

**MEMORANDUM**

**TO:** Mayor Perrin  
Finance Committee

**FROM:** A. Wyckliff Nisbet, Jr.  
Jeremiah D. Wood

**DATE:** June 7, 2011

**RE:** City of Jonesboro Retirement Plan Options

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The City of Jonesboro (the "City") is considering freezing the Retirement Plan for Employees of City of Jonesboro, Arkansas (the "Retirement Plan") and adopting a different type of retirement plan for the City's employees. Currently, the City offers the Retirement Plan and a 457(b) Plan. As a general matter, any pension or profit sharing plan sponsored by a governmental entity is known as a "governmental plan", and generally, a governmental plan is the same as any other qualified plan under Internal Revenue Code ("IRC") section 401(a) except that it is exempt from the non-discrimination rules applicable to private sector plans as well as being exempt from all of the changes to Section 401(a) added by the Employee Retirement Income Security Act of 1974 as amended. Below is an option available to the City.

**457(b) Plan with a 401(a) Plan**

The City could add a 401(a) plan and a new 457(b) Plan to encourage the participation in the 457(b) Plan by making a matching contribution into the 401(a) plan. This match could be for an amount up to a certain percent the participant's contributions made to the 457(b) Plan. Also, the 401(a) Plan could have a mandatory City contribution (typically called a profit sharing contribution in the private sector) of a set percentage of a participant's compensation.

Consider the following example. Participant X earns \$40,000 in compensation a year and makes a deferral into the 457(b) Plan of 5% of his salary (i.e., \$2,000). Under the 401(a) plan, the City would have a matching formula that states the City would match 50% of a participant's contributions to the 457(b) Plan to the extent the participant's contributions do not exceed 6% of the Participant's compensation. The City would match 50% Participant's X's contribution of \$2,000 to the 457(b) by depositing \$1,000 (i.e., 50% of Participant's contribution).

Also under the 401(a) plan, the City could make a contribution of a set percentage (e.g., 4%) of Participant X's compensation (as it would for all eligible employees), and using these facts, the City would make a \$1,600 contribution (\$40,000 x 4%) to the 401(a) plan on behalf of Participant X. Therefore, the cost to the City for Participant X would be the total contribution of \$2,600 (i.e., 6.5% of Participant X's compensation) to the 401(a) plan for the year. This contribution to the 401(a) plan is in addition to the participant's deferral into the 457(b). Thus, if Participant X contributions 5% of his pay, his total contributions would be 11.5% of pay.

**RETIREMENT PLAN FOR EMPLOYEES OF  
THE CITY OF JONESBORO  
DEFINED BENEFIT PLAN**

**Eligibility:** Full time Non-Uniform Employees who are customarily employed for more than 20 hours a week for more than five (5) months per year. Excludes elected officials. Approximately 316 active and retired employees are covered under the Plan.

**Normal Retirement Age:** Age 65

**Benefit Formula:** .5% of average compensation multiplied by Accrual Service before Nov. 1, 1970, plus 1.5% of final average compensation multiplied by number of years of Accrual Service after November 1, 1970 and after November to July 1, 1998, plus 1.5% of final average compensation for years of Accrual Service after July 1, 1998. Monthly pension payable at age 65 for life with 120 monthly payments guaranteed.

**Example:** Employee Bob became eligible to participate on January 1, 1999 when he was 28 years old. His "average compensation" as of December 31, 2011 is \$36,000.

December 31, 2011 accrued benefit is \$3,000 x 1.5% x 13 years, or \$585.00 monthly payable at age 65.

**Average Compensation:** Average Compensation over last five years of service.

**Early Retirement:** Age 65 and 5 years of service. Benefit reduced due to earlier commencement of benefits.

**Vesting:** Fully vested after 5 years of service.

**Annual City Contributions** = normal cost plus amortization of unfunded actuarial liability.

**Normal Cost:** Cost of benefits is accrued during the year (about \$500,000 per year)

**Amortization of unfunded actuarial liability:** "Catch-up" contribution (about \$130,000 per year)

## **FREEZING PENSION PLAN AS OF DECEMBER 31, 2011**

**Definition of “Freeze”:**

No new employees come into Plan after December 31, 2011. Existing Plan Participants have their accrued benefit computed as of December 31, 2011.

**Impact:**

- 1) Formal notification to retirees and active participants.
- 2) No further credit for additional employment service after December 31, 2011.
- 3) No adjustment to final “average compensation” for wages earned after December 31, 2011.
- 4) No employee hired after December 31, 2011 would participate in the frozen Plan.
- 5) Actuarial valuations continue to be prepared each year.
- 6) Plan continues to make distributions to retirees and to current participants when they retire.

**Definition of Plan “Termination”:** Same as “freeze” except all Plan assets used to purchase annuities for Plan Participants. All Plan assets distributed and all Plan activities cease.

Formal termination of the Plan will occur when assets in the Plan are sufficient to purchase annuities to fully fund accrued benefits of Participants as of date of Plan termination. Purchase price for annuities are extremely interest sensitive, therefore current environment not suitable for formal termination of the Plan.

## NEW PLAN PROPOSAL

### DEFINED CONTRIBUTION PLAN

1. Same eligibility and vesting as current pension plan.
2. 401(a) Qualified Defined Contribution Plan:
  - (i) City contributes fixed percentage of annual pay to accounts of Plan Participants
  - (ii) City contributes a “matching” contribution to the accounts of Plan Participants
3. 457(b) Deferral Plan:
  - (i) Employees encouraged to contribute to 457(b) Plan
  - (ii) City matches employee deferrals – match goes into 401(a) Plan.
4. Investments:
  - (i) 401(a) Plan assets professionally managed by Investment Manager
  - (ii) 457(b) Plan assets similarly invested
5. Plan distribution options:
  - (i) Identical to Pension Plan
  - (ii) Permit lump sum distributions
  - (iii) Permit installment distributions
6. Annual Cost: Equal to or less than current and projected pension plan costs.
  - (i) Dollar costs: \$625,256 (2011) to \$744,000 (2020).
  - (ii) Percentage of payroll: 8.6% (2011) to 7.6% (2020) of annual payroll.

# RETIREMENT PLAN FOR THE EMPLOYEES OF THE CITY OF JONESBORO

## THE MAGIC OF TIME AND COMPOUNDING

No matter what your investment time-frame, the Retirement Plan for the Employees of the City of Jonesboro can help you start *today* toward building a sound financial future. And that's important, because time can be one of your greatest assets when saving for the future. If you are nearing retirement, you'll probably need to contribute more money on a regular basis to achieve your goals. If you have a great deal of time until retirement (say, 20 to 30 years), you can contribute a smaller amount of money on a regular basis and let *compounding* and *time* act in your favor. Either way, the more you save and the sooner you start, the more you will benefit.

The accompanying table illustrates how compounding and time can work for you. The example shows contributions made to the §401(k) Plan during a 35-year period by two employees, Bob and Alice, who are the same age.

- \* Bob begins contributing to the §401(k) Plan at age 30, invests \$1,000 per year (4% of his annual current salary of \$25,000) and earns an 8% annual rate of interest. Bob maintains this investment program for 10 years and then stops making contributions. However, his accumulated savings are allowed to compound at an 8% rate of interest until he retires at age 65.
- \* Alice begins contributing to the §401(k) Plan 10 years later at age 40. Alice also invests \$1,000 per year (4% of her annual salary of \$25,000) and earns an 8% annual rate of interest. Alice maintains this investment program for 25 years until she retires at age 65.

As you can see, both Bob and Alice benefited from the power of compounding. Bob, however, used the time more effectively and was able to save about \$26,105 more than Alice despite the fact that Alice contributed a significantly greater dollar amount (\$15,000) over the years.

The "Compare Combined" column allows you to see what an employee could accumulate if \$1,000 was contributed each year for 35 years. Although the total contributed would be \$35,000, the value of your retirement account would be \$172,317. A lump sum of \$172,317 is sufficient to provide a life annuity (which could be purchased by your IRA after the Plan distribution) of about \$1,675 per month for life, beginning at age 65.

# VALUE OF COMPOUNDING

Dollar Amount Contributed  
At The End Of Each Year

YEAR	BOB	ALICE	COMPARE COMBINED
1	\$1,000	0	\$1,000
2	1,000	0	1,000
3	1,000	0	1,000
4	1,000	0	1,000
5	1,000	0	1,000
6	1,000	0	1,000
7	1,000	0	1,000
8	1,000	0	1,000
9	1,000	0	1,000
10	1,000	0	1,000
11	0	\$1,000	1,000
12	0	1,000	1,000
13	0	1,000	1,000
14	0	1,000	1,000
15	0	1,000	1,000
16	0	1,000	1,000
17	0	1,000	1,000
18	0	1,000	1,000
19	0	1,000	1,000
20	0	1,000	1,000
21	0	1,000	1,000
22	0	1,000	1,000
23	0	1,000	1,000
24	0	1,000	1,000
25	0	1,000	1,000
26	0	1,000	1,000
27	0	1,000	1,000
28	0	1,000	1,000
29	0	1,000	1,000
30	0	1,000	1,000
31	0	1,000	1,000
32	0	1,000	1,000
33	0	1,000	1,000
34	0	1,000	1,000
35	0	1,000	1,000
<b>Total Contributed:</b>	<b>\$ 10,000</b>	<b>\$25,000</b>	<b>\$ 35,000</b>
<b>Total Value:</b>	<b>\$ 99,211*</b>	<b>\$73,106*</b>	<b>\$ 172,317*</b>

\* 8% annual rate of interest

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Compare the total amount saved by each employee at the end of the 35-year period.