Public Pension Reform: The Cincinnati Experience

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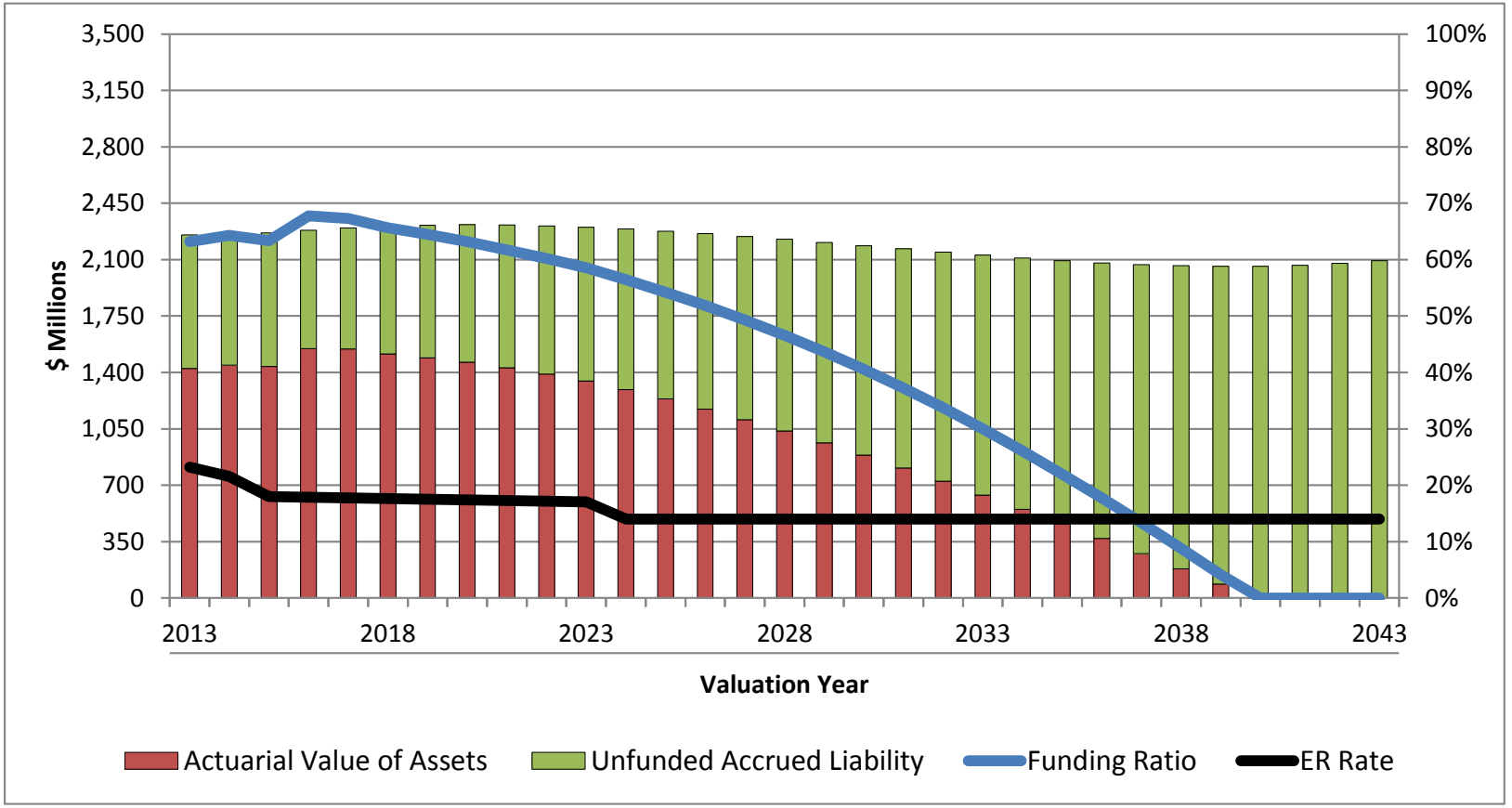
The Actuarial "Death Spiral"



- Effective 7/1/2014, City (ER) contributes 14% indefinitely (plus an additional contribution for the ERIP through 2023)
- 3.00% Return for 2014 and then 7.50% annual return thereafter
- 3% Simple COLA for all Groups
- No COLA Holiday
- $100M cash infusion in 2016

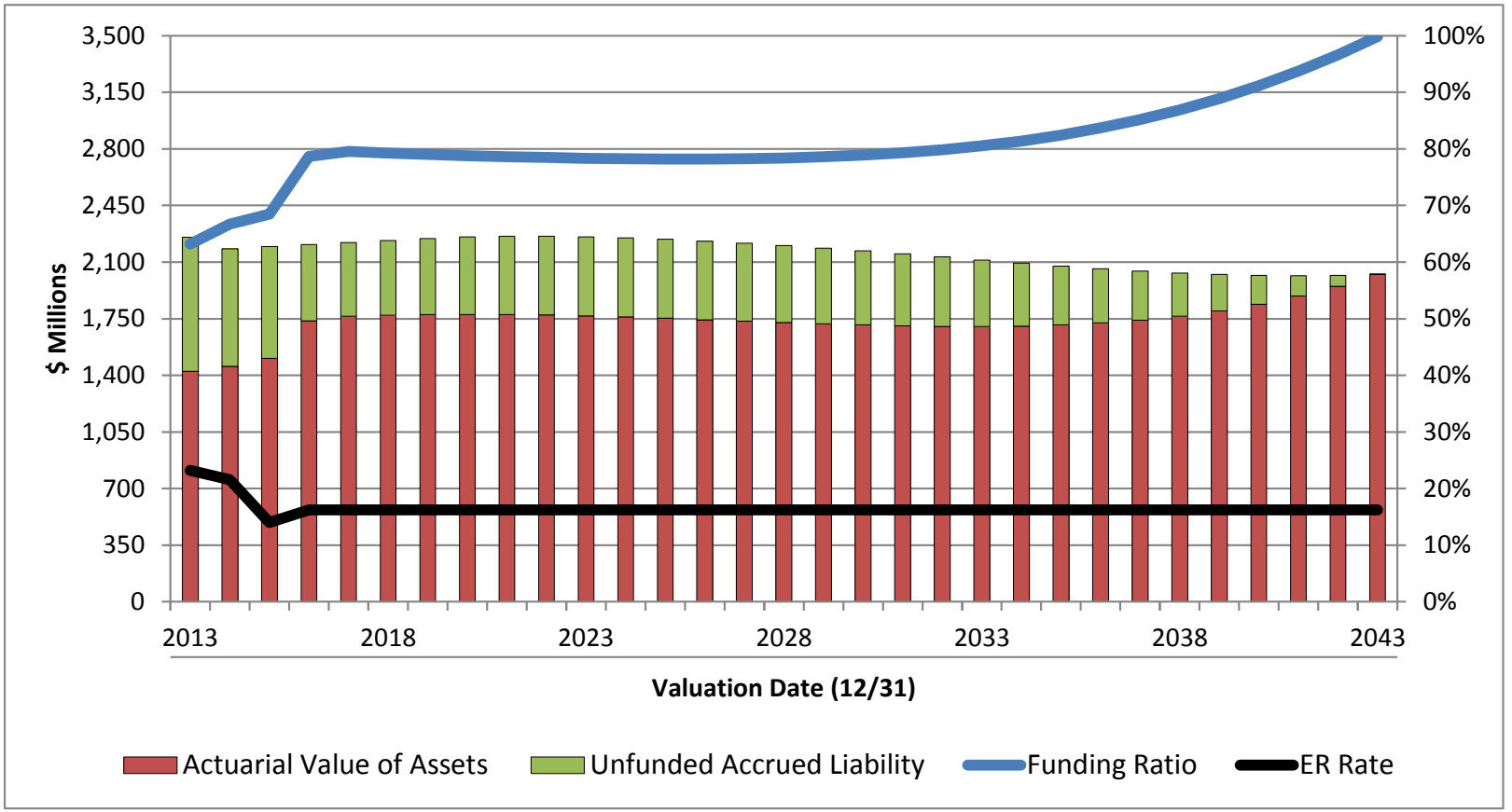
Where we were:

- Cincinnati Retirement System ("CRS") was 62 percent funded in January 2014
- $874 million unfunded liability on less than $3 billion in assets
- Employer contribution – 29% of payroll
- Threats of receivership from the State
- Basic services in jeopardy
- Infrastructure improvements and corporate incentives in jeopardy
- Multiple pieces of litigation filed by well-funded public sector labor unions and retiree groups

Where we are now:

- Federal Class Action Settlement Resulting in a Consent Decree:
  - Projected funding of 80 percent within five years
  - Projected funding of 100 percent in thirty years
  - Employer contribution of 16.25%
  - Bipartisan endorsement of plan by state officials and door open to possible merger with other large public systems
  - Dismissal of all litigation
  - Bond ratings upgrades
  - Stability – no changes without court approval

The CRS Fund today (30-year funding projection)



- City (ER) contributes 16.25% for all years beginning 1-1-2016
- Actual December 31, 2014 asset figures and then 7.50% annual return thereafter
- 3.0% simple COLA for members affected by agreement
- 3-year COLA suspension for members affected by agreement
- Proposed changes for active members vested as of July 1, 2011
- **$200M Cash Infusion in 2016**
- **Payoff of ERIP liability ($50.0 million) mid 2015**

Early Litigation
(2009 to 2013)

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2009: The City Cuts Retiree Healthcare

- In 2009, the City recalibrated retiree healthcare benefits – with no exemptions for those already retired
  - Healthcare plan went from “Mercedes” to “Cadillac” – first time many retirees had faced co-pays of any kind
  - Thanks to a quirk in the City’s Municipal Code, these changes had to be approved by a majority of nine elected council members
  - Total savings: ***$300 million***

Litigation: Round 1

- *Gamel v. City of Cincinnati*, 983 N.E.2d 375, 2012-Ohio-5152 (1st Dist. 2012)
  - "Kitchen sink" of theories:
    - Promissory estoppel
    - Breach of Contract
    - Violations of state constitution
    - Violations of federal constitution
  - Lengthy, highly-publicized trial in state court

Gamel v. Cincinnati result:

- Legal Result:
  - Ohio Supreme Court Rules that city retirees have no right under state or municipal law to any ancillary benefits such as healthcare
  - Constitutional claims and contract claims dismissed
- Practical Result:
  - City has ability to liquidate retiree healthcare trust – and leverage additional reforms

2012: Additional reforms to CRS

- Emboldened by the *Gamel* decision, City Council enacts another round of benefit reforms
  - Retirement ages – ended “30 and out.”
  - Reduced multiplier, pension calculator and lookback period
  - Ended fund-busting practice of awarding ***compound*** annual Cost of Living Adjustments (COLAs)

Litigation: Round 2

- The current employees sue:
  - *Bock v. City of Cincinnati* – another "kitchen sink" set of pleadings – this time aimed at stopping changes to the retirement age and multiplier that would affect *prospective* retirees
  - Plaintiffs seek TRO in state court, fail, then remove to federal court
  - Rare class action in government benefits context

Litigation: Round 2.1

- The public sectors unions sue (part one)
  - *Sunyak v. City of Cincinnati* – Local union sues in federal court representing thousands of specialized employees takes aim at variety of benefit modifications, including changes in annual Cost of Living Adjustments (COLAs)
  - Represented by skilled class action counsel – and Bob Klausner, nationally-recognized public pension expert and litigator
  - Soon consolidated with aforementioned *Bock* litigation

Litigation: Round 2.2

- The public sector unions sue (part two)
  - *AFSCME v. City of Cincinnati* – the piece of litigation that still sends shivers down the City's collective spine
  - Writ of mandamus in state court
  - Alleged that City had failed to follow its own formula for determining its pension contribution since 1983
  - If the writ were to have been granted, City would have had no choice but to seek bankruptcy protection

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From Litigation to Mediation (2013 to present)

Path to Mediation

- November 2013 – John Cranley elected as Cincinnati's 69th mayor
  - Harvard-educated litigator with public finance background
  - Ran on solving pension problem and removing "dark cloud" from City's finances – an unpopular issue to embrace
  - Embraced mediation concept from the outset

Path to Mediation

- Mayor championed cause of a collaborative mediation process
  - Personally drafted ordinance in which City Council delegated its negotiation and settlement authority to City Manager
  - Agreed to personally participate in mediation process
  - Personal outreach to union leaders
  - Willingness to spend political capital and threaten liquidation of healthcare trust

The path to mediation: The *Gamel* Decision

- The City re-evaluates its leverage
  - *Gamel* ruling gave allowed City to liquidate ***entire*** 401(h) healthcare trust at its sole discretion
  - Healthcare fund was 120 percent funded at $560 million thanks to previous litigation
  - Essentially the only leverage City possessed – but it had previously lacked political will to effectively employ it

Pending Lawsuits and the Incomplete Class

- Problem: The only pending lawsuits were from current employees or recently retired
- No chance for a global settlement without retirees
  - Desire for an omnibus resolution was strong
  - More than 8,000 retirees and their dependents/beneficiaries were impacted

Pending Lawsuits and the Incomplete Class

- Solution: City invites retirees to intervene
  - Allowed us to look at the big cost-drivers: COLA suspension periods and implementation of Medicare exchanges
  - Also gave retirees a seat at the table – a tough sell for after years of zero-sum litigation

Our Model: 2001 Racial Profiling Consent Decree

- City agreed to take politics out of policing in reaction to 2001 riots
  - Thirty-year agreement overseen by neutral federal judge
  - Easily-monitored metrics
  - Monthly meetings to review progress and compliance
  - All stakeholders – civil rights groups, individual and class action plaintiffs, police brass – represented in final negotiations
  - Extensive use of objective outside experts to collect and verify data

The Importance of Confidentiality – FRCP 408 & 501

- These negotiations could NOT have taken place in the public eye
  - Ohio's broad open meetings laws
  - U.S. District Court Judge Michael Barret (S.D. Ohio) employed both the federal mediation privilege (FRCP 408) and a gag order on the parties (FRCP 501)
  - Allowed for confidential exchanges of proposals and actuarial data
  - Negotiations occurred over 18-month period

The end result

- Final agreement included series of reforms which would have been unthinkable in 2009
  - All retirees agreed to forego a COLA for three years
  - All active employees agreed to forego a COLA for the first three years of their retirement
  - All COLAs now based on ***simple*** interest, not ***compound***
  - City maintains limited flexibility on healthcare

The “givebacks”

- Horse-trading closed the deal
  - Some of the 2011 modifications were rolled back
  - For instance, some litigants kept their “30 and out” retirement eligibility
  - Multiplier became somewhat more generous than in original legislation
  - Estimated $48 million in “givebacks” over 30-year span of agreement
  - Above all, retirees obtained promise of a stable system for years to come – and the City avoided the uncertainty of litigating the COLA reduction (cf. Oregon and Illinois)

Picking the right professionals

- Cavanaugh MacDonald and Xerox Buck were crucial players in the negotiations
  - Ability to run quick projections kept talks going during tough times
  - Seen as honest brokers by all parties (even though the City retained them)
  - Great witnesses at fairness hearing
  - Worked well with Segal (which provided "second opinion" for purposes of the fairness hearing

Importance of federal supervision

- For the next 30 years, any changes to CRS benefits must be approved by the federal court
  - Removes politics from process
  - Increases role of objective actuarial data
  - Ensures public input
  - Settlement process allowed objectors multiple opportunities to voice concerns, without subjecting the entire negotiation to public outcry

The Big Lessons

- If at all possible, maneuver to handle negotiations in the context of a federal mediation proceeding
- Don’t be afraid to encourage the various groups to sue your client (litigation is inevitable)
- Be patient – ours took ***18 months*** of meetings
- Be brutal and objective when evaluating the municipality’s leverage
- Be unapologetic about the perceived lack of transparency
- Remind the public officials: Courage makes careers

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