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EXECUTIVE DIRECTOR REPORT
March 17, 2016

Activities	Updates
Performance and Budget Testimony	DCRB's Performance Hearing testimony before the DC Council's Committee of the Whole was held on Tuesday, March 8, 2016. Attached, for your information, are copies of the Chairman's and the Acting Executive Director's testimony. DCRB's Budget Hearing testimony is scheduled for Thursday, April 14, 2016.
DCRB Newsletter - Police/Fire Edition	The first special DCRB newsletter for police officers and firefighters was distributed to members on March 3, 2016. The final version of that newsletter is attached for your information.
Website Transition to Responsive Design	Also on March 3, 2016, DCRB's website was converted to "responsive design," an approach that reformats website pages to be more easily readable on mobile devices (e.g., tablet and smart phone). The most noticeable change is the look of the home page. As indicated previously, website content remains the same.
Staffing	**New Hires:** Currently, DCRB is actively recruiting for qualified candidates to fill the following vacancies: Quality, Compliance and Projects Analyst (Benefits) and Staff Attorney (Legal).
Recent Retirement-Related Articles (attached)	"Public Pension Plan Investment Return Assumptions," NASRA Issue Brief, February 2016. "State and Local Government Spending on Public Employee Retirement Systems," NASRA Issue Brief, March 2016. "State and Local Fiscal Facts: 2016," Multiple Organizations, 2016.

District of Columbia Retirement Board

Performance Oversight Hearing

Statement of

Joseph M. Bress, Chairman

District of Columbia Retirement Board

Before the

Council of the District of Columbia

Committee of the Whole

March 8, 2016

Good afternoon, Chairman Mendelson and members of the Council of the District of Columbia Committee of the Whole. I am Joseph M. Bress, Chairman of the District of Columbia Retirement Board (DCRB).

As a Council-appointed member of DCRB's Board of Trustees, I want to thank you, Chairman Mendelson, and this Committee, for your continued support. I also appreciate your recently nominating me for reappointment to the Board. The Trustees look forward to working with this Committee and the Council as DCRB fulfills its fiduciary and administrative responsibilities.

I'm pleased to report that as of October 1, 2015, the beginning of Fiscal Year 2016, DCRB is a fully funded retirement system. We continue to make progress in our efforts to create a comprehensive retirement system that serves the needs of our members.

I would also like to mention two awards DCRB continues to receive each year. During Fiscal Year 2015, DCRB was among a select number of public systems to receive the Public Pension Coordinating Council's Recognition Award for Funding, "in recognition of meeting professional standards for plan funding, as set forth in the Public Pension Standards." Also, for the seventh consecutive year, DCRB was awarded, the Government Finance Officers Association's Certificate of Achievement for Excellence in Financial Reporting for its Fiscal Year 2014

Comprehensive Annual Financial Report, the highest form of recognition in the area of governmental accounting and financial reporting.

Sheila Morgan-Johnson, DCRB's Acting Executive Director and Chief Investment Officer, will now provide you with more detailed information about our recent accomplishments and our future goals.

District of Columbia Retirement Board

Performance Oversight Hearing

Before the

Council of the District of Columbia

Committee of the Whole

March 8, 2016

OPENING REMARKS

Good afternoon Chairman Mendelson and members of the Council of the District of Columbia Committee of the Whole. I am Sheila Morgan-Johnson, Acting Executive Director and Chief Investment Officer of the District of Columbia Retirement Board (DCRB). Eric Stanchfield, DCRB's Executive Director, could not be here today to provide testimony because he is recovering from surgery. On his behalf, I will testify on our recent performance and provide an overview of the Agency's goals and strategic initiatives for the near future.

Joining me today to respond to the Committee's questions are Johnetta Bond, Chief Benefits Officer, as well as, Ed Koebel, of Cavanaugh Macdonald, our independent actuary. Other senior staff in attendance include Erie Sampson, General Counsel; Peter Dewar, Chief Technology Officer; Anthony Shelborne, Chief Financial Officer, and Joan Passerino, Director of Stakeholder Communication and Outreach.

DCRB is an independent agency of the District of Columbia government that was created by Congress in 1979 under the District of Columbia Retirement Reform Act. DCRB has two core missions—managing the pension trust fund and administering retirement benefits for police officers, firefighters and teachers of the District of Columbia.

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 Fire Fighters' Retirement Fund (collectively referred to as the "Fund"), that are held in trust for the sole benefit of all Plan participants, and their eligible survivors and beneficiaries. The Fund assets can be used only to pay benefits to Plan members, as well as associated expenses necessary to administer the retirement program.

DCRB pays benefits and provides a range of retirement administration services to members of the District of Columbia Teachers' Retirement Plan and the District of Columbia Police Officers and Firefighters' Retirement Plan (collectively referred to as the "Plans") from their date of initial participation in the Plans as well as throughout their lifetime and the lifetime of their survivors. These Replacement Plans were adopted by the District on July 1, 1997. DCRB also serves as the third-party administrator for benefits under the frozen federal plans, for which the U.S. Department of the Treasury is financially responsible.

DCRB's Board (the "Board") has 12 Trustees, six (6) of whom 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 DC Treasurer (representing the District's Chief Financial Officer), serves on the Board as an ex-officio (non-voting) member. Trustees, who are fiduciaries, must act solely in the interest of all Plan members.

It should be noted that the District government, as the employer, is the Plan Sponsor, and is responsible for the design of the Plans and for paying the required employer contributions into the Fund. In addition to employer contributions, Trust income includes employee contributions and investment earnings.

As of September 30, 2015, there were 24,394 total members in the frozen federal and active District Plans, of which 16,730 are funded by the District. Of the District funded members, 6,327 were retirees and survivors, and 10,403 were active members. I am pleased to report that as of October 1, 2015, the District Plans' aggregate funded ratio was 101.7 percent. The Fund ratios are: 88.7 percent for the Teachers' Plan, and 107.6 percent for the Police and Firefighters' Plan.

As of September 30, 2015, the Fund was valued at $6.1 billion, a decrease of approximately $201 million in the total asset value over the previous 12 months. Our Fiscal Year 2016 operating budget is $32.3 million, and includes a total of 62.6 full-time employees.

DCRB'S FIVE STRATEGIC GOALS

We continue to move forward with a focus on achieving the following five strategic goals:

1. Safeguard the integrity of the Fund.
2. Prudently invest Fund assets to provide long-term, sustainable, risk-adjusted returns.
3. Expand and improve benefits administration capabilities, to assure that benefits are paid to our members accurately and timely.
4. Refine DCRB's organizational structure to meet changing agency responsibilities and needs.
5. Foster member and stakeholder trust through enhanced communications and collaborative outreach.

DCRB'S ACCOMPLISHMENTS IN FY 2015 AND INITIATIVES FOR FY 2016 AND BEYOND

Using these five goals as a guide, I will summarize our Fiscal Year 2015 accomplishments, as well as provide an overview of our progress and plans for Fiscal Year 2016 and beyond.

1. Safeguard the integrity of the Fund.

The Board's independent actuary conducts an actuarial valuation each year. Also during Fiscal Year 2015, we engaged an independent actuarial firm to perform an actuarial audit. This review provides an additional set of “eyes” and technical expertise to review our independent actuary’s assumptions and calculations. The actuarial audit resulted in a finding that the assumptions, methods, and certifications used in the annual actuarial valuations are generally sound and reasonable, and that they conform to the appropriate Actuarial Standards of Practice. Further, based on the samples tested, the audit found no reason to question the reliability of valuation results.

As part of DCRB’s FY 2015 annual financial audit, we received a “clean” opinion from an independent audit firm. DCRB publishes its audited financial statements in its Comprehensive Annual Financial Report (CAFR). Copies of the actuarial valuation, financial audit, and CAFR are posted to DCRB’s website each year. DCRB will continue to obtain clean audit opinions and report its financial activities according to governmental accounting standards.

As indicated by our Board Chair, Mr. Bress, DCRB once again received the Government Finance Officers Association’s (GFOA) Certificate of Achievement Award for Excellence in Financial Reporting for FY 2014. We have received this award for seven consecutive years. DCRB will continue to publish its CAFR based on the standards required to obtain the GFOA's certificate of recognition in future years. In addition, DCRB will continue to maintain the professional standards required to continue receiving the Public Pension Standards Award for plan funding. These activities are consistent with the Board’s fiduciary duties and pension administration best practices.

Business continuity in the event of a disaster is critical to our Agency. DCRB completed a number of projects focused on security and infrastructure availability, including updating our disaster recovery and a continuity of operations plans. Also, DCRB will utilize this plan in conjunction with the Agency’s disaster recovery site.

Data security continues to be a priority for us. We have implemented various data security measures to mitigate the risk of data loss and to keep sensitive, personally identifiable information (PII) confidential. We conduct annual training and ensure awareness of PII policies by all staff and contractors. DCRB also conducts background checks for all DCRB employees and independent contractors.

As with other organizations, cyber-security threats continue to be of concern to DCRB’s operations, and pose a serious challenge to our Agency. Mitigating this risk has been a focus of the Agency, and DCRB has invested in training and cyber-security insurance, updated our security policies, and is contracting with an incident response vendor to assist the Agency if a cyber-security event were to occur. In addition, DCRB will continue to follow professional standards and best practices in the information technology area for security, project management, and service delivery.

Finally, the Board’s Audit Committee provides independent review and oversight of DCRB’s financial reporting processes and internal controls.

2. <u>Prudently invest Fund assets to provide long-term sustainable risk-adjusted returns.</u>

In concert with the overall market decline, the Fund posted a -3.9 percent return for the fiscal year ended September 30, 2015. Since inception in October 1982, the Fund has generated an annualized gross return of 8.7 percent, surpassing the actuarial return target of 6.5 percent.

DCRB's ongoing responsibility 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 percent over the long-term. In building a solid foundation for achieving long-term, sustainable risk-adjusted returns, we routinely review investment manager performance against benchmark returns, rebalance the portfolio when appropriate to maintain compliance with asset allocation targets, and periodically review the Fund's strategic asset allocation.

During Fiscal Year 2016, DCRB will conduct an asset-liability study to assure the continued alignment of the Board's asset allocation policy with the long-term liability structure.

During FY 2015, the Board selected the Northern Trust Company to replace State Street Bank as the Fund's custodial bank. The transfer of assets to Northern Trust was successfully completed on December 1, 2015. This change resulted in a projected administrative savings of $300,000 over the next three years.

3. <u>Expand and improve benefits administration capabilities, to assure that benefits are paid to our members accurately and timely.</u>

In Fiscal Year 2013, DCRB launched a Retirement Modernization Program focused on the areas of benefits administration and information technology. The FY 2015 projects, and those scheduled for FY 2016, include activities that will lead to our eventual acquisition of a Pension Information Management System ("PIMS").

In the future, the PIMS will be a benefits administration system where pension-related information is kept in one location and electronically maintained and controlled by DCRB. This system will also enable DCRB to provide a full range of retirement services for Plan members. An RFP related to this system will be released in 2016.

The elements of this Program are as follows:

Data Reclamation Project
The primary objective of the Data Reclamation Project, which was completed in 2015, was to establish a database of service, salary, and contribution history that will increase accuracy and reduce the processing time required to calculate initial pension payments.

In partnership with the District of Columbia Public Schools (DCPS), the Metropolitan Police Department (MPD), the Office of the Chief Technology Officer (OCTO), the Office of Pay and Retirement Services (OPRS), and the District of Columbia Department of Human Resources

(DCHR), DCRB reclaimed missing data for 4,600 of approximately 10,000 active member records where there were gaps in service history.

The data will be instrumental in DCRB's ability to provide new retirees with an accurate benefit payment within 30 days of receiving completed retirement packages from the human resource offices, instead of the current 60- to 90-day timeframe.

Data Integration Project
DCRB and OCTO initiated data feeds of pension-related information to DCRB from the District's PeopleSoft system. The data feeds will assure that current and future member data is complete and accurate, and is reflective of a comprehensive individual retirement record of member information.

Data Management Project
The Data Management Project consists of three important technology applications that DCRB will use to manage member data. These are: 1) a data quality tool to perform continuous reviews of data received by DCRB from other District agencies; 2) a master data management system to serve as a central repository for Plan member data; and 3) a tool that will facilitate communications among systems. This project was initiated during the last quarter of FY 2015.

During Fiscal Years 2016 and 2017, DCRB will continue to receive data feeds from the District's PeopleSoft system; initiate the electronic transmission of member data directly to the U.S. Department of the Treasury's (Treasury) pension benefit calculation system (eliminating the current manual data entry process); upgrade our Member Services phone system; and support the employer reported pension-related member data.

Pension System Feasibility Study and Requirements Analysis Project
During FY 2015, DCRB completed a Pension System Feasibility Study and Requirements Analysis Project to gather essential information for the development of a pension information system. The study included performing market research to acquire insight into the commercial availability of features and functionality.

Pension Information Management System (PIMS) Project
During FY 2015, DCRB issued a Request for Information related to the development and implementation of a PIMS. The responses identified state-of-the-art capabilities and functions available in the pension industry. This information was useful in the development of DCRB's draft Request for Proposal (RFP) which is scheduled for release later this year.

4. Refine DCRB's organizational structure to meet agency responsibilities and needs.

During 2015, we also implemented a DCRB employee portal to improve staff communication and efficiency and to facilitate collaboration through information sharing. The employee portal has enabled DCRB to migrate to a more secure information-sharing organization. The portal will also allow authorized staff to access information and work remotely in the event of a disaster.

The Agency will continue to provide annual training for staff and Trustees on ethics and fiduciary principles, and ensure awareness of Personally Identifiable Information (PII) policies by all staff and contractors. Further, Trustees recently updated Board governance rules and guidelines. DCRB will also identify performance gaps and training needs and fill key staff vacancies, as needed, during Fiscal Year 2016.

Our primary focus over the next few years will be to transform our organizational structure from an operation that is currently manual and paper-based to an automated, digital environment that facilitates self-service and the production of benefit calculations, payments and other services accurately, timely and more efficiently.

5. **Foster member and stakeholder trust through enhanced communications and collaborative outreach.**

DCRB reaches out to members and the public to provide information on Fund performance and current issues. During FY 2015, DCRB added a special Teachers' Edition newsletter that was published over the summer, when many teachers consider retirement. In FY 2016, DCRB published a special Police/Fire Edition newsletter for public safety officers. The focus of these newsletters is to provide information about retirement benefits and to encourage retirement planning. DCRB distributes newsletters to our members via e-mail and hard copy.

DCRB will maintain communication with Plan members about retirement benefits through the newsletters, additional correspondence, and website communications. During 2016, we will also update the Plans' Summary Plan Descriptions, which are required to be updated during 2017.

In late FY 2015, DCRB initiated a "Benefits Community of Interest" group, which includes human resources personnel from stakeholder District agencies. We met in October 2015, and plan to meet periodically to discuss subjects and issues of mutual interest. This group will be of special importance as DCRB begins the process of selecting the PIMS in FY 2017.

DCRB will continue to expand its collaboration with District human resources offices to provide retirement workshops for retiring plan members. During FY 2015, DCRB joined with DCPS in hosting a Teachers' Retirement Workshop, which was held at DCRB offices. Attendees were provided with information about the Teachers' Retirement Plan, given an overview of the retirement process, and a guest speaker from the Social Security Administration's training division spoke about Social Security and Medicare benefits. Another workshop for teachers is being planned for later this month.

During FY 2016, DCRB plans to use social media as a component of our communications portfolio and we are reviewing our website to assure compliance with federal legislation for members with disabilities. Further, as a result of recent work with the District's Office of the Chief Technology Officer, our website was recently updated to ensure compatibility with mobile devices. We also maintain a retirement calculator on our website so active members can enter their information and receive personalized retirement estimates. DCRB will communicate with Plan members and update the DCRB website to include relevant content as needed.

DCRB continues to receive member feedback by issuing surveys to callers, and by monitoring phone calls and correspondence for quality and training purposes.

CONCLUSION

In summary, we are pleased to report that the Fund is in excellent shape. Our Board has maintained conservative investment assumptions, the Plans are in sound financial condition, and we strive to pay members accurately and timely. We have an engaged Board and an experienced team managing our strategic initiatives. And, most importantly, we continue to make strides toward creating a comprehensive retirement system to serve the needs of Plan participants.

In closing, I'd like to thank the Committee for your support in helping us to carry out this vision. As we proceed, we may seek your assistance to help us accomplish our goals and we look forward to working with you and your staff.

This concludes DCRB's Performance Testimony. We look forward to answering your questions. Thank you.

PUBLIC OVERSIGHT HEARING ON THE ANNUITANTS HEALTH CONTRIBUTION - OTHER POST-EMPLOYMENT BENEFITS FUND FOR FISCAL YEAR 2015

Before the
Committee of the Whole
Council of the District of Columbia

The Honorable Phil Mendelson, Chairman

March 8, 2016, 11:00 a.m.
John A. Wilson Building, Room 412
1350 Pennsylvania Avenue, NW
Washington, DC 20004

Testimony of
Jeffrey Barnette
Deputy Chief Financial Officer - Treasurer
Government of the District of Columbia

Good afternoon Chairman Mendelson and members of the Committee of the Whole. I am Jeffrey Barnette, Deputy Chief Financial Officer and Treasurer of the District of Columbia. I am pleased to testify on the FY 2015 performance of the Other-Post Employment Benefits Fund, hereafter referred to as the "Trust Fund" or the "Plan".

The Trust Fund's assets can only be used to pay health and life insurance benefits for participating District annuitants and the associated administrative expenses. The Trust Fund is administered pursuant to the Annuitants' Health and Life Insurance Employer Contribution Plan document.

As you are aware, Council legislation established an Other-Post Employment Advisory Committee ("Advisory Committee") comprised of independent, outside subject-matter experts, who can review with OCFO staff important issues that can impact the performance and value of the Trust Fund, including actuarial assumptions, investment objectives and recommendations with regard to best practices. We have selected the four OCFO members of the advisory board and the Mayor has appointed her member. The first meeting was conducted September 29, 2015. We also held a conference call last month to discuss recent actuarial findings and to get recommendations from the advisory board.

Considerable effort has been taken over the past few years to ensure that the investments, actuarial analyses and all other necessary elements are in place to ensure the Trust Fund is funded at a level to provide for the Districts' cost portion for annuitants' health and life insurance needs.

A plan's "Funding Ratio" is the ratio of the value of plan assets to the actuarial accrued liability at a point in time. A plan is considered fully funded when it has a funding ratio between 90% and 120% as of the actuarial analysis date. The funding ratio we will be discussing in today's testimony is higher than the funding ratio that was published in the FY15 CAFR and this ratio change is the result of actuarial adjustments recently made to the Plan.

As you know the District is in a unique position where employees hired before 1987 fall under the civil service retirement plan and receive retiree health benefits through that federal program. The Annuitants Health and Life Insurance Employer Contribution Trust Fund was established to pay for health benefits for employees mostly hired after 1987 and the initial modeling assumptions for participation rates were very conservative to ensure the Plan was appropriately funded. As the Plan has matured, additional data has been gathered during an Experience Study by our external actuary firm PRM Consulting. This study indicates actual retiree participation rates are lower than the initial participation assumptions, which have led to an overfunding of the Plan.

The CFO's office, along with DCHR and PRM Consulting conducted additional analyses to model a more appropriate participation rate. We have shared this analysis with the Advisory Committee and they have validated the need to make changes to the Plan participation rate. The analysis resulted in recommending a participation rate of 70% across all employee groups. This change will lower the modeled participation rates that currently range from 75% to 95%. This review has also allowed us to make additional changes to the actuarial assumptions by adjusting the amortization period from a 30-year closed to a 20-year closed and adjusting the target rate of return from 7.0% to 6.50%. The amortization and return assumption changes will match those of DCRB. The actuary also will be making slight changes to the mortality rates assumed for participants, changes in assumed inflation, healthcare trend rates and assumed claims costs.

So what will be the impacts to the Plan after the modeling changes are implemented? The changes have a significant impact on the Plan funding ratio and the Plan annual required contribution. The Plan funding ratio as shown in the FY15 CAFR was 87.2%. However, the lower participation rate moves the funding ratio to 120.1%. The previous model assumed higher future costs to the District and because those costs have decreased, the funding ratio has improved. The second major impact is the reduction of the annual required contribution (ARC). Since the Plan has an improved funding ratio, the ARC will be lower for the current and future years. The FY16 ARC has dropped from $95.4 million to $29 million and the FY17 ARC has dropped from $101.8 million to $31 million.

All of the parties that have been involved in this analysis believe the new modeling assumptions are appropriate for the District's Plan and the new model will keep the Plan in a solid financial position for the future. The participation rate will need to be monitored very closely to make sure the Plan aligns with actual data points. Actuarial modeling is an ongoing process and we will continue working with DCHR, the Advisory Committee and the actuary to make sure we have the most appropriate model.

Aside from the model changes we would like to share with you some additional information on the Plan's program. As of September 30, 2015, the Trust Fund was valued at $1.076 billion and had 995 beneficiaries participating in the Plan. The operations and the financial statements of the Plan are examined annually during the CAFR audit and the Plan received an unqualified (clean) opinion.

With respect to investment performance, the Trust Fund's portfolio had rate of return of -5.18% over the past year. The financial markets have been very volatile over the past year and the performance was negatively impacted. For comparison, the policy index had a rate of return of -3.29%. However the long term performance has been positive. The Trust Fund had a return of 5.61% for the three year period and 6.25% for the five-year period. The long term performance is now slightly below the new rate of return target of 6.5%.

OFT works directly with our investment consultant, SegalRogersCasey (Segal), to constantly review the performance of our investment managers. Segal also works with us to determine the proper asset allocation to achieve the Plan's investment return target. The goal of the allocation is to provide the best risk adjusted returns. Last year, we increased our allocations to Global Fixed Income, Emerging Markets Equity, and Diversified Commodities.

We also continue to work with our managers to better understand the impact of exposure to fossil fuels. We do not explicitly tell managers how to manage their respective portfolios. However, they are aware of the political debate in the District and the impact exposure could create. As of fiscal year end the Trust Fund's portfolio had 0.05% of equity exposure and 0.14% of fixed income exposure to the top 200 fossil fuel companies for our individually managed accounts. As we have stated in the past, the OCFO has a fiduciary duty to maximize the performance of the fund and takes no position on the issue of divestment. We rely on our outside managers to determine what is prudent for investment.

Although the District's Trust Fund is well-funded, we continue to review the Trust Fund's program to ensure it not only meets best practices but exceeds them, which is consistent with one of the OCFO's goals of continuous improvement. We provided and will continue to provide an annual report to the Mayor, Council and the public that includes: Trust Fund information, the audited financial statements, Plan performance, and actuarial information.

In summary, the Trust Fund is in excellent shape. Our goals are to become more transparent, improve oversight of the plan and ensure that the Trust Fund is managed using best practices.

This concludes my remarks. I would be pleased to answer any questions you may have.

A Publication of the District of Columbia Retirement Board for Active and Retired Police Officers, Firefighters and Teachers

DCRBReport

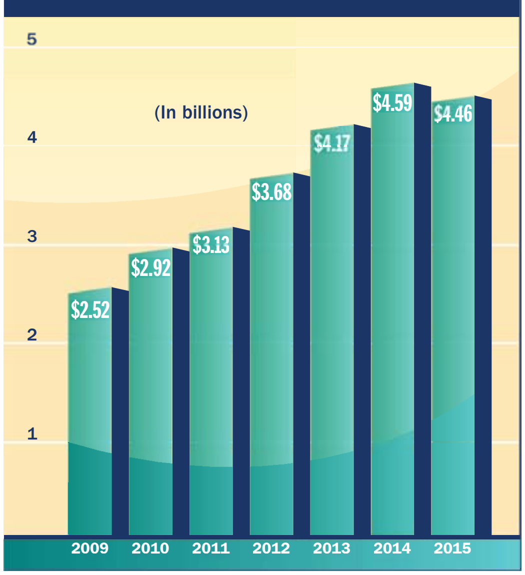
Police Officers and Firefighters' Edition

WINTER 2016

Inside

The District of Columbia Retirement Board's mission is to prudently invest the assets of the Police Officers, Firefighters, and Teachers of the District of Columbia, while providing those employees with total retirement services.

Market Value of Police Officers and Firefighters' Plan Assets (As of September 30, 2015)



CHAIRMAN'S CORNER

From the Chairman of the Board

Joseph M. Bress

DCRB is pleased to provide you with this first edition of the annual newsletter for District police officers and firefighters who are active or retired members of the District of Columbia Police Officers and Firefighters' Retirement Plan (the Plan). Over the past year, we explored additional ways of reaching out to you, and we hope that you will find this information useful.

Going forward, this newsletter will provide you with general information about your Plan and DCRB's administration of it. We will also include articles that are of specific interest to you as public safety officers or are reflective of the Board's activities that are applicable only to your Plan.

Thomas N. Tippett

One example is the recent election for the Retired Firefighter Trustee to serve on the Board. The election results, which were presented to the Board at our meeting on November 19, 2015, certified retired firefighter Thomas N. Tippett for a four-year term that began on January 28, 2016. Trustee Tippett initially represented active firefighters on the Board from 1996 to 2000, when he retired as Acting Fire Chief. He was subsequently elected as the Retired Firefighter Trustee. This will be his fifth term on the Board.

Other current Board Trustees who were elected by police officers and firefighters are: Gary W. Hankins, Retired Police Officers; Darrick O. Ross, Active Police Officers; and Edward C. Smith, Active Firefighters.

DCRB looks forward to keeping you informed in future newsletters. We are proud to serve you and welcome your feedback!

Cost-of-Living Adjustments and Your Plan

Your Plan allows for cost-of-living adjustments (COLAs) to your retirement benefit. Any COLA is effective on March 1 and paid on April 1 of each year. The Plan's COLA reflects the movement in the Consumer Price Index for All Urban Consumers—CPI-U (1967 base) during the prior calendar year. This is different from the COLAs for Social Security benefits, which reflect the inflation rate for the 12-month period ending the prior September 30 (the end of the federal fiscal year). The Social Security COLA is based on the change in the Consumer Price Index for Urban Wage Earners and Clerical Workers (the CPI-W). Because your Plan's COLA and Social Security's COLA use different indexes and are calculated over different time frames, they are usually not the same percentage.

Tax-Deductible Health Insurance Premiums

Internal Revenue Code Section 402(l) allows eligible retired public safety officers to exclude from their gross taxable income on their federal tax return up to $3,000 in health insurance premiums. Those premiums must be deducted from your monthly retirement benefit payment and paid directly to the health insurance carrier by an "eligible governmental retirement plan," such as the District of Columbia Police Officers and Firefighters' Retirement Plan. Eligible retirees may report the exclusion on line 7 or line 16(b) on their Form 1040. An explanation of the exclusion is found under "Insurance Premiums for Retired Public Safety Officers" on page 26 of the 2015 Form 1040 Instruction Booklet available on the IRS website at **www.irs.gov/pub/irs-pdf/i1040gi.pdf**.

To qualify for the exclusion:

- You must have retired from a public agency (MPD or FEMS) while serving in an official capacity as a law enforcement officer, a firefighter, a chaplain of a police or fire department, or as a member of a rescue squad or ambulance crew after reaching normal retirement age (Optional Retirement) or under Disability Retirement.
- You must have all or part of your retirement benefit from the Plan subject to federal tax withholding (refer to Box 2 of your Form 1099-R).
- Your health insurance premiums must be deducted directly from your retirement benefit payment. The deducted premiums may include coverage for you, your spouse, or other dependents. Your tax-deductible health insurance premiums will not be reported on your Form 1099-R, but they should be reflected in your year-end earnings statement.

As indicated previously, you may only exclude up to the amount of your taxable retirement income, not exceeding $3,000. For example, if your health insurance premiums are $3,700 and your taxable retirement benefit in Box 2a of your 1099-R is $12,000, you may only exclude up to $3,000 from your income.

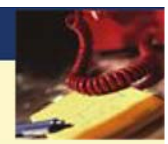
To determine eligibility for this exclusion, retirees should consult with their tax advisors, the IRS Form 1040 Instruction Booklet, or call the IRS directly at 1(800) 829-1040 or the IRS's taxpayer advocate service at 1(877) 777-4778.

Medicare Eligibility

District police officers and firefighters hired or rehired on or after April 1, 1986, pay Medicare taxes and, therefore, are eligible for Medicare benefits. You are first eligible for Medicare at age 65, but you may defer enrolling if you work beyond that age. In either case, there are specific time frames to keep in mind. For instance, if you plan to retire at age 65, you may enroll in Medicare during the seven-month period beginning three months before your 65th birthday, the month of your birthday, and the three months following that birthday. If you retire and you do not enroll during that seven-month period, your premiums for Medicare Parts B (doctors and other medical services) and D (prescriptions) will be increased. If no premium is required for Medicare Part A (hospital services), you may want to enroll in that coverage, even if you continue to work after age 65.

You should be aware that the District's health care coverage (DCEHB) assumes that you (or your covered spouse or domestic partner) will sign up for Medicare as soon as eligible to do so, which is the window of time around your (or their) 65th birthday. So, for example, if you retire earlier at age 60, your District health care coverage will automatically become the secondary payor (20%) of your medical bills when you reach age 65. If you do not sign up for Medicare at age 65, then your only coverage will be your secondary District coverage. To assure that you have adequate health care coverage in retirement, you should remember to include this step in your retirement planning process. Generally, for retirees who have federal health insurance (FEHB) coverage, Medicare becomes your primary payor when you become an annuitant and either you or your covered spouse has Medicare.

Useful Contacts



DCRB Member Services
(202) 343-3272
Toll Free (866) 456-3272
dcrb.benefits@dc.gov

DC Department of Human Resources **(202) 442-9700**

Metropolitan Police Department Human Resources Office
(202) 727-4261

Department of Fire and Emergency Medical Services Human Resources Office **(202) 673-6443**

Police and Fire Retirement and Relief Board **(202) 442-9622**

Office of Personnel Management (OPM) **Toll Free (724) 794-2005**

Social Security Administration
(800) 772-1213
http://www.ssa.gov

What Happens to Your Pension if You Divorce?

The District of Columbia Police Officers and Firefighters' Retirement Plan is subject to the DC Spouse Equity Act (the Act) of 1988. This means that in the event you divorce, your retirement benefit from the Plan may be divided between you and your ex-spouse as marital property in a court order. DCRB cannot pay a portion of your retirement benefit or a survivor annuity to your ex-spouse (the Alternate Payee) without an appropriate "qualifying court order," which is usually a qualified domestic relations order (QDRO). For purposes of the Act, a court order is one that has been issued or approved by any state or the District of Columbia court in connection with a divorce, annulment, or legal separation.

DCRB is responsible for reviewing and determining if your court order is a QDRO under the Act and if it is acceptable to the Plan. The QDRO cannot award greater benefits to your ex-spouse than the Plan allows, nor in a form that does not comply with Plan provisions (e.g., the Plan does not pay lump-sums). Although a court may approve an order as a QDRO, DCRB, as the Plan Administrator and custodian of the retirement fund, makes the final determination and will reject court orders that are deficient. DCRB will be pleased to review any draft QDRO before it is submitted to a court.

For a court order to be acceptable to the Plan under the Act as a QDRO, among other things, it must:

- state the name of the Plan that the QDRO applies to;
- state the name of the Act as the authority to enforce the QDRO;
- clearly award the Alternate Payee all or a portion of your retirement benefit as a fixed dollar amount, fraction, or percentage; and state if cost-of-living adjustments (COLAs) apply; and
- state if the Alternate Payee is entitled to a portion or all of any surviving spouse annuity, and if COLAs apply.

For your former spouse to be eligible for a survivor annuity, your former spouse:

- must have been married to you for at least nine months while you were an active member or retired; and
- you must have at least 18 months of creditable service under the Plan.

Your former spouse may lose eligibility for a survivor annuity if he/she remarries prior to age 55.

After a QDRO is accepted, and if you are already retired, DCRB will calculate and process the Alternate Payee's portion of your retirement benefit. Payments to Alternate Payees are not retroactive. It is important for you or your former spouse to make sure we have your QDRO and current contact information to ensure timely processing. No payments are made to an Alternate Payee until you retire. Further, you should be aware that DCRB does not accept or process QDROs after the death of a Plan member.

The Act also allows your eligible former spouse to continue health insurance coverage at his/her own expense under certain conditions.

Information about the Act, including a DC Spouse Equity Act Information Statement and model QDROs, is available from DCRB by calling the DCRB Member Services Center at (202) 343-3272 or toll free at (866) 456-3272.

Questions You Asked

Treatment of Unused Sick Leave upon Retirement

Recently, we have received questions from a number of you regarding the treatment of unused sick leave upon retirement. For those of you who did not call but have the same question, the information below may be helpful.

For members who retire under Optional Retirement, unused sick leave is added to your total creditable service and is used in calculating your retirement benefit. You should be aware that your unused sick leave is *not* used to determine your eligibility to retire. You must still reach the required amount of service years (e.g., 25 years for Tiers 2 and 3) for retirement eligibility. Once you have the required 25 years of service, your unused sick leave is added to your benefit calculation *only*. Please note, however, that unused sick leave is not included in the calculation of retirement benefits for either Disability or Deferred Retirement.

DC Retirement Board
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Inside this DCRB Report

Information Specific to Members of the District of Columbia Police Officers and Firefighters'Retirement Plan

Social Security Benefits

Although police officers and firefighters who are members of the District of Columbia Police Officers and Firefighters' Retirement Plan do not pay Social Security taxes, many members who call DCRB are interested in knowing more about Social Security benefits. Below is a sampling of the information callers have requested.

Eligibility

To be eligible for Social Security benefits, a person must work and pay a minimum in Social Security taxes for at least 40 quarters (ten years) during their working lives. One quarter is earned for each three-month period in which someone earns at least $1,260 (as of 2016), and the quarters earned need not be consecutive. A person can also qualify by being an eligible survivor (e.g., widow, widower, minor child, or former spouse) of an eligible family member who has died.

When Benefits are Payable and in What Percentages

Full Social Security benefits are payable at 66 years of age, and increase incrementally up to age 67, based on an individual's year of birth. See the chart below.

Year of Birth	Full Retirement Age
1943 - 1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 or later	67

If the person elects to receive the benefit early, there is a reduction in the full benefit, and if he/she elects to take it later, there is an increase. For example, if a full benefit is paid at age 66, receiving the benefit at the earliest date (age 62) would result in the benefit being reduced by 25%. If the person elects to wait until the latest date (age 70), the benefit would be increased by 32%. In this case, a full benefit of $1,000 per month would be reduced to $750 at age 62 or increased to $1,320 at age 70.

If you are eligible for Social Security, you can estimate your benefit by using the calculator on the Social Security website at **www.socialsecurity.gov**. See page two for other contact information.

D.C. Retirement Board

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NASRA Issue Brief: Public Pension Plan Investment Return Assumptions

Updated February 2016

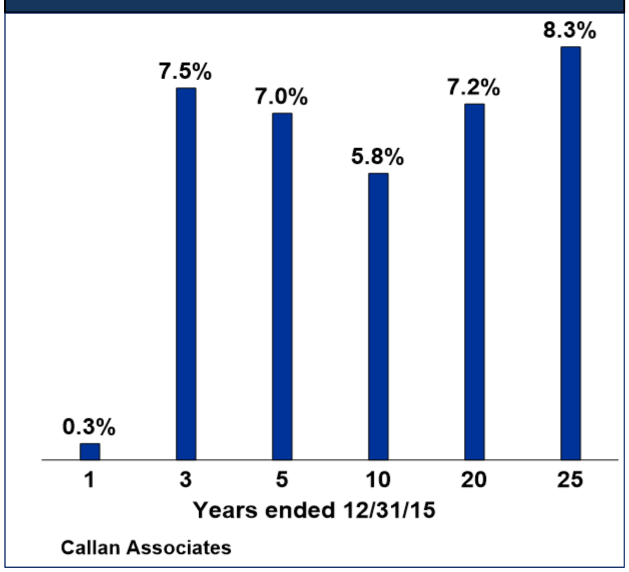
As of September 30, 2015, state and local government retirement systems held assets of $3.56 trillion.[1] These assets are held in trust and invested to pre-fund the cost of pension benefits. The investment return on these assets matters, as investment earnings account for a majority of public pension financing. A shortfall in long-term expected investment earnings must be made up by higher contributions or reduced benefits.

Funding a pension benefit requires the use of projections, known as actuarial assumptions, about future events. Actuarial assumptions fall into one of two broad categories: demographic and economic. Demographic assumptions are those pertaining to a pension plan's membership, such as changes in the number of working and retired plan participants; when participants will retire, and how long they'll live after they retire. Economic assumptions pertain to such factors as the rate of wage growth and the future expected investment return on the fund's assets.

As with other actuarial assumptions, projecting public pension fund investment returns requires a focus on the long-term. This brief discusses how investment return assumptions are established and evaluated, and compares these assumptions with public funds' actual investment experience.

Some critics of current public pension investment return assumption levels say that current low interest rates and volatile investment markets require public pension funds to take on excessive investment risk to achieve their assumption. Because investment earnings account for a majority of revenue for a typical public pension fund, the accuracy of the assumption has a major effect on the plan's finances and actuarial funding level.

Figure 1: Median public pension annualized investment returns for period ended 12/31/2015



An investment return assumption that is set too low will overstate liabilities and costs, causing current taxpayers to be overcharged and future taxpayers to be undercharged. A rate set too high will understate liabilities, undercharging current taxpayers, at the expense of future taxpayers. An assumption that is significantly wrong in either direction will cause a misallocation of resources and unfairly distribute costs among generations of taxpayers.

Although public pension funds, like other investors, experienced sub-par returns in the 2008-09 decline in global equity markets, and in 2015, median public pension fund returns over a longer period exceed the assumed rates used by most plans. Specifically, as shown in Figure 1, the median annualized investment return for the 25-year period ended December 31, 2015, exceeds the average assumption of 7.62 percent.

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[1] Federal Reserve, *Flow of Funds Accounts of the United States: Flows and Outstandings, Third Quarter 2015*, Table L.120

Public retirement systems typically follow guidelines set forth by the Actuarial Standards Board to set and review their actuarial assumptions, including the expected rate of investment return. Most systems review their actuarial assumptions regularly, pursuant to state or local statute or system policy. Actuarial Standards of Practice No. 27 (Selection of Economic Assumptions for Measuring Pension Obligations) (ASOP 27) prescribes the considerations actuaries should make in setting an investment return assumption. As described in ASOP 27, the process for establishing and reviewing the investment return assumption involves consideration of various financial, economic, and market factors, and is based on a very long-term view, typically 30 to 50 years. A primary objective for using a long-term approach in setting public pensions' return assumption is to promote stability and predictability of cost to ensure intergenerational equity among taxpayers.

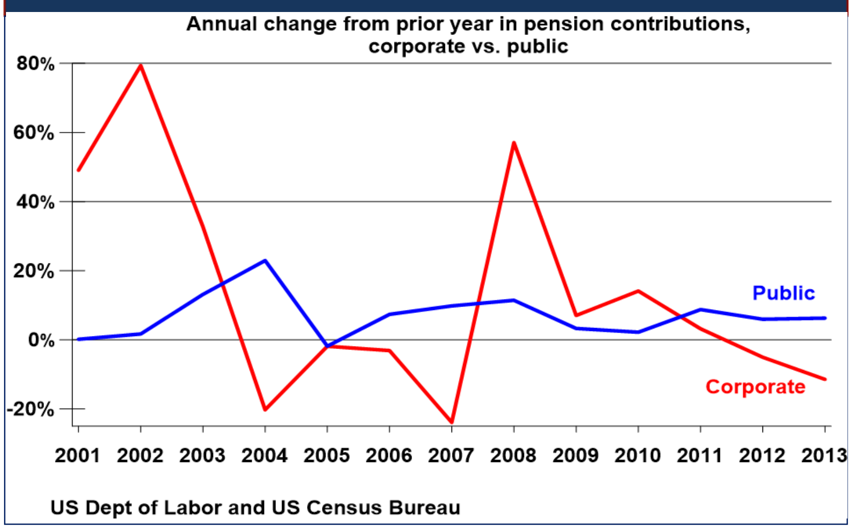
The investment return assumption used by public pension plans typically contains two components: inflation and the real rate of return. The sum of these is the nominal return rate, which is the rate that is most often used and cited. The inflation assumption typically is applied also to other actuarial assumptions, such as the assumed level of wage growth and, depending on the plan's benefit structure, assumed rates of cost-of-living adjustments.

The second component of the investment return assumption is the real rate of return, which is the return on investment after adjusting for inflation. The real rate of return is intended to reflect the return produced as a result of the risk taken in investing the assets. Achieving a return approximately commensurate with the inflation rate normally is attainable by investing in securities, such as US Treasury bonds, that are considered to be risk-free, i.e., that pay a guaranteed rate of return that is absolutely risk-free. Achieving a return higher than the risk-free rate requires taking some investment risk; for public pension funds, this risk takes the form of investments in public and private equities, real estate, and other asset classes.

The average real rate of return among plans in the Public Fund Survey has risen since FY 01, from approximately 4.25 percent to 4.60 percent. This has occurred as a result of some plans that have reduced their inflation assumption without changing their nominal investment return assumption; or reductions in inflation assumptions by an amount greater than they have reduced their nominal assumption; or both.

Unlike public pension plans, corporate plans are required by federal regulations to make contributions on the basis of current interest rates. As Figure 2 shows, this method results in plan costs that are volatile and uncertain, often changing dramatically from one year to the next. This volatility is due in part to fluctuations in interest rates and has been identified as a leading factor in the decision among corporations to abandon their pension plans. By focusing on the long-term and relying on a stable investment return assumption, public plans experience less volatility of costs.

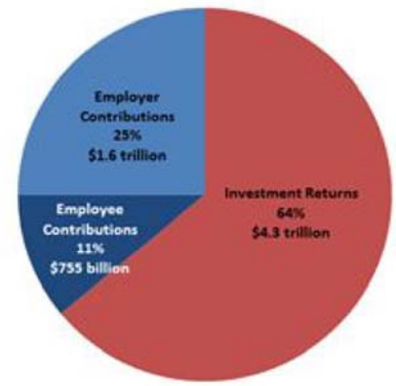
Figure 2: Annual change in contributions from prior year, corporate vs. public pensions



Source: Compiled by NASRA based on U.S. Department of Labor and U.S. Census Bureau data

As shown in Figure 3, since 1985, public pension funds have accrued an estimated $6.7 trillion in revenue, of which $4.3 trillion, or 64 percent, is estimated to have come from investment earnings. Employer contributions account for $1.6 trillion, or 25 percent of the total, and employee contributions total $755 billion, or 11 percent.[2]

Figure 3: Public Pension Sources of Revenue, 1985-2014



Source: Compiled by NASRA based on U.S. Census Bureau data

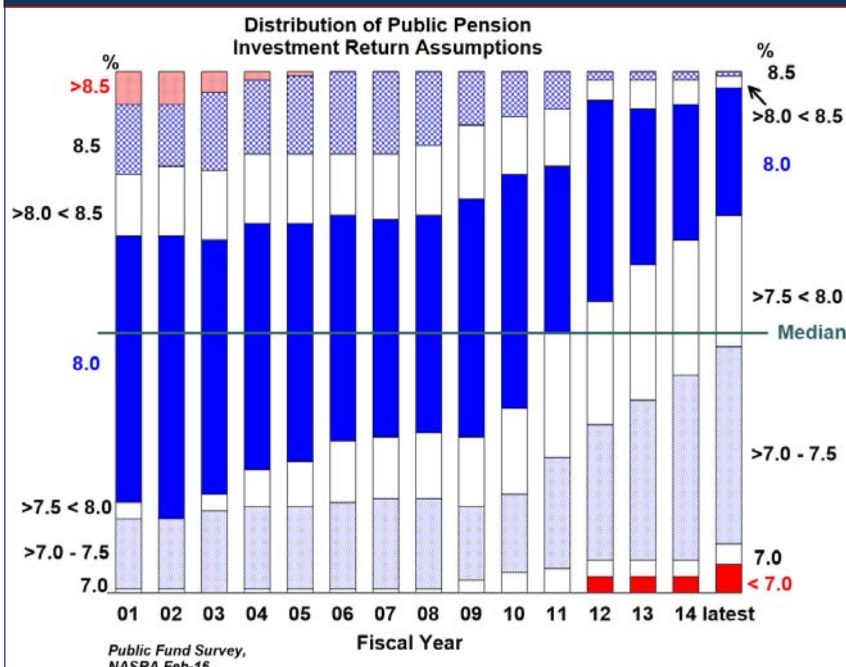
Public retirement systems operate over long timeframes and manage assets for participants whose involvement with the plan can last more than half a century. Consider the case of a newly-hired public school teacher who is 30 years old. If this pension plan participant elects to make a career out of teaching school, he or she may work for 35 years, to age 65, and live another 25 years, to age 90. This teacher's pension plan will receive contributions for the first 35 years and then pay out benefits for another 25 years. During the entire 60-year period, the plan is investing assets on behalf of this participant. To emphasize the long-term nature of the investment return assumption, for a typical career employee, more than one-half of the investment income earned on assets accumulated to pay benefits is received *after* the employee retires.

The investment return assumption is established through a process that considers factors such as economic and financial criteria; the plan's liabilities; and the plan's asset allocation, which reflects the plan's capital market assumptions, risk tolerance, and projected cash flows.

Standards for setting an investment return assumption, established and maintained by professional actuaries, recommend that actuaries consider a range of specified factors, including current and projected interest rates and rates of inflation; historic and projected returns for individual asset classes; and historic returns of the fund itself. The investment return assumption reflects a value within the projected range.

As shown in Figure 4, many public pension plans have reduced their return assumption in recent years. Among the 127 plans measured, more than one-half have reduced their investment return assumption since fiscal year 2008. The average return assumption is 7.62 percent. Appendix A details the assumptions in use or adopted by the 127 plans in this dataset.

Figure 4: Change in distribution of public pension investment return assumptions, FY 01 through February 2016

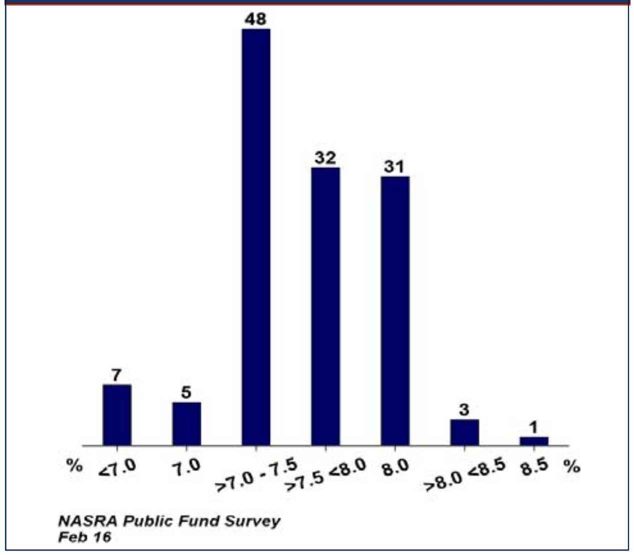


[2] US Census Bureau, Annual Survey of Public Pensions, State & Local Data

Conclusion

Over the last 25 years, a period that has included three economic recessions and four years when median public pension fund investment returns were negative, public pension funds have exceeded their assumed rates of investment return. Changes in economic and financial conditions are causing many public plans to reconsider their investment return assumption. Such a consideration must include a range of financial and economic factors while remaining consistent with the long timeframe under which plans operate.

Figure 5: Distribution of investment return assumptions



See Also:

- Actuarial Standards of Practice No. 27, Actuarial Standards Board
- The Liability Side of the Equation Revisited, Missouri SERS, September 2006
- The Public Fund Survey is sponsored by the National Association of State Retirement Administrators (registration required).

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National Association of State Retirement Administrators

Appendix A: Investment Return Assumption by Plan

(Figures reflect the nominal assumption in use, or announced for use, as of February 2016)

Plan	Rate (%)
Alaska PERS	8.00
Alaska Teachers	8.00
Alabama ERS	8.00
Alabama Teachers	8.00
Arkansas PERS	7.75
Arkansas Teachers	8.00
Arizona Public Safety Personnel	7.50
Arizona SRS	8.00
Phoenix ERS	7.50
California PERF	7.50
California Teachers	7.50
Contra Costa County	7.25
LA County ERS	7.50
San Diego County	7.75
San Francisco City & County	7.50
Colorado Affiliated Local	7.50
Colorado Fire & Police Statewide	7.50
Colorado Municipal	7.50
Colorado School	7.50
Colorado State	7.50
Denver Employees	8.00
Denver Public Schools	7.50
Connecticut SERS	8.00
Connecticut Teachers	8.50
DC Police & Fire	6.50
DC Teachers	6.50
Delaware State Employees	7.20
Florida RS	7.65
Georgia ERS	7.50
Georgia Teachers	7.50
Hawaii ERS[1]	7.55
Iowa PERS	7.50
Idaho PERS	7.00
Chicago Teachers	7.75
Illinois Municipal	7.50
Illinois SERS	7.25
Illinois Teachers	7.50
Illinois Universities	7.25
Indiana PERF	6.75
Indiana Teachers	6.75
Kansas PERS	8.00
Kentucky County	7.75
Kentucky ERS	7.75
Kentucky Teachers	7.50
Louisiana Parochial Employees	7.25
Louisiana SERS	7.75
Louisiana Teachers	7.75
Massachusetts SERS	7. 50
Massachusetts Teachers	7. 50
Maryland PERS	7.55
Maryland Teachers	7.55
Maine Local	7.13
Maine State and Teacher	7.13
Michigan Municipal	7.75
Michigan Public Schools	8.00
Michigan SERS	8.00
Duluth Teachers	8.00
Minnesota PERF	8.00
Minnesota State Employees	8.00
Minnesota Teachers[2]	8.40
St. Paul Teachers	8.00
Missouri DOT and Highway Patrol	7.75
Missouri Local	7.25
Missouri PEERS	8.00
Missouri State Employees	8.00
Missouri Teachers	8.00
St. Louis School Employees	8.00
Mississippi PERS	8.00
Montana PERS	7.75
Montana Teachers	7.75
North Carolina Local Government	7.25
North Carolina Teachers and State Employees	7.25
North Dakota PERS	8.00
North Dakota Teachers	7.75
Nebraska Schools	8.00
New Hampshire Retirement System	7.75
New Jersey PERS	7.90
New Jersey Police & Fire	7.90
New Jersey Teachers	7.90

New Mexico PERF	7.75
New Mexico Teachers	7.75
Nevada Police Officer and Firefighter	8.00
Nevada Regular Employees	8.00
New York City ERS	7.00
New York City Teachers	8.00
New York State Teachers	8.00
NY State & Local ERS	7.50
NY State & Local Police & Fire	7.50
Ohio PERS	8.00
Ohio Police & Fire	8.25
Ohio School Employees	7.75
Ohio Teachers	7.75
Oklahoma PERS	7.50
Oklahoma Teachers	8.00
Oregon PERS	7.75
Pennsylvania School Employees	7.50
Pennsylvania State ERS	7.50
Rhode Island ERS	7.50
Rhode Island Municipal	7.50
South Carolina Police	7.50
South Carolina RS	7.50
South Dakota PERS[3]	7.25
TN Political Subdivisions	7.50

TN State and Teachers	7.50
City of Austin ERS	7.75
Houston Firefighters	8.50
Texas County & District	8.00
Texas ERS	8.00
Texas LECOS	8.00
Texas Municipal	7.00
Texas Teachers	8.00
Utah Noncontributory	7.50
Fairfax County Schools	7.50
Virginia Retirement System	7.00
Vermont State Employees[4]	8.10
Vermont Teachers[4]	7.90
Washington LEOFF Plan 1[5]	7.80
Washington LEOFF Plan 2	7.50
Washington PERS 1[5]	7.80
Washington PERS 2/3[5]	7.80
Washington School Employees Plan 2/3[5]	7.80
Washington Teachers Plan 1[5]	7.80
Washington Teachers Plan 2/3[5]	7.80
Wisconsin Retirement System	7.20
West Virginia PERS	7.50
West Virginia Teachers	7.50
Wyoming Public Employees	7.75

1. The Hawaii ERS rate is scheduled to change to 7.50 percent effective 7/1/17.
2. The Minnesota Legislature is responsible for setting the investment return assumption for pension plans in the state. Legislation approved in 2015 established a rate of 8.0 percent for all plans except the TRA, which is using a select and ultimate rate pending completion of an actuarial experience study. (For more information on select-and-ultimate rates, please see Actuarial Standards of Practice No. 27: http://www.actuarialstandardsboard.org/pdf/asops/asop027_145.pdf.) The Minnesota Legislative Commission on Pensions and Retirement recommended that the legislature adopt a rate for the TRA of 8.0 percent; the legislature may act on this recommendation during its session that ends in May.
3. The SDRS set the rate at 7.25% through FY 2017, after which the rate will rise to 7.50% unless the SDRS board takes action otherwise.
4. The Vermont retirement systems adopted select-and-ultimate rates in 2011; the rates shown reflect the single rates most closely associated with the funding results for the respective plans, based on their projected cash flows.
5. For all Washington State plans except LEOFF Plan 2, the assumed rate of return will be reduced to 7.7% on July 1, 2017, under current state law.

NASRA Issue Brief:
State and Local Government Spending on Public Employee Retirement Systems

Updated March 2016

State and local government pension benefits are paid not from general operating revenues, but from trust funds to which public retirees and their employers contributed while they were working. On a nationwide basis, contributions made by state and local governments to pension trust funds account for 4.1 percent of direct general spending (see Figure 1).[i] Pension spending levels, however, vary widely among states and are sufficient for some pension plans 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.[ii] Although some lawmakers have considered closing existing pension plans to new hires, most determined that this would increase—rather than reduce—costs,[iii] particularly in the near-term. Instead, states and cities have made changes to their pension plans 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.[iv]

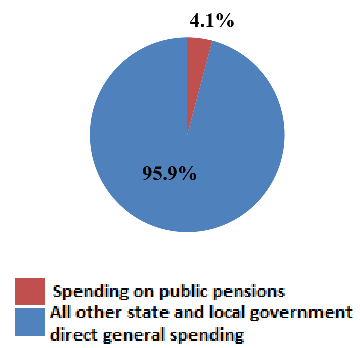
This update provides figures for public pension contributions as a percentage of state and local government direct general spending for FY 2013, and projects a rate of spending on pensions for FY 2014.

Nationwide Spending on Public Pensions

Based on the most recent information provided by the U.S. Census Bureau, 4.1 percent of all state and local government spending is used to fund pension benefits for employees of state and local government. As shown in Figure 2, pension costs have remained within a narrow range over a 30-year period, declining from a high point of 5.0 percent, in FY 85, to a low of 2.3 percent in FY 02, and reaching 4.1 percent in FY 13. State and local governments contributed, in aggregate, an estimated $121 billion to pension funds in FY 14, a figure that is projected to equal 4.5 percent of projected state and local direct general spending, as displayed in Figure 2.[v]

Although pensions on average do not comprise a significant portion of state and local spending, as shown in Table 1, spending on pensions by states and political subdivisions do vary widely, from 1.63 percent to nearly 8.0 percent. Some municipalities have reported higher pension costs as a percentage of their budget. One study estimates that total required spending on pensions could consume as much as 13 percent of one state's budget,[vi] due mostly to past failures to adequately fund pension costs and assuming a relatively low five percent investment return. Failure to pay required contributions results in greater future contributions to make up the difference.

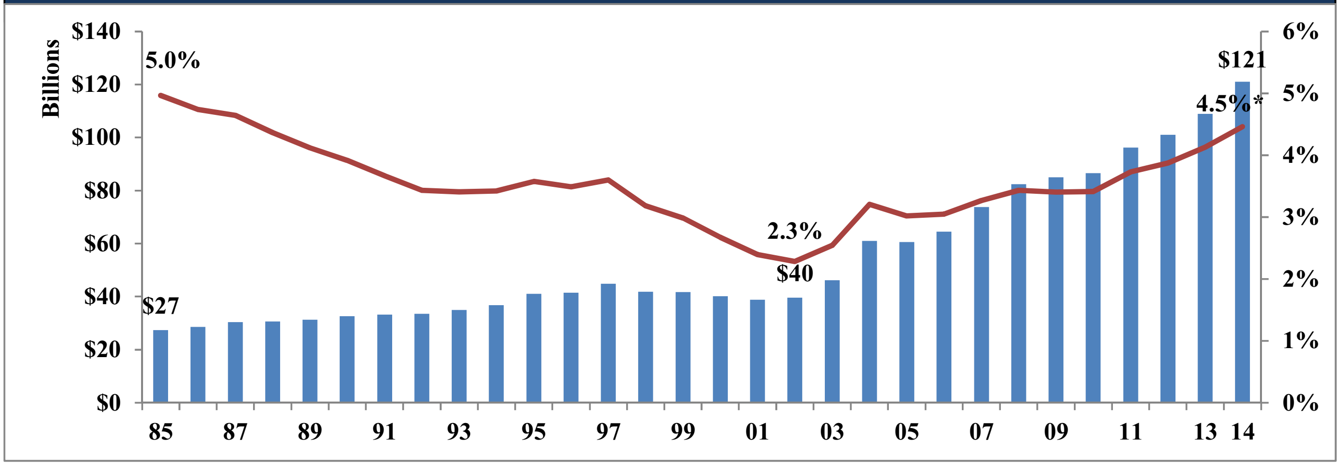
Figure 1: State and local spending on public pensions as percentage of total government direct general spending, 2013



Compiled by NASRA based on U.S. Census Bureau data

Most of the variation in pension spending levels among states is attributable to two factors: differences in benefit levels, and variations in the size of unfunded pension liabilities. As a percentage of total spending, pension costs for cities are higher than states by approximately 32 percent over the 30-year period spanning 1985-2014.[vii] This is likely due in part to the types of services delivered at the local level (i.e., more labor-intensive) and the resulting larger share of municipal budgets that is committed to salaries.

Figure 2: State and local pension contributions, in dollars, and as a percentage of state and local direct general expenditures, 1985-2013 (with 2014 projection)



Compiled by NASRA based on U.S. Census Bureau data
**Projected, based on estimated state and local government spending from National Association of State Budget Officers (NASBO) and U.S. Census Bureau data*

Consistent comparisons of pension spending by local governments can, however, be difficult to make, as the fiscal relationship between a state and its political subdivisions is unique with respect to revenue and spending structure and taxing authority, and varies widely. For example, funding responsibility for K-12 education budgets ranges from primarily a state duty to primarily a local responsibility. Likewise, revenue-sharing arrangements and the authority of local governments to tax and raise revenue also run a wide range. As with states, pension costs for municipalities can vary widely.

Cost and Financing Factors

Public pensions are financed through a combination of contributions from public employers (state and local agencies) and public employees, and the investment earnings on those contributions.[viii] Since 1985, investment earnings have accounted for 64 percent of all public pension revenue; employer contributions, 25 percent; and employee contributions, 11 percent.

Employee Contributions

Because nearly all public employees are required both to participate in their employer-sponsored retirement plan and to contribute toward the cost of their pension benefit—typically four to eight percent of pay—most state and local government retirement plans are, in fact, mandatory savings programs. In recent years, many states have increased rates of required employee contributions. On a national basis, in fiscal year 2014, employee contributions accounted for 27 percent of all public pension plan contributions, with employer contributions making up the remaining 73 percent.[ix]

Employer Contributions

A variety of state and local laws and policies guide governmental pension funding practices. Most require employers to contribute what is known as the Actuarially Determined Contribution (ADC), which is the amount needed to finance benefits accrued each year, plus the annual cost to amortize unfunded liabilities from past years, minus required employee contributions.

On a weighted basis, the average ARC paid in recent years has been around 84 percent. Beneath this average ARC experience lies diversity: approximately 60 percent of plans in the Public Fund Survey[x] consistently receive 90 percent or more of their ADC.[xi] This means that although a majority of plans have been receiving their required funding, some plans have not been adequately funded, which will result in higher future costs.

Leading national public sector associations established a Pension Funding Task Force, which in 2013 released its report *Pension Funding: A Guide for Elected Officials* urging policymakers to follow recommended guidelines for an actuarially determined contribution to government retirement systems.

Social Security Coverage

Twenty-five to thirty percent of state and local governments and their employees make contributions to their retirement plan instead of to Social Security. This is the case for most to substantially all of the state and local government workforce in seven states, 40 percent of the nation's public school teachers, and a majority of firefighters and police officers.[xii] Pension benefits—and costs—for those who do not participate in Social Security are usually higher than for those who do participate, in order to compensate for the absence of Social Security benefits. This higher cost should be considered in the context of the 12.4 percent of payroll, or an estimated $31.2 billion annually,[xiii] these employers and employees would otherwise be paying into Social Security.

Investments and Other Parts of the Financing Equation

The largest portion of public pension funding comes from investment earnings, which illustrates the major role this revenue source plays in determining pension costs (see *NASRA Issue Brief: Public Pension Plan Investment Return Assumptions*, February 2016). Other factors that affect pension costs include expectations for wage and general inflation, rates of worker retirement and attrition, and rates of mortality. Expectations for these and other economic and actuarial events typically are based on long timeframes, such as 20 to 50 years.

In addition to the performance of pension fund investments, macro-economic and demographic events also affect the cost of the plan. These events include such changes as retirement rates, attrition and rates of hiring, and wage growth, which can be affected by salary cuts and layoffs. Additionally, legislatures in nearly every state have made changes to pension benefits and/or financing structures, in some cases reducing plan costs and long-term obligations.

Conclusion

On average, retirement programs remain a relatively small part of state and local government spending, although required costs, benefit levels, funding levels, and funding adequacy vary widely, and this rate has been rising in recent years. Over $250 billion is paid out annually from these trusts to retirees and their beneficiaries, reaching virtually every city and town in the nation.[xiv]

Changes to benefit levels and required employee contributions adopted by states and cities have been widespread and diverse, dependent in part on such factors as the legal authority to make changes to benefits or required employee contribution rates, and the plan's financial condition. Generally, states and cities with a history of paying their required pension contributions are in better condition and have needed more minor adjustments to benefits or financing arrangements compared to those with a history of not adequately making their contributions.

Table 1: State and local government contributions to pensions as a percentage of all state and local government direct general spending, by state, 2013

Alabama	2.86	*Louisiana*	7.79	Oklahoma	4.29
Alaska	4.18	*Maine*	2.65	Oregon[2]	3.08
Arizona	3.90	Maryland	4.77	Pennsylvania	3.10
Arkansas	3.80	*Massachusetts*	4.31	Rhode Island	5.26
California	5.21	Michigan	4.03	South Carolina	3.40
Colorado	2.97	Minnesota	2.06	South Dakota	1.82
Connecticut	6.16	Mississippi	3.81	Tennessee	2.96
Delaware	3.19	Missouri	4.03	*Texas*	2.84
District of Columbia	1.88	Montana	2.79	Utah	3.88
Florida	2.25	Nebraska	2.54	Vermont	1.76
Georgia	2.92	*Nevada* [1]	7.23	Virginia	3.80
Hawaii	4.72	New Hampshire	2.64	Washington	2.16
Idaho	2.77	New Jersey	3.51	West Virginia	5.22
Illinois	7.61	New Mexico	3.25	Wisconsin	1.94
Indiana	4.23	New York	6.82	Wyoming	2.00
Iowa	2.47	North Carolina	2.13	U. S. weighted avg.	4.13
Kansas	2.79	North Dakota	1.63	*Compiled by NASRA based on U.S. Census Bureau data*	
Kentucky	4.24	*Ohio*	3.51		

Percent-of-spending as of publication date. Figures are subject to periodic revisions by the U.S. Census Bureau.

States where more than one-half of public employee payrolls are estimated to be outside of Social Security are italicized.

[1] In addition to being a non-Social Security state, one-half of Nevada PERS employers' contribution is attributable to a non-refundable pre-tax salary reduction to fund the employees' portion of the contribution.

[2] Contributions include an annual amount required to amortize the balance of employer side accounts

See also

National Governors Association, National Conference of State Legislatures, The Council of State Governments, National Association of Counties, National League of Cities, The U.S. Conference of Mayors, International City/County Management Association, National Council on Teacher Retirement, National Association of State Auditors, Comptrollers and Treasurers, Government Finance Officers Association, and National Association of State Retirement Administrators, "Pension Funding: A Guide for Elected Officials," 2013, http://www.nasra.org/files/JointPublications/PensionFundingGuide.pdf

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[i] Prior published versions of this brief calculated pension spending by state and local governments as a percentage of total state and local spending; this brief reflects a revised methodology which substitutes direct general spending for total spending. Direct general expenditures represent all government spending excluding intergovernmental transfers. Included in this category are payments to current and retired employees, as well as government operations and capital outlays. Some state and local government spending is non-discretionary, and therefore not in competition for funds with other programs and services. Including non-discretionary spending would make the effect of pension spending appear smaller. In addition, some states and cities do not contribute the amount determined actuarially to adequately fund the plan.

[ii] Selected Approved Changes to State Public Pensions to Restore or Preserve Plan Sustainability, http://www.nasra.org/files/Compiled%20Resources/nasrasustainabilitychanges.pdf, (updated June 2015)

[iii] NASRA.org, "Costs of Switching from a DB to a DC Plan," http://www.nasra.org/plansdesignchange

[iv] Center for Retirement Research at Boston College, "State and Local Pension Costs: Pre-Crisis, Post-Crisis, and Post-Reform," February 2013

[v] Projected spending for 2013 derived from actual state expenditures as reported by the National Association of State Budget Officers in the 2013-2015 State Expenditure Report (http://www.nasbo.org/sites/default/files/State%20Expenditure%20Report%20%28Fiscal%202013-2015%29S.pdf) p. 8 and projected increase in local government direct general spending from 2012-2013, as provided by the U.S. Census Bureau http://www.census.gov/govs/local/

[vi] Center for Retirement Research at Boston College, "The Impact of Public Pensions on State & Local Budgets," supra

[vii] Author's calculations using public pension and state and local government finance data provided by the U.S. Census Bureau

[viii] U.S. Census Bureau, http://www.census.gov/govs/retire/ - Table 2a. Revenues of State and Local Public Employee Retirement Systems by State and Level of Government, Fiscal Year 2012-2013

[ix] U.S. Census Bureau, https://www.census.gov/govs/retire/ - State and Locally-Administered Defined Benefit Pension Systems – All Data by State and Local Government: 2014

[x] Public Fund Survey, http://www.publicfundsurvey.org/

[xi] The Annual Required Contribution Experience of State Retirement Plans, FY 01 to FY 13, http://www.nasra.org/arc

[xii] http://www.nasra.org/socialsecurity

[xiii] Author's calculation based on 30 percent of state and local government employees not participating in Social Security

[xiv] U.S. Census Bureau, http://www.census.gov/gos/retire/ ; see also "Economic Effects of Public Pensions," http://www.nasra.org/economiceffects

State and Local Fiscal Facts: 2016

State and Local Finances · Municipal Bonds · State and Local Pensions

Fiscal Condition of State and Local Governments

In the past few years, state and local government revenues have been slowly improving. While challenges remain, officials have been taking steps to replenish rainy day funds and address long-term structural imbalances.

State Finances[1]

For states, 2015 brought a moderate improvement in fiscal conditions. While stable state fiscal conditions for 2016 are projected, powerful macro conditions such as weak commodity prices, stock market volatility, and global uncertainties could destabilize this projection. General fund spending and revenues are projected to increase for the sixth consecutive year based on states' enacted budgets. Since the end of the Great Recession, states have transitioned to a sustainable period of fiscal rebuilding, but progress remains slow and fiscal challenges are likely to continue due to rising spending demands in areas such as healthcare and education and limited gains in revenue collections.

- Forty-three states enacted higher general fund spending in FY16 than in FY15.
- States have enacted minimal mid-year spending cuts over the last several years, indicating that states' fiscal situations have stabilized.
- States have replenished some spending for areas cut back during the recession, including K-12 and higher education.
- Thirty-nine states exceeded their FY 2015 revenue projections, and most states expect to meet or exceed their FY 2016 revenue projections as well.

City Finances[2]

City fiscal conditions continue to show modest improvement but remain weakened since the Great Recession. Growth is slow and fiscal challenges are likely to continue. A number of factors determine the revenue performance, spending levels and overall fiscal condition of cities. Among the factors most negatively influencing city conditions are increases in infrastructure demands, and employee and retiree-related costs including pensions, healthcare and wages. Positive factors include the value of the city tax base, health of the local economy, and in most cities, the drop in gas and oil prices.

Issued By:

NGA -	National Governors Associaton
NCSL -	National Conference of State Legislatures
CSG -	The Council of State Governments
NACo -	National Association of Counties
NLC -	National League of CIties
USCM -	U.S. Conference of Mayors
ICMA -	International City/County Management Association
NASBO -	National Association of State Budget Officers
NASACT -	National Association of State Auditors, Comptrollers and Treasurers
GFOA -	Government Finance Officers Association
NASRA -	National Association of State Retirement Administrators

- Property tax revenue has increased and is anticipated to have positive growth in 2016.
- Sales and income tax revenues continue to show positive rates of increase.
- Ending balances have returned to pre-recession levels.
- Despite improvements in tax sources, and in the general fund, the pace of growth is concerning. Cities are operating at only about 90 percent of pre-recession revenues.
- City finance officers are optimistic but more fiscally conservative and are cautiously preparing for the next economic downturn.
- Management of infrastructure and employee-related costs and volatilities such as gas and oil prices, inflation and state aid could continue to affect fiscal sustainability long term.

County Finances[3]

For counties, recovery has accelerated; however, challenges remain. County economies grew strongly last year, yet most have not returned to pre-recession levels on jobs and unemployment. Notably:

- Recovery accelerated on unemployment rates and home prices, but GDP recovery was less pronounced.
- Economic recovery is spreading more rapidly, but most economies still have not recovered.
- Economic recovery is creating an uneven geography of opportunity.
- Real wage growth has not kept pace with productivity gains.

Municipal Bankruptcy

While the fiscal condition of state and local governments as a whole is improving, there are governments where fiscal stress continues. Generally, these governments' fiscal troubles are based on long-standing economic problems and other unique circumstances. It is important to note that bankruptcy, while headline-grabbing, is rare and is not an option for most localities.

- Bankruptcy is not a legal option for state sovereign entities. States have taxing authority and have constitutional or statutory requirements to balance their budgets.
- States determine whether their political subdivisions may pursue bankruptcy in the event of insolvency.
- Only 12 states authorize Chapter IX bankruptcy filings for their general purpose governments and 12 states conditionally authorize such filings. Twenty-six states have either no Chapter IX authorization or such filings are prohibited.
- Bankruptcies remain rare and are a last resort for eligible municipal governments. Since 2010, only 9 out of 51 filings have been by general-purpose governments. The majority of filings have been submitted not by cities, but by lesser-known utility authorities and other narrowly-defined special districts throughout the country.[4]
- Chapter IX of the federal Bankruptcy Code does not provide for any federal financial assistance, and filing under this section of the law is not a request for federal funding.

Federal Intervention

The Founding Fathers believed in a balance between state and federal power. The 10th Amendment reads "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." State and local governments can weather difficult economic periods and officials are taking steps to restore fiscal stability. Interference in the fiscal affairs of state and local governments by the federal government is neither requested nor warranted. Long-term issues such as outdated methods of taxation, rising health care costs and growing pension liabilities are already being discussed by state and local government leaders and changes in many areas are underway.

Municipal Bonds

Municipal securities are predominantly issued by state and local governments for governmental infrastructure and capital needs purposes, such as the construction or improvement of schools, streets, highways, hospitals, bridges, water and sewer systems, ports, airports and other public works. Between 2003 and 2014, states, counties, and other localities invested $3.5 trillion in infrastructure through long-term tax-exempt municipal bonds[5]; the federal government provided $1.46 trillion. [6]

On average, 11,600 municipal issuances are completed each year.

The principal and interest paid on municipal bonds is a small and well-protected share of state and municipal budgets:

- Debt service is typically only about 5 percent of the general fund budgets of state and municipal governments.
- Either under standard practice or as required by law or ordinance, debt service most often must be paid first before covering all other expenses of state and municipal governments.
- Municipal securities are considered to be second only to Treasuries in risk level as an investment instrument. The recovery rate of payment for governmental debt far exceeds the corporate recovery rate.

Types of Debt and Default

Municipal debt takes two forms: General Obligation, or GO Debt, backed by the full faith and credit of a general purpose government like a state, city, or county; and Non-GO debt issued by governments and special entities that is usually backed by a specific revenue source (special taxes, fees or loan payments) associated with the enterprise or borrower.

There are two types of defaults: (1) the more minor "technical default," where a covenant in the bond agreement is violated, but there is no payment missed and the structure of the bond is the same and (2) defaults where a bond payment is missed, or in the rare event that debt is restructured at a loss to investors.

From 1970 through 2014, there were 92 rated municipal bond defaults, of which only six were rated city or county governments. The majority of rated defaulted bonds were issued by not-for-profit hospitals or housing project financings.

Historically, municipal bonds have had lower average cumulative default rates than global corporates overall and by like rating category. Between 1970 and 2013, the average 10-year default rate for Moody's Aaa-rated municipal bonds was zero compared to a 0.49 percent default rate for Moody's Aaa-rate corporate bonds.[7] Furthermore, over the last five years, during which state and local governments struggled to recover from the Great Recession, rated state and local GO defaults were remarkably low at 0.005 percent. [8]

- In the double-A rating category to which the majority of municipal ratings were assigned, average cumulative default rates are much lower for municipals than for corporates with the same double-A symbol. [9]
- There has been only one state that has defaulted on its debt in the past century, and in that case bondholders ultimately were paid in full.

Federal Tax Exemption

The federal tax exemption for municipal bonds is an effective, efficient and successful way for state and local governments to finance infrastructure. Municipal securities existed prior to the formation of the federal income tax in 1913. Since then, the federal Internal Revenue Code has exempted municipal bond interest from federal taxation. Between 2000 and 2014 the federal exemption saved state and local governments an estimated $714 billion in additional interest expenses.[10] Many states also exempt from taxation the interest earned from municipal securities when their residents purchase bonds within their state. Because of the reciprocal immunity principle between the federal government and state and local governments, state and local governments are prohibited from taxing the interest on bonds issued by the federal government.

State and Local Pensions[11]

Although some state and local government pension trusts are fully funded with enough assets for current pension obligations, there are legitimate concerns about the extent of underfunding in certain jurisdictions. In most cases, a modest increase in contributions to take advantage of compound interest, or modifications to employee eligibility and benefits, or both, will be sufficient to remedy the underfunding problem.[12]

Significant Reforms Enacted

State and local employee retirement systems are established and regulated by state laws and, in many cases, further subject to local governing policies and ordinances. Federal regulation is neither needed nor warranted, and public retirement systems do not seek federal financial assistance. State and local governments are taking steps to strengthen their pension reserves and operate under a long-term time horizon.

- Between 2009 and 2014, every state made changes to pension benefit levels, contribution rate structures, or both. Many local governments have made similar fixes to their plans.[13]
- Although pension obligations in some states are backed by explicit state constitutional protections or statutes, states generally are permitted to change retiree health benefits, including terminating them, as they do not carry the same legal protections. Therefore, it is misleading to combine unfunded pension liabilities with unfunded retiree health benefits.
- Thirty-three states hold approximately $33 billion in other post-employment benefits (OPEB) assets as of FY 2013. This figure is up from 18 states reported for the period FY 2009-FY 2011. At the same time, state government units offering retiree health care benefits have declined during the past decade.[14]

Pension Finances

Public retirees and their employers contribute to their pensions while they are working. Assets are held in trust and invested in diversified portfolios to prefund the cost of pension benefits[15] for over 14 million working and 9 million retired employees of state and local government.[16] Public pension assets are accumulated, invested, and paid out over decades, not as a lump sum.

- Public employees typically are required to contribute 5 to 10 percent of their wages to their state or local pension. Since 2009, 36 states have increased required employee contribution rates.[17]
- As of September 30, 2015, state and local retirement trusts held $3.56 trillion in assets.[18]
- For most state and local governments, retirement systems remain a relatively small portion of their budget. On average, the portion of combined state and local government spending dedicated to retirement system contributions is four percent.[19] Current pension spending levels vary widely and are sufficient for some entities and insufficient for others.

- Funded levels - the degree to which a plan has accrued assets to pay expected benefits for current and future retirees - among pension plans vary substantially. Although a number of plans are more than 100 percent advance-funded, on average, the funded level in 2014 was 74 percent, and 20 percent were less than 60 percent funded.[20]
- Many public pension plans have reduced their return assumption in recent years. Among the 126 plans measured in the Public Fund Survey, two-thirds have reduced their investment return assumption since FY2008. The median return assumption is 7.75 percent. For the 25-year period ending June 30, 2015, the median annualized public pension investment return was 8.4 percent; the 10-year median was 6.6 percent.[21]

Endnotes

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Operations Committee Meeting
Proposed Action Item
Investment Compliance Consultant
March 17, 2016

Background

DCRB promotes an organizational culture that seeks to eliminate or mitigate compliance risks. An effective investment compliance program enhances investment performance, while contributing positively to DCRB's reputation. In the fiscal year 2016 operating budget, the Board approved a new staff position for an Investment Compliance and Risk Officer. After consulting with the Executive Director, the Chief Investment Officer is proposing to initially fill the position with a contract employee, who will perform the following tasks:

- Develop, implement, and monitor a compliance and risk management program for the Investment Department;
- Develop compliance policies and procedures that establish key metrics to define and measure regulatory risk and compliance, as well as provide regular compliance program updates;
- Support the CIO, Executive Director, and Investment Committee in its oversight capacity with regard to compliance with policies, risk assessment and propose an effective control environment;
- Identify, report, and recommend remediation of investment policy violations;
- Recommend restructuring of the automated solution for storing investment-related business records that conform with policy and legal requirements;
- Collaborate on the negotiations of various transaction-related legal documents;
- Perform investment and operational due diligence on new and existing service provider relationships.
- Evaluate compliance with investment guidelines and contractual terms;
- Evaluate the impact of new laws and regulations on DCRB and help develop appropriate internal audit programs; and
- Assess costs and develop a plan to better manage costs, including conducting a review of DCRB's basis point cost in accordance with effective measures used by other public pension funds and recommend best practices for fee reporting in the private equity industry.

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TO: BOARD OF TRUSTEES

FROM: EDWARD SMITH, CHAIRMAN

DATE: MARCH 17, 2016

SUBJECT: BENEFITS COMMITTEE REPORT

The Benefits Committee did not meet in March 2016. The following report reflects Benefits Department activities and projects that occurred since the February Board meeting.

The Benefits Department will soon begin the groundwork for the following first-time and annual projects.

Term Vested Project

This month, DCRB began working with US Treasury to develop a project plan for locating terminated vested Plan participants. The purpose of this project is to identify former employees who terminated employment prior to retirement eligibility and who left their contributions in the Fund and to build a data base to track them until they either request a refund of their contributions or begin receiving a deferred retirement annuity. Another reason for locating such participants is to assure that this information is included for Plan funding purposes.

Since terminated vested members are not currently receiving an annuity, they often do not contact DCRB when they move, so the addresses we have on file for them are usually outdated. Consequently DCRB and Treasury met with potential vendors this month who specialize in locating such participants.

Disability Income Review Project

In March, the Benefits Department began its annual Disability Income Verification Project. Under the District of Columbia Police Officers and Firefighters' Retirement Plan, annuitants under the age of 50 who are receiving a disability retirement benefit are required to submit a notarized statement reporting earned income and tax returns for the prior calendar year. Annuitants receiving a disability retirement benefit will have their annuity stopped if, in the calendar year prior to reaching age 50, their income from wages, self-employment, or both equal or exceeds their earnings limitation. DCRB will be mailing approximately 150 income verification letters to retirees as well as those members who have been previously restored to earning capacity.

Annuitant Verification Project

Also, as a standard practice nationwide, public retirement systems conduct periodic verifications to ensure benefit payments are properly disbursed to annuitants in accordance with governing rules. To fulfill this responsibility, DCRB periodically sends verification letters to a random sampling of annuitants, requesting that they acknowledge receipt of their monthly benefit payments, verify their address, and update other information, as appropriate.

Stakeholder Outreach

Teachers Retirement Workshop

DCRB will host a DC Public Schools Retirement Workshop on March 23, 2016 from 4:00 pm – 7:00 pm on the ML level of our building. Active Teachers' Trustee, Nathan Sanders, WTU President, Elizabeth Davis, DCPS' Director of Benefits and Compensation, Jana Wood-Jefferson, and DCRB's Chief Benefits Officer, Johnetta Bond, will participate in this Workshop. As in the past, participating teachers will be provided with information on the Teachers' Plan, the retirement process, and post-retirement health and life insurance benefits. A copy of the agenda and the number of attendees will be provided to you next month.

Benefits Department Monthly Statistics

Processing volume by month:

Activity	February	January	December
Retirement Claims Received	104	224	189
Processed Retirements	145	137	118
Average Processing Days	58	n/a	n/a
Telephone Calls	2072	2072	2287
Walk-in Customers	147	97	233
Scanned Documents	12,656	12,695	19,726
QDROs Approved	3 final, 1 draft (1 rejected)	2 final, 1 draft	2 drafts
Purchase of Service	11($6,706.38)	14 ($16,200.02)	19 ($17,459.21)

You will find more details of the Benefits Department statistics in the attached reports.