICATIONS

Annuitants received notification of their March 1, 2014, effective Cost of Living adjustments through messages on their pay advice, information posted on DCRB's website, and information contained in the Spring 2014 DCRB Newsletter.

BENEFIT PROCESS IMPROVEMENTS

The Benefits Department has been successful in recruiting and hiring all staff members for the Quality, Compliance, and Projects Unit. This new unit, a recommendation of the Benefits Process Review project, will be vital in contributing to continued benefit process improvements by reviewing cases for errors, performing quality reviews, and completing many special projects. The new hires are listed in the Executive Director's Report.

The Benefits Department is still continuing to get positive feedback from annuitants regarding the communications efforts we have implemented. New applicants are mailed an initial letter confirming receipt of their application within 10 business days. This letter provides a date for their first payment and any retroactive payment due. For the month of April, 99% of the retirement cases have been processed and put in payment status within 60 days of receipt of the completed retirement application.

Since relocating back to the second floor, the Benefits Department now has a Member Services staff person in the DCRB reception area to assist walk-in customers. Staff has been successful in answering most of the benefits questions and providing copies of documents requested by walk-in customers. This process improvement reduces the retirement services analysts' involvement with walk-in customers and thereby allows them to focus on processing cases.

THE NEXT BENEFITS COMMITTEE MEETING

The date of the next Benefits Committee meeting will be sent to members via e-mail.