

## City of San Jose Retirement Benefits Frequently Asked Questions

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### What is the difference between a defined benefit plan and a defined contribution plan?

A **defined contribution plan** provides an individual account for each participant. The benefits are based on the amount contributed into the plan and are also affected by income, expenses, gains and losses. There are no promises of a set monthly benefit at retirement. Some examples of defined contribution plans include 457 plans, 401(k) plans, 403(b) plans, employee stock ownership plans and profit sharing plans.

A **defined benefit plan** guarantees the participant a specific monthly benefit at retirement. Monthly benefits may be a specific amount or may be calculated through a formula that considers a participants salary and service. Unlike defined contribution plans, the participant is not required to make investment decisions and has no investment risk.

The City provides a **defined benefit plan** to the majority of its full-time employees who meet certain eligibility requirements. Most employees' lifetime retirement income and healthcare benefits well exceed the amount of contributions they make to the retirement system during their career.

For Example:

An employee who retires from the Federated City Employees' Retirement System after 20 years of service making \$50,000 per year would receive the following pension benefit:

$\$50,000 \times 2.5\% \times 20 = \mathbf{\$25,000}$  Annual Pension\*

An employee earning \$50,000 per year would make the following contributions over a 20 year career:

$\$50,000 \times 11.2\%^{**} \times 20 = \mathbf{\$112,000}^{***}$

After collecting a pension for **4.12** years, an employee's retirement income would exceed the amount of their contributions into the retirement system.

\* Does not reflect 3% annual COLA increase in future years and does not take into consideration interest posted to employee contributions.

\*\* This reflects only the Fiscal Year 2011-2012 rate of employee contributions.

\*\*\* Does not reflect any investment gains or losses.

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### **Are the employee contributions pre-tax or post-tax?**

As of April 19, 1987, the contributions are withdrawn from the employees' paycheck on a pre-tax basis.

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### **I've heard that the retirement contribution rates for the City have been 0% at times. Is that correct?**

No. Both the City and employees contribute towards the funding of retirement benefits. Even in past strong investment markets, City and employee contributions to retirement benefits have been necessary. The following summarizes the City and Employee's current contribution rates for pension and retiree healthcare in Fiscal Year 2011-2012.

	Police		Fire		Federated	
	City	Employee*	City	Employee	City	Employee*
Pension	49.29%	10.46%	51.05%	10.76%	28.34%	4.68%
Retiree Healthcare	7.61%	7.01%	5.27%	4.68%	7.16%	6.52%
<b>Total</b>	<b>56.90%</b>	<b>17.47%</b>	<b>56.32%</b>	<b>15.62%</b>	<b>35.50%</b>	<b>11.20%</b>

For the 2011-2012 Fiscal Year, the City will contribute approximately \$256.2 million into the retirement plans.

\* Please refer to the applicable MOAs and/or benefit and compensation summaries for additional information regarding employee contributions.

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### **Is it true that employee contributions primarily fund the City's pension plans?**

No. As noted above, the City's contributions are a significantly higher percentage than employee contributions. City contributions, employee contributions and investment earnings fund the pension plans.

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### **On average, how long does a retiree receive a pension benefit?**

Retirement data from each retirement plan was reviewed for the period of 2002 to 2007. Retirees from the Police and Fire Department Retirement Plan receive a pension benefit for approximately 21 years. Retirees from the Federated City Employees' Retirement System receive a pension benefit for approximately 18 years.

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### **When a City employee retires, will they receive a cost of living adjustment?**

Yes. Retirees are eligible for a 3% annual cost of living adjustment (COLA).

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### What does a funding ratio mean?

Actuarial valuations of retirement plans examine how each plan's assets compare with its liabilities. This is typically described as a *funding ratio*, which is the plan's assets divided by its liabilities. If assets are greater than liabilities, the funded ratio is over 100%. When assets are less than liabilities, the funded ratio is under 100% and there is an "unfunded liability."

Information regarding current funding ratios is available on the City's [Retirement Benefits Information website](http://www.sanjoseca.gov/employeeRelations/retirementbenefits/PensionFundingRatios.pdf) at:  
<http://www.sanjoseca.gov/employeeRelations/retirementbenefits/PensionFundingRatios.pdf>

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### I've heard that retirement contribution rates may increase significantly. Is that true, and if so, when will that happen?

Contribution rates increased significantly in Fiscal Year 2010-2011 as shown in the comparison of City's contribution rates from Fiscal Year 2009-2010 to Fiscal Year 2010-2011 chart below.

	FEDERATED		POLICE		FIRE	
	FY 09-10	FY 10-11	FY 09-10	FY 10-11	FY 09-10	FY 10-11
<b>Pension</b>	18.31%	23.18%	21.61%	38.77%	24.12%	40.69%
<b>Retiree Healthcare</b>	5.70%	6.41%	5.28%	6.26%	4.19%	3.92%
<b>Total City Contributions</b>	24.01%	29.59%	26.89%	45.03%	28.31%	44.61%
<b>% Increase</b>	23.24%		67.46%		57.58%	

Fiscal Year 2010-2011 was only the first of several years of significant increases in the City's contribution rates.

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### What is the funding arrangement for retirement benefits?

#### *Funding Arrangement for Pension Benefits*

The current pension funding arrangement provides for the following cost sharing of benefits:

1. The current service cost, or "Normal Cost," is the cost of funding the retirement benefits for each year of service. Current service rate cost sharing is set in the

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City Charter as an eight-to-three ratio between the City and the employees. Thus, for every \$3 contributed by a City employee, the City contributes \$8.

2. The Unfunded Actuarial Liability (“UAL”) is the difference between the Plans’ assets and liabilities. The San Jose Municipal Code provides that the City is responsible for **100%** of the unfunded liability for the pension benefit.

As a result of this funding arrangement, the City is responsible for a significantly higher portion of the cost for the pension benefits that are provided to employees. The City also bears 100% of the investment risk for the pension fund.

### *Funding Arrangement for Retiree Healthcare Benefits*

It is important to note that retiree healthcare benefits have a different cost sharing arrangement than pension benefits. Contributions for retiree medical benefits are split 50/50 by the City and employees (approximately 75/25 for dental). The City and eight bargaining units reached significant agreements in 2009 to begin a five-year phase-in to fully pre-fund retiree healthcare benefits. With the exception of employees represented by the San Jose Fire Fighters (IAFF, Local 230), both the City and employee contributions to fund retiree healthcare benefits increased in July 2009 and will continue to increase incrementally pursuant to the new funding methodology. Effective July 1, 2011, the City and employees represented by IAFF, Local 230, began to phase into fully pre-funding retiree healthcare.

In addition, full pre-funding of retiree healthcare benefits does not mean that the existing liability (that was estimated to be as high as \$1.4 billion) will be paid off immediately. It will take 30 years to pay off the existing unfunded retiree healthcare liability.

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### **Are the City and employees fully pre-funding retiree healthcare?**

Effective June 28, 2009, the City and employees represented by SJPOA, ABMEI, AEA, IBEW, AMSP, CAMP, OE#3, MEF, and CEO and employees in Unit 99 began to phase into fully pre-fund retiree healthcare. Effective July 1, 2011, the City and employees represented by IAFF, Local 230, began to phase into fully pre-funding retiree healthcare.

Full pre-funding requires setting aside the amount of money estimated to pay the long-term costs to provide retiree medical insurance. This is similar to the estimates developed to fund the pension benefit.

The City’s goal is to achieve full pre-funding of retiree healthcare for all City employees, similar to how the pension benefit is currently funded.

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## City of San Jose Retirement Benefits Frequently Asked Questions

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### **Why is there a huge retiree healthcare liability?**

The City and employees have been partially pre-funding retiree healthcare and have not been paying the full Annual Required Contribution (ARC), which is one of the main reasons why the liability is significant. The ARC is the amount of money the actuary calculates that would need to be contributed on an annual basis in order to cover the estimated costs of the retiree healthcare benefit.

There are also a variety of other factors that contribute to the high cost of providing retiree healthcare benefits. These include the dramatic increase in the cost of healthcare, the number of years that retirees receive the benefits, and an increased number of retirees.

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### **How do I obtain more information regarding retirement benefits?**

For more information on retirement benefits, please visit the Department of Retirement Services website at [www.sjretirement.com](http://www.sjretirement.com) or call them at (408) 794-1000. In addition, the City's [Retirement Benefits Information website](#) has additional information.