FINAL REPORT

CITY OF SAN DIEGO PENSION REFORM COMMITTEE

SEPTEMBER 15, 2004

TABLE OF CONTENTS

		Page
	Executive Summary/PowerPoint………………………………………………..	4
	List of Committee Members……………………………………………………..	22
	Objectives of Committee………………………….……………………………..	23
	Introduction……………………………………………………………………	23
I.	**Background**……………………………………………………………………	24
II.	**The Current Funded Status of the System**……………………………….	25
	a. The Pension Plan	
	b. Retiree Health Care	
III.	**How Did This Happen?**...	27
	a. Quantification of Causes	
	b. Description of Causes	
	1. Investment Performance	
	2. Under-funding by the City	
	3. Use of Plan Earnings for Contingent Benefits	
	i. 13th Check	
	ii. Corbett Settlement	
	iii. Other	
	4. Actuarial Gains and Losses	
	5. Benefit Improvements	
IV.	**Reducing/Eliminating the Unfunded Actuarial Accrued Liability**…………	31
	a. Pension Obligation Bonds (POBs) as an Option	
	b. Using City Real Estate as a Funding Mechanism	
	Recommendation #1	
	c. Increased Annual Contributions	
	Recommendation # 2	
	Recommendation # 3	
V.	**Treatment of Contingent Benefits**………………………………………....	36
	Recommendation # 4	
VI.	**Treatment of Retiree Health Care Benefits**…………………………………	37

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Recommendation # 5

VII. Reduction of Normal Cost……………………………………………………… 37
Recommendation # 6
Recommendation # 7
Recommendation # 8
Recommendation # 9
Recommendation # 10

VIII. Retiree Medical Benefits……………………………………………………... 41
Recommendation # 11
Recommendation # 12
Recommendation # 13

IX. Governance…………………………………………………………………… 43
Recommendation # 14
Recommendation # 15

X. Other Recommendations…………………………………………………….. 45
a. Study Disability Retirement Application Process and System
Recommendation # 16
b. Employee/Employer Sharing of Pension Costs
Recommendation # 17
c. Actuarial Assumptions

XI. Appendices…………………………………………………………………….. 48
a. Biographical Information on Committee Members
b. Interim Report of Pension Reform Committee to Mayor and City Council January 22, 2004
c. Example: 30 Year Amortization Schedule – Fixed % of Inflation-Adjusted Salary
d. Retirement Age Factors for Benefits
e. Study from Gabriel, Roeder, Smith & Company on Proposed New Benefit Structure

XII. Glossary…………………………………………………………………… 61

XIII. Bibliography……………………………………………………………… 68

XIV. Attachment 1: Additional Information to City Council April 19, 2004…. 74

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

EXECUTIVE SUMMARY

CITY OF SAN DIEGO PENSION REFORM COMMITTEE

SEPTEMBER 15, 2004

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Ms. April Boling, CPA (Chairperson)
President
San Diego County Taxpayers Association

Mr. Stephen Austin, CPA
Managing Partner
Swenson Advisors, LLP

Mr. Robert Butterfield
Attorney
Butterfield Schechter LLP

Mr. Timothy Considine, CPA
Of Counsel
Considine & Considine

Mr. Stanley Elmore
Past President Retired Fire & Police Association
City Retiree

Ms. Judith Italiano
President and General Manager
San Diego Municipal Employees Association

Mr. William Sheffler
Consulting Actuary
Sheffler Consulting Actuaries, Inc.

Mr. Richard Vortmann
President
National Steel and Shipbuilding Company

Ms. Kathleen Walsh-Rotto
Senior Relationship Manager
Principal Financial Group

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OR GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

OBJECTIVES OF THE COMMITTEE

- Report back to the City Council no later than 120 days from the date appointments are confirmed.
- After reviewing and considering the scope and depth of audit activity currently being conducted by SDCERS, conduct any additional or supplemental independent audits, studies, or investigations deemed necessary and appropriate.
- Provide recommendations to address any unfunded liability problems of the system.
- Examine how the existing pension system has performed compared to other similar systems, including examination of actions other systems have taken to address funding shortfall problems, such as issuance of pension obligation bonds.
- Examine whether changes should be made to the existing pension system. Examine whether the make-up and representative constitution of the Retirement Board should be restructured.
- Examine whether the system should be changed from a defined benefit plan to a defined contribution plan for new employees.
- Examine whether the City should join the California Public Employees Retirement System or any other retirement system.
- Make any other recommendations as appropriate.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

BACKGROUND – PENSION ISSUES

- Current employees and the pension plan sponsor (the City of San Diego) make annual contributions to the pension plan which is a trust. The annual contribution to the City of San Diego's pension plan (Plan) is computed by an actuary. (This annual contribution is typically expressed as a percentage of payroll.)

- When actual experience does not match the assumptions used, the shortfall is spread (amortized) over a period of time and payments are made to ultimately make up the difference.

- When there is a deficit, it means that those assets are not in the Plan's investment pool where they would be generating investment earnings (foregone earnings).

- The City Manager recommends and the City Council approves the Plan benefits. Employees bargain for those benefits through the "Meet and Confer" process.

- The San Diego City Employees' Retirement System (SDCERS) Trustees (the Retirement Board) administer the plan.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

THE CURRENT FUNDED STATUS OF THE SYSTEM

- The most recent formal Actuarial Valuation of the Plan is as of June 30, 2003. In that valuation, the Unfunded Accrued Actuarial Liability (UAAL) was calculated at $1.157 Billion and the Plan was determined to be 67.2% funded.

- At June 30, 2003, the Fair Market Value (FMV) of Plan assets was $2.329 Billion, while the Actuarial Value was $2.375 Billion. The difference of $46 Million will be recognized over future periods. ***Note: Adjusted to exclude Port and Airport Assets.***

- The annual valuation does not consider the present value of the Plan's contingent benefits. Contingent benefits are primarily Corbett settlement, 13th check, COLA etc.

- The UAAL was updated to January 31, 2004. Rather than $1.157 Billion as was identified at June 30, 2003, the UAAL had increased to $1.167 Billion. The funded ratio, however, had increased slightly to 68.7%.

The Committee calculated the amount of contribution that would need to be transferred into the Plan during FY05 to keep the UAAL from growing as follows:

Contribution Components	(in millions) Contribution Amounts
Normal Cost	$76.01
Contingent Benefits	20. 30
Retiree Medical Benefits (current year premium only)	13.00
Interest (foregone earnings) on the UAAL	93.36
Total	$202.67*

(*Excludes the unfunded liability for medical costs)

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

In FY04, the City's contribution to the Plan was $85 Million. The agreed-upon payment for the lawsuit in FY05 is $130 Million, ramping up to approximately $180 Million in FY08.

RETIREE HEALTH CARE

THE SECOND DEFICIT IN SDCERS RELATES TO RETIREE HEALTH CARE.

Current retirees' health care is being paid from a special reserve within the Pension Plan.

Currently, this is a "pay as you go" system. Based upon a 5% annual "Medflation" rate, the liability is estimated at $545 million.

	(in millions)
Normal Cost	$26.08
Amortization of Liability	$58.96
TOTAL	**$85.04**

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

HOW DID ALL THIS HAPPEN?

MAJOR REASONS FOR THE UNDER-FUNDED PROBLEM

(From July 1, 1996 to June 30, 2003)

1. Investment performance	**6%**
2. Under-funding by City	**10%**
3. Use of Plan earnings for contingent benefits	**12%**
4. Net Actuarial losses	**31%**
5. Benefit improvements	**41%**
	100%

Note: This analysis of under-funding does not include future impact of contingent Corbett Settlement and 13th Check.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

DESCRIPTION OF CAUSES FOR UNDER-FUNDED STATUS

1. Investment Performance

The actual investment performance experience in fact has been 8% on average over the long-term.

2. Under-Funding by the City

The City purposely under-funded the Plan through MP I and II. Even if the City had not entered into MP I and II, the deficit would have grown due to the amortization system selected. This was exacerbated by the drain on Plan assets from the payment of contingent benefits and retiree medical benefits.

It appears that this and previous Mayors and City Councils did not understand all the implications of the foregoing and it is possible that many, if not most, of the Retirement Board trustees did not understand.

3 Use of Plan earnings for contingent benefits

The Plan is, in fact, experiencing 8% earnings on its assets. It does not, however, retain those earnings in order to pay future retirement benefits. Instead, a significant portion is siphoned off to pay contingent benefits such as:

13th Check
Corbett Settlement

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

NET ACTUARIAL GAINS AND LOSSES

Major Drivers:

– Extremely low employee turnover

– Significant service purchase subsidies

– Pay increases above those assumed

Retirement/DROP elements

5. Benefits Improvements

A variety of retirement benefits have been granted since 1996. The past service element of these benefits has caused a significant portion of the increase to the Plan's UAAL. The long-term impact of these benefit improvements was not fully understood.

HOW DO WE REDUCE/ELIMINATE THE UAAL?

The UAAL has been treated as off balance sheet debt when in fact it is a full obligation of the City.

When assessing solutions to the Plan's under-funded status, there are two discreet components of the issue:

Recommendations with respect to reduction or elimination of the Unfunded Actuarial Accrued Liability (UAAL) and Recommendations regarding the ongoing annual costs of the basic plan and the contingent benefit.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

PENSION OBLIGATION BONDS (POBS)

Recommendation #1

$600 Million in assets should be infused into the plan over the next three fiscal years. Of that amount, no less than $200 Million should be placed in the Plan during FY05 (preferably by December 31, 2004) and that amount should be attained through the issuance of Pension Obligation Bonds. Subsequent infusions, bringing the total to $600 Million can be through POBs, or some form of real estate secured transactions.

The Pension Reform Committee does not support the idea of negative interest amortization and believes that the payment against the UAAL should always be set at a level that actually decreases the debt rather than adding to it.

Recommendation #2

The City Charter should be amended to require that when amortizing net actuarial gains or losses, a period of no longer than 15 years be used for the amortization of losses and that a period of no shorter than 5 years be used for the amortization of a surplus. This change should be effective for FY08 contributions.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Recommendation #3

The City Charter should be amended to require that for all new pension benefit improvements to the currently existing plan, SDCERS will, when setting actuarial assumptions and methodologies, for funding purposes, use an amortization period no greater than straight-line 5 years fixed for any past service liability for each new benefit improvements. This change should be effective immediately.

Because they are not considered in the calculation of a Normal Cost, the net result is that the UAAL grows each year by the amount of the contingent benefits paid and the amount of the addition to the Plan's retiree "health care reserve". The Pension Reform Committee believes that an amount equal to the value of the contingent benefits siphoned from the Plan earnings should be replaced by the City annually based on an estimate calculated at the beginning of the fiscal year for that fiscal year.

Recommendation #4

The City's annual required contribution to the Plan for a given year should be defined as the total of Normal Cost, UAAL amortization (including interest), and an amount equivalent to the estimated contingent liabilities related to that year.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

TREATMENT OF RETIREE HEALTH CARE BENEFITS

Recommendation #5

Payments for retiree health care benefits should no longer be funded via the retirement plan. SDMC 24. 1502(a)(5) should be eliminated thereby removing health care benefits from the Plan's distribution waterfall.

REDUCTION OF NORMAL COST

> The City's pension benefits are generous by almost any standard applied (24% of payroll.)

Recommended changes 6-10 will impact new hires only. The savings illustrated will only be fully realized only when all employees under the existing benefit structure have retired.

Recommendation #6

The normal retirement age should be raised by seven years for all employees and the early retirement age should be set at a number of years that are five years less than the normal retirement age. Any retirement earlier than normal age will be cost-neutral, actuarially reduced.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

This will result in a savings of 3.69% of pay, or based on current payroll, $22,342,000.

The above recommendation will result in the following normal and early retirement ages:

	Normal	Early
General members	62	57
Fire and Police	57	52
Legislative	62	57

REDUCTION OF NORMAL COST

Recommendation #7

The annual accrual rate for the percentage of the final base payroll to be used in calculating the pension benefit is reduced by 20%.

This will result in a savings of 2.61% of pay, or based on current payroll, $15,774,000.

The above recommendation will result in the following accrual rate percentages:

General Members	2.0%
Fire and Police	2.4%
Legislative	2.8%

Recommendation #8

The final base payroll should be based on an average of the employee's highest three years of salary rather than on the highest one year of salary.

This will result in a savings of 1.06% of pay, or based on current payroll, $6,413,000 annually.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Recommendation #9

The final base payroll should exclude salary differentials such as second shift differential, bilingual differentials, etc.

This will result, conservatively, in a savings of 3.5% of pay, or based on current payroll, $21,175,000 annually.

Note: The cumulative effect of Recommendations 6-9 is substantial, but not additive.

RETIREE MEDICAL BENEFITS

Recommendation #10

Eliminate specific programs that permit DROP and purchase of years of service credits, except those that are federally protected.

Recommendation #11

The City should establish either a separate trust or a separate accounting within the pension trust to account for the assets and liabilities of the retiree medical benefit plan. Retiree Medical Plan assets may be commingled with Retirement Plan assets for investment purposes, but be accounted for separately for all other purposes. Annual contributions to the Retiree Medical Plan should be separately identified in the City budget and in no way be confused or commingled with Retirement Plan contributions.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

The Governmental Accounting Standards Board (GASB) has acknowledged this problem.

The newly-issued Statement 43 provides a framework for transparent financial reporting by governmental entities that have fiduciary responsibility for OPEB plan assets regarding their stewardship of plan assets, the funded status and funding progress of the plan, and employer contributions to the plan.

RETIREE MEDICAL BENEFITS

Recommendation #12

Adopt GASB Statement #43 (Financial Reporting for Participant Benefit Plans other than Pension Plans), effective July 1, 2005

The above recommendations deal with the accounting for the benefits, they do not address the ability or inability of the City to fund this already-existing liability.

Recommendation #13

When amortizing the unfunded liability for retiree medical benefits, a method should be used that does not create negative amortization of the liability.

The City Charter currently dictates the composition of the 13 member Board of Trustees as follows:

- 3 representatives from City management
- 2 representatives elected by police and fire members
- 3 representatives elected by General Members
- 1 representative elected by retired members
- 4 independent citizens nominated by the Mayor and appointed by Council

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

At the heart of the concern is that, of the 13 members of the Retirement Board, 8 members (62%) can clearly benefit by enabling the City to fund its current operating budget at the expense of the retirement plans.

The second significant problem is the technical skill required to understand the complex issues may not be sufficient.

GOVERNANCE

Recommendation #14

Change the composition of the Retirement Board to seven members appointed by the City Council. These members will serve with staggered terms of four years each, with a two consecutive term maximum. Such appointees will have the professional qualifications of a college degree and/or relevant professional certifications, fifteen years experience in pension administration, pension actuarial practices, investment management (including real estate), banking, or certified public accounting. Such appointees will be US Citizens and resident of the City of San Diego, but cannot be City employees, participants (directly or indirectly through a direct family member) of the SDCERS, nor a union representative of employees or participants, nor can such appointees have any other personal interests which would be, or create the appearance of, a conflict of interest with the duties of a Trustee.

Recommendation #15

An additional provision should be made to the City Charter that would codify the current disability retirement determination process as it is now except that the hearing officer's decision would be final rather than a recommendation for the Board for approval.

Study disability retirement application process and systems.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

OTHER RECOMMENDATIONS

Recommendation #16

The City should establish a committee to review the entire disability retirement system. Representatives on this committee should include knowledgeable employees of both the City and SDCERS as well as outside professionals with experience in this area (Employee/Employer Sharing of Pension costs.)

Recommendation #17

The City Council Rules Committee should require a report (with recommendations) From SDCERS on the issue of the 50/50 employer/employee cost split by the end of the calendar year (Actuarial Assumptions).

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Committee Members

In September 2003, the Mayor nominated and the City Council approved appointment of a nine person Pension Reform Committee (the Committee) to address the growing public concern over the financial status of the City's pension system (the System). The Committee was to include a City retiree with pension experience, a City employee with union pension experience, a member of the Retirement Board, a taxpayer advocate and five citizens with experience in defined benefit pension plans.

Task Force Member	***Professional Background***
Ms. April Boling (Chairperson)	San Diego County Taxpayers Association (Taxpayer Advocate)
Mr. Stephen Austin	Swenson Advisors, LLP (Pension Plan Experience)
Mr. Robert Butterfield	Butterfield Schechter LLP (Pension Plan Experience)
Mr. Timothy Considine	Considine & Considine (Pension Plan Experience)
Mr. Stanley Elmore	City of San Diego Retiree with pension experience
Ms. Judith Italiano	San Diego Municipal Employees Association (City Employee/Union member with pension experience)
Mr. William Sheffler	Sheffler Consulting Actuaries, Inc. (Pension Plan Experience)
Mr. Richard Vortmann	San Diego City Employee Retirement System Board member/National Steel and Shipbuilding Company, NASSCO (Retirement Board Member)
Ms. Kathleen Walsh-Rotto	Principal Financial Group (Pension Plan Experience)

* Biographical information available in **Appendix A**

Objectives of the Committee

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

1. Report back to the City Council no later than 120 days from the date appointments are confirmed.
2. After reviewing and considering the scope and depth of audit activity currently being conducted by CERS, conduct any additional or supplemental independent audits, studies, or investigations deemed necessary and appropriate.
3. Provide recommendations to address any unfunded liability problems of the system.
4. Examine how the existing pension system has performed compared to other similar systems, including examination of actions other systems have taken to address funding shortfall problems, such as issuance of pension obligation bonds.
5. Examine whether changes should be made to the existing pension system. Examine whether the make-up and representative constitution of the Retirement Board should be restructured.
6. Examine whether the system should be changed from a defined benefit plan to a defined contribution plan for new employees.
7. Examine whether the City should join the California Public Employees Retirement System or any other retirement system.
8. Make any other recommendations as appropriate.

Introduction

The Committee has met weekly since early October. The City Council received a report **(Appendix B)** from the Committee on January 22, 2004. Additional information was provided to the Council on April 19, 2004 **(Attachment 1.)**

Certain recommendations made by the Committee required changes to the City Charter. While the Committee would have preferred to make these recommendations in the context of the total report, time constraints surrounding the placing of changes to the Charter on the ballot required that these proposals be brought forward ahead of the body of the report. The Committee presented proposed Charter changes to the Council's Rules Committee and the City Council and actions have been taken by the Council on those proposals.

Since early October, the Committee has gathered data, interviewed staff and other knowledgeable individuals related to the plan, and analyzed the information presented. Specific individuals with interest or expertise in the System were invited to present their issues to the Committee (See Section XIII Bibliography – Item 97.) The extent of the problem was identified and various corrective actions were evaluated. This report summarizes the analysis the Committee performed and presents the Committee's corrective recommendations and the rationale therefore. The recommendations contained herein relate only to the City of San

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Diego's portion of the System.

I. BACKGROUND

Under a defined benefit pension plan, current employees and the pension plan sponsor (in this case, the City of San Diego) make annual contributions to the pension plan which is a trust. The theory is that these annual contributions, combined with the investment earnings of the pension plan, will ultimately provide sufficient funds to pay retirement benefits to all of the pension plan's participants who retire.

The annual contribution to the City of San Diego's pension plan (Plan) is computed by an actuary based upon the characteristics of the retirement commitment (e.g. age of retirement, percentage of replacement of base pay, etc.) and a variety of assumptions (e.g. rate of investment return, rate of inflation, mortality, etc.) This annual contribution is typically expressed as a percentage of payroll.

When actual experience does not exactly match the assumptions used by the Plan's actuary, it is possible to have either more or less assets in the Plan than needed to meet the projected liabilities. The shortfall is spread (amortized) over a period of time and annual payments are made to ultimately make-up the difference.

It should be noted that when there is a deficit, it means that those assets are not in the Plan's investment pool where they would be generating investment earnings. As a result, the payoff of the deficit must also account for the forgone earnings. This is analogous to principal and interest on a mortgage.

Because actual experience never perfectly matches the actuarial assumptions, the total annual contribution to any defined benefit plan will have two components: one is the cost of benefits earned during the year, and the other is the payment to close the deficit or surplus.

The City Manager recommends and the City Council approves the Plan benefits. Employees bargain for those benefits through the "Meet and Confer" process. In the opinion of the City Attorney's office, an employee becomes vested in the characteristics of the Plan as of the date he or she is hired. It is not possible, therefore, to change Plan benefits for either retirees or any current employee.

The San Diego City Employees' Retirement System (SDCERS) Trustees (the Retirement Board) administer the Plan. That includes managing the Plan's investment portfolio as well as ensuring the timely delivery of retirement benefits to the Plan's beneficiaries. The Trustee's primary fiduciary duty is to the beneficiaries of the Plan. Administration of the Plan includes approval of actuarial assumptions to be used in determining the annual contribution by the employees and

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

the City. The composition of the Retirement Board is set by the City Charter.

II. THE CURRENT FUNDED STATUS OF THE SYSTEM

Note: Section XII of this report is a glossary of terms. We encourage the reader to review the glossary before continuing with this report. Two important terms are defined here as well to assist the reader in understanding the following section of the report.

Normal Cost is defined as that portion of the actuarial present value of pension plan benefits and expenses which is allocated to a valuation year by the actuarial cost method, excluding any payment in respect of an unfunded actuarial accrued liability.

The Unfunded Accrued Actuarial Liability or UAAL is defined as the excess of the Actuarial Accrued Liability over the Actuarial Value of Assets.

A critical task of the Committee was to determine the amount of the deficits present in the SDCERS system.

The Pension Plan

The most recent formal Actuarial Valuation of the Plan was as of June 30, 2003. In that valuation, the Unfunded Accrued Actuarial Liability (UAAL) was calculated at $1.157 Billion and the Plan was determined to be 67.2% funded.

It is important to understand that the Plan assets are not valued at Fair Market Value (FMV) for purposes of the Actuarial Valuation. As with other pension plans, unrealized gains and losses are smoothed over a period of time to mitigate the effects of dramatic swings in the stock market. In the SDCERS Valuation, a smoothing period of five years is used. At June 30, 2003 the FMV of Plan assets was $2.329 Billion, while the Actuarial Value was $2.375 Billion (adjusted to exclude Port and Airport assets.) The difference of $46 Million will be recognized over future periods.

The annual valuation does not consider the present value of the Plan's contingent benefits. Contingent benefits (Corbett settlement, 13th check, COLA etc.) paid to the beneficiaries out of Plan earnings, thereby reducing the amount of earnings that stay with the Plan to fund its future commitments to retirees. Because these costs are considered contingent, they are not part of Normal Costs and, therefore, are not included in the calculation of the City's annual payment to the Plan. The net result is that even if the investment earnings exactly match the actuarial assumption, the UAAL increases each year by the amount of the contingent benefits.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Further, the current method and period being used for amortization of the UAAL does not generate a required payment that is high enough to cover even the forgone investment earnings, much less pay down any of the underlying UAAL.

Put another way, when one considers the drain on Plan earnings caused by payment of the retiree health costs and contingent benefits coupled with the fact that the UAAL amortization is applying nothing to the actual principal portion of the liability, it becomes clear that "full actuarial funding" is a misleading term at best.

In the spring of this year, the Committee requested and received an updated calculation of the UAAL from the Plan's actuary. The Committee was aware that there had been positive movement in the market but was also aware that there would be additional losses recognized from earlier periods due to asset smoothing. The UAAL was updated to January 31, 2004. Rather than $1.157 Billion as was identified at June 30, 2003, the UAAL had increased to $1.167 Billion. The funded ratio, however, had increased slightly to 68.7%.

Based on an assumption that the UAAL would still be at $1.167 Billion as of June 30, 2004 (meaning no further variances from the actuarial assumptions) and that there would also be no variances from the actuarial assumptions for FY05 (the year ended June, 2005), the Committee calculated the amount of contribution that would need to be transferred into the Plan during FY05 to keep the UAAL from growing as follows:

	(in millions)
Normal Cost	$76.01
Contingent Benefits	20.30
Retiree Medical Benefits (current year premium only)	13.00
Interest (foregone earnings) on the UAAL	93.36
Total	$202.67*

* Excludes the unfunded liability for medical costs discussed in paragraph B below

In FY04, the City's contribution to the Plan was $85 Million. Under the settlement, the lawsuit brought by the System's retirees, the agreed-upon payment for FY05 is $130 Million, ramping up to approximately $180 Million in FY08.

Retiree Health Care

The second deficit in SDCERS relates to retiree health care. Currently, the City itself is not making any payments on the liability. Current retirees' health care is being paid from a special reserve within the Plan. The reserve is funded by "siphoning off" earnings from the Plan as discussed above, thereby increasing the UAAL.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

The larger problem, however, is that this is a "pay as you go" system, meaning that there is no recognition of the long-term liability for the medical premiums of retirees in future years nor is there recognition that the City is also incurring a liability every year for the existing employees' right to a health benefit when they eventually retire.

In the opinion of the City Attorney, various groups of employees and retirees have different levels of vesting related to health care. Based on the assumption that current and future retirees will continue to receive this benefit at the same level as enjoyed currently, the Pension Reform Committee requested and received an analysis of the current liability associated with this commitment. Based upon a 5% annual "medflation" rate, the liability is estimated at $545 million. This is in addition to the $1.167 Billion UAAL identified above. The payment required to cover the Normal Cost associated with retiree health care and to eliminate the unfunded liability of $545 over 15 years is calculated as:

	(in millions)
Normal Cost	$26.08
Amortization of Liability	$58.96
Total:	$85.04

This payment is required in addition to any payment needed to fund the Plan itself.

III. HOW DID THIS HAPPEN?

In attempting to describe how we believe the current pension and retiree health problems came to be, the Pension Reform Committee's purpose is not to find fault or allocate blame. Rather it is to ensure a full understanding of the interrelated causes of the problem as a means to ensure they are not repeated in the future. In this section we will address causes. In subsequent sections we will address corrective recommendations.

Quantification of Causes

The Pension Reform Committee requested and received an analysis of the components of the increase in the Unfunded Actuarial Accrued Liability (UAAL) from July 1, 1996 to June 30, 2003. This analysis, prepared by the Plan's actuary, provided the following allocation:

Investment performance	6%
Under-funding by City	10%

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Use of Plan earnings for contingent benefits	12%
Net Actuarial losses	31%
Benefit improvements	41%
	100%

Note: This analysis of under-funding does not include future impact of contingent Corbett Settlement and 13th Check.

It should be noted that the Retirement Board commissioned a similar study that resulted in a significantly different allocation resulting from the interdependence of the various factors. The variance is currently being analyzed by the Retirement Board. The most insignificant variance, however, was in investment performance where the Retirement Board's study indicates an allocation factor of 7% rather than 6%.

Description of Causes

Investment performance

While this is the least significant factor mathematically, it warrants discussion because the market "bubble" of the late 1990s masked the other factors, providing an unwarranted sense of well-being by the Retirement Board and the City.

As discussed in the initial section, the City's annual contribution is calculated using a variety of actuarial assumptions. One of those assumptions is an 8% average rate of return on investment. Looking back over ten years, the experience has, in fact, been 8% on average over the long-term.

During the late 1990s, the City felt comfortable not only increasing benefits but also making lower contributions than it should have. When the market adjusted back to the investment rate of return originally anticipated in the actuarial assumptions, the fiscal impact of decisions made during the bubble became evident. As a result, there was an inclination to blame the declining funded status of the Plan on the decreasing market rather than acknowledging that the stabilization of the market was simply baring the results of ill-advised decisions.

Under-funding by the City

As previously discussed, the term "full actuarial funding" is misleading given the City's method of implementation. It implies that a Plan sponsor is paying an amount sufficient to cover not only current costs but also to pay an amortized portion of any unfunded liability. In the case of the City's Plan, the unfunded liability increases due to the drain on Plan earnings resulting from

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

payments into the reserve for retiree medical benefits or any of the contingent liabilities. Additionally, because of the amortization method and schedule used to retire the deficit, the deficit actually grows.

Full actuarial funding as currently defined did not and does not result in a required payment large enough to keep the Plan's deficit from growing.

It appears that this and previous Mayors and Councils did not understand all the implications of the foregoing and it is possible that many, if not most, of the Retirement Board trustees did not understand it either. As a result, when the City Manager approached the Retirement Board in 1996 asking that it agree to contributions of less than "full actuarial funding", it did so. This action was perpetuated by a similar agreement entered into in 2002. Even at "full actuarial funding", the City would have been increasing its liability. By paying less than that, the problem was exacerbated.

Use of Plan earnings for contingent benefits

When determining the annual contribution, the actuary uses an 8% earnings assumption. The Plan is, in fact, experiencing 8% earnings on its assets. It does not, however, retain those earnings in order to pay future retirement benefits. Instead, a portion is siphoned off to pay contingent benefits. The most widely discussed of these contingent benefits are (described in layman's terms):

a. 13th Check - In 1980, when the Plan's investments were doing well, the Council created the 13th check to share the Plan's unexpectedly high rate of earnings with the retirees. In 1983, that policy generated potential 13th checks that were higher than the recipient's usual total annual benefit. As a result, the Retirement Board attempted to pass a Rule that would limit the amount of the 13th check to $30 per year of service. A lawsuit was filed against the City. The City lost and appealed. Before the appeal was completed, the City and the plaintiff reached a settlement which was approved by the court. Because of this settlement, the Retirement Board must make an additional payment to the employees in years where the Plan has earnings (the definition is complex and not particularly relevant), however those payments are capped at (with some variation) $30 per year of service. Thus, a retiree with thirty years of service will typically receive $900. In years where there are no earnings, the check is not payable and, in fact, cannot be paid. Each year stands on its own, and there is no forward accumulation if there are not earnings in a particular year. As this payment is made to all retirees, it is an expanding population. Currently, these payments are about $4 Million per year.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

b. Corbett Settlement - In another California jurisdiction, a question arose as to whether or not retirement benefits had been calculated using all pertinent elements of salary A lawsuit was brought and it was determined that they had not. Similar suits were brought in other jurisdictions including San Diego. A decision was made to settle the lawsuit. As a result, the City changed its methodology. In addition, it is now bound to make additional payments to a specific group of retirees. Those payments are made out of the Plan's earnings (again the complex definition). Unlike the 13th check, these payments accumulate. If a payment is not made in one year due to the Plan's earnings level, that payment is payable in the next year when there are earnings. The payment does not, however, accrue interest. Because these payments are made to a specific group of retirees, this is a decreasing population. These payments are currently about $5.5 Million per year. There was also a one-time retroactive payment of approximately $20 Million.

c. Other - There are other smaller contingent benefits including a reserve for the supplemental COLA.

Actuarial Gains and Losses

These represent deviations from the actuarial assumptions. Based upon the Plan actuary's analysis, these are:

- Extremely low employee turnover
- Significant service purchase subsidies
- Pay increases above those assumed
- Retirement/DROP incidence

Benefit Improvements

When a new or improved benefit is granted to existing employees with retroactive applicability for all prior years of service, not only does the "Normal Cost" of the Plan increase, but a "past service liability" is also created. This is most easily understood through the following example:

> Joe has worked for the City for 25 years. During those 25 years, the Plan called for retirement based on 2.5% benefit for every year of service. Joe was expecting to retire at 75% of base pay if he stayed for 30 years (30 years X 2.5% per year = 75% of base pay). The actuary also expected the same thing and the contribution into the plan was based upon that 75% assumption. But during Joe's 26th year of service, there was a plan improvement. Instead of receiving 2.5% for each year of service, he will now receive

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

3.0% for each year. An option would have been to have Joe receive 2.5% for his first 25 years of service and 3.0% for the future 5 years, but that was not the way the benefit was granted. Because of the "retroactive element," Joe now will retire at a 90% of base pay (30 years X 3%). The actuary will adjust Normal Cost for the upcoming years to reflect the increase, but the shortfall related to Joe's first 25 years of service becomes a "past service liability".

A variety of such benefits have been granted since 1996. The past service element of these benefits has caused a significant portion of the increase to the Plan's UAAL.

IV. REDUCING/ELIMINATING THE UAAL

When assessing solutions to the Plan's under-funded status, there are two discreet components of the issue: 1) recommendations with respect to reduction or elimination of the Unfunded Actuarial Accrued Liability (UAAL), and 2) recommendations regarding the ongoing annual costs of the basic plan and the contingent benefits. This section deals with the first of these two items.

An ongoing theme among Pension Reform Committee members was concern that the UAAL is not treated as a real obligation of the City. It is referred to publicly as "soft debt" because it is not required to be disclosed as debt on the financial statements of the City. Since it is not included in the City's debt, it is (and this is subject to considerable debate) not considered by lenders when decisions are made as to other City bonded indebtedness including bonding capacity. One of the underlying goals of the Committee is to bring this debt onto the books of the City so that the full obligation is acknowledged and dealt with.

One strategy for reduction of the UAAL is to do nothing and hope that the market simply takes care of the problem. This is a naive and unrealistic strategy given that the actuarial expectation is an 8% investment return. For the UAAL to be permanently relieved through the market, the Plan would need to achieve (over many years) a consistent return of more than 8%. Further, since the $1.157 Billion in assets (the amount of the UAAL) is not in the Plan currently, the Plan now loses the benefit of <u>any</u> earnings those funds might realize.

The only real option is an infusion of assets into the Plan coupled with a ramp-up of annual contributions.

Pension Obligation Bonds (POBs) as an Option

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Assuming that the City has adequate bonding capacity and can borrow at interest rates below the Plan's investment rate of return (currently an 8% assumption), there is the potential benefit of interest arbitrage (i.e. borrow at 6.5% and invest at 8%) . The cash provided by the POB is contributed to the Plan to reduce the deficit thereby increasing the funded status of the plan. Such bonds are taxable and are generally looked upon more favorably by investors if they are part of an overall plan to reduce the deficit and control costs.

Using City Real Estate as a Funding Mechanism

It was recognized that there may be limits to the City's debt capacity or other pressing City needs for that capacity that would make the extensive use of POBs either not possible or not attractive. The City owns a considerable amount of real estate that could be used, in a variety of forms, to provide the needed cash infusion. The most straight-forward option would be for the City to sell City-owned real estate and transfer the cash into the plan. Another possibility would be to borrow against the real estate, using it as collateral.

The third possibility would be to transfer specific real estate into the Plan. The concern about this option was that this would put the Plan in the position of becoming an unintentional landlord and might also expose the Plan to any liabilities associated with the property. Assuming the Plan was willing to hold the real estate, the Council-adopted Investment Guidelines related to percentages of Plan assets invested in certain types of investments (in this case, real property) may need to be changed.

A fourth possibility would be to allow the Plan to hold a fully amortizing note carrying the actuarially assumed interest rate of 8% secured by specific City real estate. This would have the benefit of assuring the actuarial rate of return without the City losing the use of the real estate or its potential gain in value. As with the third possibility discussed above, this may require a change to the Council-approved Investment Guidelines. While it was determined that this is a viable possibility, it is clear that the Plan's investment advisors would prefer to have the City borrow against the real estate and place the cash into to the Plan.

Recommendation #1

$600 Million in assets should be infused into the plan over the next three fiscal years. Of that amount, no less than $200 Million should be placed in the plan during FY 05 (preferably by December 31, 2004) and that amount should be attained through the issuance of Pension Obligation Bonds. Subsequent infusions, bringing the total to $600 Million can be through POBs, or some form of real estate secured transaction.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Implementation of this proposal should bring the Plan back to an 85% funded status by FY07.

To illustrate the impact of this recommendation on the funded ratio through fiscal year 2010, the following is a projection of the UAAL on 6/30/05 followed by a projected payment schedule.

PROJECTION OF UAAL @ 6/30/05

Projected 6/30/04 UAAL @ market	**$1,167.0**
Interest on UAAL $1,167 X 8%	**93.4**
Normal Cost '05 $605 active salary X 11.95%	**72.3**
Corbett (2 years past)	**5.5**
Corbett (1 year past)	**5.4**
Corbett (based on FY '04 earnings)	**5.3**
13th check (based on FY '04 earnings)	**4.1**
Supplemental COLA	**2.9**
FY '05 settlement payment	**(130.0)**
Projected UAAL @ 6/30/05	**$1,225.9**

$ expressed in millions

PROJECTED PAYMENT SCHEDULE (in millions)

Assumptions:
$200 POB 12/31/04
$200 TD or other secured loan 12/31/05
$200 TD or other secured loan 12/31/06
UAAL 30-yr for '06 & '07, reset to 15-yr in '08 (06/30/06 valuation)

Expressed in millions	**FY '05**	**FY '06**	**FY '07**	**FY '08**	**FY '09**	**FY '10**
Normal Cost ($605 active salary X 1.0425% inflation X 11.95%)		75.4	78.6	81.9	85.4	89.0
Corbett		5.3	5.2	5.1	5.1	5.0

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

13th Check		4.1	4.2	4.3	4.3	4.4
Supplemental COLA		2.9	2.9	2.9	2.9	2.9
Annual contribution excluding medical and UAAL amortization		87.7	90.9	94.2	97.7	101.3
$200 POBs @ 6.36%/29 years/Issued 12/31/04		15.5	15.5	15.5	15.5	15.5
$200 Trust Deed @ 8%/30 years/Issued 12/31/05			17.9	17.9	17.9	17.9
$200 Trust Deed @ 8%/30 years/Issued 12/31/06				17.9	17.9	17.9
UAAL Amort / .965% per 100 / 30 years		(22.3)	(17.4)			
UAAL Amort / 1.59% per 100 / 15 years				10.8	14.4	18.5
Interest on remaining UAAL		82.4	68.2	53.6	52.7	51.5
		75.6	84.2	115.7	118.5	121.3
Total payment (excluding medical)		**163.3**	**175.0**	**209.9**	**216.2**	**222.6**
Estimated Plan Liabilities	4000	4400	4800	5400	6014	6600
UAAL		1029.9	852.2	669.6	658.7	644.3
$200 Each TD issued 12/31/05 & 12/31/06		-200.0	-200.0			
Principal amortization		22.3	17.4	-10.8	-14.4	-18.5
	1029.9	852.2	669.6	658.7	644.3	625.8
Funded Ratio	**74.25 %**	**80.63%**	**86.05%**	**87.80%**	**89.29%**	**90.52%**

Increased Annual Contributions

As discussed previously, the UAAL has been growing, in part, as a result of the use of a payment calculation mechanism that results in the unfunded balance increasing in the early years of the amortization schedule.

Under the current methodology (widely used in public pension plans), the payment is calculated as a fixed percentage of inflation adjusted payroll based upon a 30-year amortization schedule. Thus, rather than the payment remaining constant as with a home mortgage, the payment amount increases each year as payroll increases due to inflation. **(Appendix C)** Since the interest rate on the unpaid balance remains constant at 8%, the net result is a payment in the early years of the

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

schedule that does not cover the interest. The unpaid interest is then added to the principal. In other words, a $1 Billion debt would increase to approximately $1.16 Billion before it would start decreasing.

While it is true that such a method will result in full payment of the UAAL by the end of year 30, the common practice among public plans is to start over on the amortization plan as soon as the ever-increasing payment level becomes uncomfortable.

The Pension Reform Committee does not support the idea of negative interest amortization and believes that the payment against the UAAL should always be set at a level that actually decreases the debt rather than adding to it. While there is certainly more than one way to eliminate negative amortization, the Pension Reform Committee sees no reason to believe that the Retirement Board will choose an amortization method other than the fixed percentage of inflation adjusted payroll. Assuming use of that method, the longest amortization period that will not result in negative amortization is fifteen years.

Conversely, the Committee was concerned that if there is a surplus, that surplus could be amortized over a one-year period, resulting in a contribution "holiday". Because actuarial methods consistently strive for the smoothest possible (within reason) payment schedule, the Committee believes that a period no shorter than five years should be used for the amortization of a surplus.

Recommendation #2

The City Charter should be amended to require that, when amortizing net actuarial gains or losses, a period of no longer than 15 years be used for the amortization of losses and that a period of no shorter than 5 years be used for the amortization of a surplus. This change should be effective for FY08 contributions.

As previously discussed, the retroactive granting of new or improved benefits to existing employees creates a past service element/cost. While this form of benefit enhancement is certainly the prerogative of the Mayor and Council, the Pension Reform Committee believes that the past service cost should be dealt with over a reasonably short period of time so that a more accurate comparison can be made between the impact of a current compensation enhancement (e.g. pay raise) and the current impact of a retroactive pension benefit increase.

Recommendation #3

The City Charter should be amended to require that for all new pension benefit improvements

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

to the currently existing plan, SDCERS will, when setting actuarial assumptions and methodologies for funding purposes, use an amortization period no greater than straight -line 5 years fixed for any past service liability for each new benefit improvement. This change should be effective immediately.

V. TREATMENT OF CONTINGENT BENEFITS

As previously discussed, contingent benefits and retiree health care premiums are paid from Plan earnings. Because they are not considered in the calculation of "Normal Cost", the net result is that the UAAL grows each year by the amount of the contingent benefits paid and the amount of the addition to the Plan's health care reserve**.**

To make matters worse, the payment for any given fiscal year is paid in the subsequent year (usually November). For example, there are sufficient earnings in FY04 to trigger payment of the 13th check. Currently, that liability is not reflected in the June 30, 2004 actuarial valuation nor is there a reserve established for it at June 30, 2004 even though the fact of the liability is known. The payment is made in FY05 and because it was not considered in Normal Cost, adds to the UAAL at 6/30/05. The UAAL for 6/30/05 is quantified during FY06 and amortization of that liability begins in FY07.

The Pension Reform Committee believes that an amount equal to the value of the contingent benefits siphoned from the Plan earnings should be replaced by the City annually based on an estimate calculated at the beginning of the fiscal year for that fiscal year. For example, the amount of the 13th check related to FY06 should be calculated on the assumption that it will be paid. That amount should be added to the FY06 contribution for Normal Cost and the contribution for amortization of the UAAL. If, at the end of FY06, it is determined that there are not sufficient Plan earnings to trigger the 13th check, then additional City contribution to the Plan would become an actuarial gain.

In the case of the Corbett settlement, a reserve should be established for any amounts not paid due to lack of Plan earnings. The treatment is different because Corbett accumulates and the 13th check does not. Other contingent benefits should be replaced by the City in a similar manner to that discussed above.
It should be noted that the above funding mechanism affects only the calculation of the City's annual contribution to The Plan and does not affect the way in which the contingent benefits themselves are calculated or paid.

<u>Recommendation #4</u>

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

The City's annual required contribution to the Plan for a given year should be defined as the total of Normal Cost, UAAL amortization (including interest), and an amount equivalent to the estimated contingent liabilities related to that year.

VI. TREATMENT OF RETIREE HEALTH CARE BENEFITS

While the liability related to retiree health care benefits is discussed in a later section, elimination of the current method of payment is more appropriately addressed at this juncture as it is akin to the treatment of contingent benefits.

Recommendation #5

Payments for retiree health care benefits should no longer be funded via the retirement plan. SDMC 24.1502(a)(5) should be eliminated thereby removing health care benefits from the Plan's distribution "waterfall".

VII. REDUCTION OF NORMAL COST

The City's pension benefits are generous by almost any standard applied. According to the latest actuarial valuation, the "Normal Cost" of the plan is approximately 24% of payroll. This amount is split nearly equally (to be discussed further in a later section) between the employer (the City) and the employee.

One rationale presented to us was that the employees are entitled to generous pension benefits because they are paid at a lower rate than the private sector during their working career. Evidence to support his assertion was primarily anecdotal. Other evidence indicated that the non-safety employees have been well represented through the collective bargaining process and that areas of significant under-compensation have been surfaced and corrected. After two meetings on this topic, we concluded that there was insufficient evidence to conclude that City employees are paid either better or worse than their counterparts.

Another rationale presented to us was that the pension benefits are generous because City

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

employees do not participate in Social Security. This means that neither the employer nor the employee pay 6.2% FICA. The fact, however, is that as an offset to the absence of a Social Security benefit, the City was required to provide General Member employees a Supplemental Pension Savings Plan (SPSP). Safety members are not entitled to SPSP but are entitled to a higher pension factor than General Members. SPSP is a defined contribution plan that is in addition to the defined benefit plan. The City pays 3.05% of the employee's salary into this SPSP plan. The employee is required to contribute 3.05% also and can voluntarily contribute up to another 3% which the City will match. Thus, if the employee takes advantage of the full employer match, the City has to contribute up to 6.05% of the employee's salary.

The Committee determined that there is nothing inherently wrong with a defined benefit plan and that eliminating the defined benefit plan in favor of a defined contribution plan would not necessarily result in an improved situation. This is particularly true in light of the City Attorney's opinion that any Plan changes can only affect newly hired employees.

Furthermore, a conversion to a defined contribution plan for new hires could result in increased cost for all employees as a group. Applying the normal cost of the Plan of approximately 24% as a contribution percentage for the demographically younger group and new hires will have the actuarial effect of increasing the normal cost as a percentage of payroll for the group of employees remaining in the Plan. This is because the actual normal cost for younger employees is lower than the 24% average normal cost, and the actual normal cost for older than average employees is significantly more than the 24%. The newly hired, younger than average employees, under the current Plan in effect subsidize the older than average employees.

The Committee believes City employees overwhelmingly are seeking the long-term benefits of a defined benefit plan. The Committee believes, based on credible evidence, that the City would experience recruitment and retention difficulties in offering only a defined contribution plan in lieu of a defined benefit plan to its newly hired employees.

The Committee received credible evidence that the long-term investment performance of the existing Plan will significantly exceed the performance of individually directed contribution accounts, resulting in greater benefit for employees as a group per dollar of City/employee contribution. The Committee also recognized the difficulty of replicating current disability benefits without a defined benefit plan.

The Committee also concluded, based upon data obtained from the California Public Employees Retirement System (CalPERS), that it would not be fiscally prudent for the Plan to join CalPERS. There is no evidence to suggest that CalPERS is better managed than the City's system, nor that its investments are performing at a superior rate of return.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

The conclusion of the Pension Reform Committee was that the City should stay with a defined benefit plan but that benefits should be scaled back for new hires. We understand that these changes cannot be unilaterally dictated by the Mayor and Council, but will be negotiated through the “meet and confer” process. If, in the end, agreement cannot be reached, we believe the City will ultimately have no financial choice but to either require that the employees pay a larger share of the pension costs or else convert to a defined contribution plan. To this end, we are recommending a series of potential plan changes affecting new employees.

Recommendations 6-10 will impact new hires only. The savings illustrated will be fully realized only when all employees under the existing benefit structure have retired.

Recommendation #6

The normal retirement age should be raised by seven years for all employees and the early retirement age should be set at a number of years that are five years less than the normal retirement age. (See Appendix D) Any retirement earlier than normal age will be cost-neutral, actuarially reduced.

This will result in a savings of 3.69% of pay, or based on current payroll, $22,342,000.
The above recommendation will result in the following normal retirement ages:

General members	62
Fire and Police	57
Legislative	62

Early retirement ages would be:

General members	57
Fire and Police	52
Legislative	57

Recommendation #7

The annual accrual rate for the percentage of final base payroll to be used in calculating the pension benefit is reduced 20%. . (See Appendix D)

This will result in a savings of 2.61% of pay, or based on current payroll, $15,774,000.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

The above recommendation will result in the following accrual rate percentages:

General members	2.0%
Fire and Police	2.4%
Legislative	2.8%

Recommendation #8

The final base payroll should be based on an average of the employee's highest three years of salary rather than on the highest one year of salary.

This will result in a savings of 1.06% of pay, or based on current payroll, $6,413,000 annually.

Recommendation #9

The final base payroll should exclude salary differentials such as second shift differential, bilingual differential, etc.

This will result, conservatively, in a savings of 3.5% of pay, or based on current payroll, $21,175,000, annually.

Recommendation #10

Eliminate specific programs that permit DROP and purchase of years of service credit, except those that are federally protected.

The cost of DROP has not been projected due to technical issues. However, it is instructive to note that this benefit was created to alleviate a problem that was produced by poor judgment in plan design. Namely, that the current benefit structure encourages early retirement. In fact, some employees suffer a loss of benefits if they do not take early retirement. While focusing on the costs of various benefit improvement options, inadequate consideration has been devoted to the incentives of the current plan design and their effect on employment.

Simply stated, expensive early retirement benefits led to the additional costs of DROP. A more carefully crafted set of early retirement benefits would have reduced plan costs initially, and made DROP unnecessary.

Based on current employment levels, total losses of $22,000,000 to $25,000,000 would be

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

avoided due to elimination of service purchase. That amount translates into savings on annual amortization payments of $2,380,000 to $2,705,000.

The SDCERS actuary, Gabriel, Roeder, Smith & Company, calculated the values and costs presented in Recommendations 6 through 10. Their complete analysis, including methods and assumptions are contained in **Appendix E.**

The pricing of each of these benefit changes was made independently of any other change. Due to the effect of overlapping changes, such as retirement ages, and benefit factors, the cost savings for the proposals will be less than the sum of the individual estimates. A more precise determination can be made once the components have been finally agreed upon.

VIII. RETIREE MEDICAL BENEFITS

The unfunded liability related to the City's retiree medical benefit commitment is arguably an even worse problem than the pension liability. This is not necessarily related to its size ($545 Million vs. $1.157 Billion for the pension) but is related to the fact that it is hidden and is being deferred out to future year's' taxpayers.

As was discussed under the funded status of the system, these benefits are currently being covered by a pay-as-you go basis out of earnings of the Plan. In a previous recommendation we have indicated that such a practice should stop.

<u>Recommendation #11</u>

The City should establish either a separate trust or a separate accounting within the pension trust to account for the assets and liabilities of the retiree medical benefit plan. Retiree Medical Plan assets may be commingled with Retirement Plan assets for investment purposes, but be accounted for separately for all other purposes. Annual contributions to the Retiree Medical Plan should be separately identified in the City budget and in no way be confused or commingled with Retirement Plan contributions.

The liability for the Retiree Medical Plan should be clearly stated on the books of the City. The Governmental Accounting Standards Board (GASB) has acknowledged the problem that is being created nationally by lack of accounting for the liabilities associated with these plans. This year it issued Statement 43 Financial Reporting for Post employment Benefit Plans Other Than

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Pension Plans. Other post employment benefits (OPEB) include healthcare and other non-pension benefits provided to employees as part of their compensation for services. In its news release of
May 11, 2004, Karl Johnson, the GASB project manager states:

> "Statement 43 provides a framework for transparent financial reporting by governmental entities that have fiduciary responsibility for OPEB plan assets regarding their stewardship of plan assets, the funded status and funding progress of the plan, and employer contributions to the plan."

While GASB #43 is not yet effective and the City is therefore not yet required to comply, the Pension Reform Committee urges its early adoption.

Recommendation #12

Adopt GASB #43 effective July 1, 2005

The above recommendations deal with the accounting for the benefits, they do not address the ability or inability of the City to fund this already-existing liability**.**

While an in-depth review of the retiree medical benefits is outside the "charter" of the Pension Reform Committee, we suggest that the City should conclude, as soon as possible, whether the current employees have a vested right to retiree health care. If the answer is no, the employees should be given that information. If the answer is yes, a plan for payment of the liability should be immediately developed.

Recommendation #13

When amortizing the unfunded liability for retiree medical benefits, a method should be used that does not create negative amortization of the liability.

IX. GOVERNANCE

The Pension Reform Committee discussed the basic component of governance of the pension system. The city ostensibly has created an independent Board, separate from the City, to manage the pension. However, the City Charter dictates the composition of the 13 member Board of

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Trustees as follows:

3 representatives from City management
2 representatives elected by police and fire members
3 representatives elected by General Members
1 representative elected by retired members
4 independent citizens nominated by the Mayor and appointed by the City Council

While contributions to the Plan are made by both the employees and the City, only the City acts as the final guarantor of all benefits paid by the Plan. This ultimate guarantee of the Plan's ability to pay the agreed-upon benefits means that the primary, if not the sole, stakeholder in the operation of the Plan itself are the citizens of the City of the San Diego.

At the heart of the concern is that, of the thirteen members of the Retirement Board, eight members can clearly benefit by enabling the City to fund its current operating budget at the expense of the retirement plan as long as the ramifications to the Plan are not severe over the short term. The notion that the Board is simply administrative, as some would argue, is countered by the fact that the intentional under-funding of the plan requested by the City Manager in both 1996 and 2002 had to be approved by the Board before it could even be heard by the City Council.

The second significant problem is the technical skills required to understand the complex issues that are present in the administration of the Plan. The combination of the highly technical rules for pension administration and the need to understand the use of arcane actuarial science in the measurement of present and future Plan liabilities requires an experienced and trained Board member to effectively govern the Plan. While some may argue that the purpose of the Board member is to set policy and that technical aspects are handled by trained professionals, lack of understanding of the finer points of administration means that a Board member may be unable to ask meaningful questions.

Finally, there is an issue in communication between the City Council and the Retirement Board. The City Council seems to view the Board as its eyes and ears in the retirement system. Councilmembers have repeatedly commented that if there are any problems in the retirement system, they depend on the Board to let them know. This includes any actions the Council might consider taking that could be potentially harmful, even in a minor way, to the Plan. The Board, on the other hand, views itself as strictly administrative and does not seem to feel that advisory input to the Council is appropriate.

For all of these reasons, the Pension Reform Committee believes that the Plan, the beneficiaries,

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

and the City would be better served by a Board composed of qualified professionals who have no vested interest in the Plan.

Recommendation #14

Change the composition of the Retirement Board to seven members appointed by the City Council. These members will serve with staggered terms of four years each, with a two consecutive term maximum. Such appointees will have the professional qualifications of a college degree and/or relevant professional certifications, fifteen years experience in pension administration, pension actuarial practices, investment management (including real estate), banking, or certified public accounting. Such appointees will be U.S. Citizens and residents of the City of San Diego but cannot be City employees, participants (direct or indirectly through a direct family member) of the SDCERS, nor a union representative of employees or participants, nor can such appointees have any other personal interests which would be, or create the appearance of, a conflict of interest with the duties of a Trustee.

Another governance issue that was addressed related to applications for disability retirement. Currently, when an application is submitted for disability retirement, it is first reviewed by SDCERS staff. If the application is recommended for approval, it moves directly to the Board for action. If the application is not recommended for approval, it is forwarded to an outside adjudicator who hears from both parties, reviews documents, and renders a finding. That finding then returns to the Board where, more often than not, the whole application is heard again, though not under oath.

Again due to the possible conflicts of interest present when a Board member is asked to make these types of findings related to another employee who either was or is in the same bargaining unit, this process places Board members in an extraordinarily awkward position. The Pension Reform Committee felt it would be in the best interest of everyone concerned to create a process whereby applications forwarded to an adjudicator would not be returned to the Board. Instead, the finding of the adjudicator would be final.

Recommendation #15

An additional provision should be made to the City Charter that would codify the current disability retirement determination process as it is now except that the hearing officer's decision would be final rather than a recommendation to the Board for approval.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

X. OTHER RECOMMENDATIONS

A. Study disability retirement application process and system

In grappling with the issues surrounding the cost of the City's Plan, the Pension Reform Committee found that the complexities and nuances of the portion of the system related to disability retirement appear to have resulted not only in inconsistent treatment among employee groups but have created a system that appears ripe for abuse.

At one point the Committee attempted to recommend application of the Social Security definition to the City system, but determined that it could create unintended consequences. This area clearly needs additional study and should be reviewed by a team of individuals who have appropriate human resources and/or legal experience.

Recommendation #16

The City should establish a committee to review the entire disability retirement system. Representatives on this committee should include knowledgeable employees of both the City and SDCERS as well as outside professionals with experience in this area.

Employee/Employer Sharing of Pension Costs

Section 143 of the City Charter states:

> "The City shall contribute annually an amount substantially equal to that required of the employees for normal retirement allowances, as certified by the actuary, but shall not be required to contribute in excess of that amount, except in the case of financial liabilities accruing under any new retirement plan or revised retirement plan because of past service of the employees."

This section of the Charter has apparently been loosely interpreted to mean that the employees bear 50% of Normal Cost and that all other costs are borne by the City. Another reading would be that past service costs (discussed earlier) are the sole responsibility of the City, but that any other costs should be split 50/50. Even if one agrees that the 50/50 split applies to Normal Cost only, then it appears that the Charter may not be being followed.

The Pension Reform Committee attempted to get a full explanation of these issues, but was not able to do so. This issue was identified fairly late in the process and it appears that it will take a significant amount of investigation and possible legal interpretation.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Even if it is determined that the employees have not been paying an amount consistent with the intent of the Charter, a question remains as to what can be done about that either retroactively or prospectively. It is our understanding that the Retirement Board is now investigating this matter.

Recommendation #17

The City Council Rules Committee should require a report (with recommendations) from SDCERS on the issue of the 50/50 employer/employee cost split by the end of the calendar year.

Actuarial Assumptions

The Plan's actuary has recommended several changes to the actuarial assumptions used to determine the employer and employee contribution rates. Recently the Retirement Board engaged a second firm to audit the June 30, 2003 actuarial valuation and to evaluate the assumptions being used and/or recommended.

The Committee supports the recommended changes to assumptions with the exception of the recommendation regarding investment return.

As discussed extensively in earlier sections, the Plan's assets generate investment earnings and increase in value due to both inflation and market forces. The problem is that a portion of those earnings are siphoned off to pay for other commitments such as retiree medical benefits and contingent benefits. The Committee has addressed this by recommending a change to the computation of the City's annual contribution that would require replacement of those "lost" earnings.

Both the Plan's actuary and the auditor chosen by the Retirement Board have recognized this same phenomenon and attempted to compensate for it by reducing the assumed investment return to acknowledge the fact that the entire investment return is not applied to Plan growth.

The Plan's assumed investment rate of return is 8%. The Plan has been experiencing 8%. Therefore the Committee believes that it is simply more straightforward to deal with the dilution of Plan assets annually rather than artificially adjusting the investment rate of return to compensate.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

XI. Appendices

A. Biographical information on Pension Reform Committee

B. Interim Report of Pension Reform Committee to Mayor and City Council
January 22, 2004

C. Example: 30-year Amortization Schedule – Fixed % of Inflation-Adjusted Salary

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

D. Retirement Age Factors for Benefits

E. Study from Gabriel, Roeder, Smith & Company on Proposed New Benefit Structure

Appendix A

BIOGRAPHICAL INFORMATION
PENSION REFORM COMMITTEE

Mr. Stephen Austin, a certified public accountant, is the managing partner at Swenson Advisors, LLP in San Diego, where he specializes in auditing a wide variety of companies and their pension plans. Mr. Austin received a bachelor's degree in accounting from Bob Jones University and a master's of business administration from the University of Georgia.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Ms. April Boling, president of the San Diego County Taxpayers Association, was nominated by that organization and serves on the Committee as the taxpayer advocate. She served on the Mayor's Blue Ribbon Committee on City Finances and the City of San Diego's Citizens' Budget Committee. Ms. Boling, a certified public account and owner of a private accounting practice, holds a bachelor's degree in accounting from the University of San Diego and also serves as the chair of this Committee.

Mr. Robert Butterfield is an attorney at Butterfield Schechter LLP, where he specializes in employee benefits, ERISA, executive compensation, retirement planning and taxation. Mr. Butterfield served on the San Diego City Employees Retirement System Board and on its Investment Committee from 1986 to 1991. He received his bachelor's degree in business from Boston University and his law degree from the University of San Diego.

Mr. Timothy Considine operates his own accounting business, Considine & Considine, which manages the affairs of various types of pension plans. Mr. Considine provides regular financial advice on the investment of retirement assets and understands the importance of proper fund allocation to maximize results for plan beneficiaries. He received a bachelor's degree in accounting from San Diego State University.

Mr. Stanley Elmore was nominated by the City of San Diego Retired Employees' Association and the San Diego Police Officers Association Inc. to serve on the Committee as the City retiree. He is a member and past president of the Retired Fire & Police Association and the San Diego City Employee Retirement System Health Advisory Committee. Mr. Elmore holds a degree in police science from San Diego City College.

Ms. Judith Italiano is the president and general manager of the San Diego Municipal Employees Association, (MEA), the City's largest labor union representing over 5,000 employees. As the lead negotiator for MEA, Ms. Italiano has developed extensive knowledge of the City of San Diego Employee Retirement System. She holds a degree in early childhood education from Fresno State University and serves on the Committee as the City employee representative.

Mr. William Sheffler, a consulting actuary for his own firm, provides actuarial services for defined benefit plan administrators and trustees. Mr. Sheffler provides actuarial testimony on valuation of employee benefits. He holds a bachelor's degree in economics and mathematics from Claremont Men's College and a master's degree in mathematics from the University of Arizona.

Mr. Richard Vortmann serves on the Committee as the San Diego City Employee Retirement System Board member and Vice Chair. Mr. Vortmann is president of National Steel and Shipbuilding Company, NASSCO. He has also served on the Mayor's Blue Ribbon Committee

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

on City Finances. Mr. Vortmann holds a bachelor's degree in finance and a master's degree in business administration from the University of California, Berkeley.

Ms. Kathleen Walsh-Rotto has over fourteen years of experience in working with defined benefit plans. Ms. Walsh-Rotto is currently employed by the Principal Financial Group as a Senior Relationship Manager and has expertise in defined benefit plan design, IRS required testing, legislative issues, fiduciary due diligence and compliance. She holds a bachelor's degree in political science from Iowa State University.

Appendix B

Pension Reform Committee

Date: January 22, 2004

Attention: Honorable Mayor and Members of the City Council

Subject: Interim Report from the Pension Reform Committee

On September 9, 2003, the Mayor and City Council established the Pension Reform Committee

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

(Committee) to address concerns about the current unfunded liability of San Diego City Employees Retirement System (SDCERS) and review the scope and depth of audits to be performed on SDCERS. On September 24, the nine Committee members were officially appointed by the Mayor and City Council.

The Committee held its first meeting on October 1, 2003 and established a weekly meeting schedule. A special web site was set-up on the City of San Diego's web site to provide the public with the minutes, agendas and background information on the Committee. Since inception, the Committee has had two primary areas of focus: a) education, b) scope of SDCERS' audits.

Education

The Committee has requested and received a number of formal presentations from City staff and consultants to educate them on various aspects of SDCERS. The educational presentations they have received to date were on the following topics:

1. **Retirement System Overview** – The Retirement System Administrator provided an overview of the System's Benefits, Actuarial Valuation and Investments.
2. **Laws and Regulations Relating to City Employee Benefits and Collective Bargaining** – A presentation on the meet and confer process was provided by an attorney from the City Attorney's Office, and a presentation on laws pertaining to SDCERS was provided by the general counsel to SDCERS.
3. **Actuarial Valuation** - The actuary for SDCERS provided an overview of actuarial analysis and how it applies to SDCERS.

4. **Distribution of Surplus Earnings** – The Retirement System Administrator provided an overview of the history of SDCERS' surplus earnings, how they are distributed and applicable municipal code provisions.
5. **401K, SPSP and Deferred Compensation** – The City's Risk Management Department provided a presentation on the City's three defined contribution plans including Supplement Pension Savings Plans SPSP, SPSP-M, SPSP-H, 401(k) and Deferred Compensation (457) Plan.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

6. **Pension Obligation Bonds (POBs)** – The City Manager's Office provided a presentation on what POBs are, why they are issued, the legal basis for POBs and their risks and benefits.
7. **Compensation Comparisons** – The City's Human Resources Manager provided a presentation comparing public sector compensation. The data compared the salary and compensation of the City's safety classifications with that of the County, the cities within the County, and the ten largest cities in California.
8. **City Employee Labor Organizations** – The following labor organizations provided input to the Committee on pension reform issues: Police Officers' Association (POA) and Municipal Employees Association (MEA). American Federation of State, County and Municipal Employees, Local 127 and International Association of Firefighters Local 145 are scheduled to provide a presentation at the January 27 meeting of the Committee.

Retirement System's Audits

The SDCERS Retirement Board has commissioned three audits on the Retirement System: a) actuarial, b) investment operations, and c) best practices. The Committee is hopeful that the findings from the audits will be available for review by April, 2004. The Committee has asked the Audit Committee of the SDCERS Retirement Board to utilize the audit process to confirm that the Committee can rely upon work of the SDCERS actuary. In addition, the Committee has asked to have the audit process confirm that the investment results for SDCERS are correctly placed in the top decile when compared to other organizations. Once these confirmations

are complete, the Committee plans to contract the actuary for further studies the Committee needs to complete its work for the City. The Committee estimates the cost of these and other studies to be undertaken by the Committee will be approximately $100,000. This funding has been identified by the City.

Sincerely,

April Boling

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Chair, Pension Reform Committee

Appendix C

EXAMPLE - 30 YEAR AMORTIZATION SCHEDULE - FIXED % OF INFLATION-ADJUSTED SALARY

Salary (4.25% incr.)	UAAL Balance	Interest @ 8.0%	@9.667%	Apply to Prin.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

YEAR	1	605,000,000	1,000,000,000	80,000,000	58,485,350	(21,514,650)
YEAR	2	630,712,500	1,021,514,650	81,721,172	60,970,977	(20,750,195)
YEAR	3	657,517,781	1,042,264,845	83,381,188	63,562,244	(19,818,944)
YEAR	4	685,462,287	1,062,083,788	84,966,703	66,263,639	(18,703,064)
YEAR	5	714,594,434	1,080,786,852	86,462,948	69,079,844	(17,383,104)
YEAR	6	744,964,698	1,098,169,956	87,853,597	72,015,737	(15,837,859)
YEAR	7	776,625,697	1,114,007,815	89,120,625	75,076,406	(14,044,219)
YEAR	8	809,632,289	1,128,052,035	90,244,163	78,267,153	(11,977,009)
YEAR	9	844,041,662	1,140,029,044	91,202,324	81,593,507	(9,608,816)
YEAR	10	879,913,432	1,149,637,860	91,971,029	85,061,232	(6,909,797)
YEAR	11	917,309,753	1,156,547,657	92,523,813	88,676,334	(3,847,479)
YEAR	12	956,295,418	1,160,395,136	92,831,611	92,445,078	(386,533)
YEAR	13	996,937,973	1,160,781,669	92,862,534	96,373,994	3,511,460
YEAR	14	1,039,307,837	1,157,270,209	92,581,617	100,469,889	7,888,272
YEAR	15	1,083,478,420	1,149,381,937	91,950,555	104,739,859	12,789,304
YEAR	16	1,129,526,253	1,136,592,633	90,927,411	109,191,303	18,263,892
YEAR	17	1,177,531,118	1,118,328,740	89,466,299	113,831,933	24,365,634
YEAR	18	1,227,576,191	1,093,963,107	87,517,049	118,669,790	31,152,742
YEAR	19	1,279,748,179	1,062,810,365	85,024,829	123,713,256	38,688,427
YEAR	20	1,334,137,477	1,024,121,937	81,929,755	128,971,070	47,041,315
YEAR	21	1,390,838,319	977,080,622	78,166,450	134,452,340	56,285,891
YEAR	22	1,449,948,948	920,794,732	73,663,579	140,166,565	66,502,986
YEAR	23	1,511,571,778	854,291,746	68,343,340	146,123,644	77,780,304
YEAR	24	1,575,813,579	776,511,442	62,120,915	152,333,899	90,212,983
YEAR	25	1,642,785,656	686,298,458	54,903,877	158,808,089	103,904,213
YEAR	26	1,712,604,046	582,394,245	46,591,540	165,557,433	118,965,894
YEAR	27	1,785,389,718	463,428,352	37,074,268	172,593,624	135,519,356
YEAR	28	1,861,268,781	327,908,996	26,232,720	179,928,853	153,696,133
YEAR	29	1,940,372,705	174,212,863	13,937,029	187,575,829	173,638,800
YEAR	30	2,022,838,545	574,062	45,925	195,547,802	195,501,877

Appendix D

RETIREMENT AGE FACTORS FOR BENEFITS

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

	General			Safety		
	Current	Recommendations		Current	Recommendations	
Age	Plan	#6	#7	Plan	#6	#7
50				3.00%		
51				3.00%		
52				3.00%	2.06%	2.40%
53				3.08%	2.30%	2.46%
54				3.19%	2.55%	2.55%
55	2.50%	1.35%	2.00%	3.29%	2.80%	2.63%
56	2.50%	1.54%	2.00%	3.29%	3.04%	2.63%
57	2.50%	1.72%	2.00%	3.29%	3.29%	2.63%
58	2.50%	1.91%	2.00%	3.29%	3.29%	2.63%
59	2.50%	2.09%	2.00%	3.29%	3.29%	2.63%
60	2.55%	2.28%	2.04%	3.29%	3.29%	2.63%
61	2.60%	2.46%	2.08%			
62	2.65%	2.65%	2.12%			
63	2.70%	2.70%	2.16%			
64	2.75%	2.75%	2.20%			
65	2.80%	2.80%	2.24%			

Recommendation #6: Early Retirement Factor Changes
Recommendation #7: Normal Retirement Factor 20% Reduction

Appendix E.

August 31, 2004

To: Pension Reform Commission

RE: Study to Isolate Impact of Elements of Pension Reform Commission's Proposed New Benefit Structure

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Dear Members of the Commission,

We are summarizing results of our actuarial analysis in regard to isolating elements of a revamped benefit structure you are proposing:

Since we have previously isolated the impact of various elements and have already isolated the impact of extending the final average compensation period from 1 to 3 years in May, all calculations in this report are based on the existing 1 year final average period for compensation determination.

All demographics and assumptions are the same as those used in the June 30, 2003 actuarial valuation except for lower service retirement incidence in Scenarios #1 and #2 at earlier retirement ages.

We assumed that 90% benefit caps would apply.

As was the case for our August 13 report, the Elected Officer group is so small that we have not done any analysis of any change so as to keep our fees to a minimum.

The summary of what we were asked to value follows:

Scenario #1: Isolate the impact of Early Retirement Reduction Factors

Future General hires will receive the same benefit of 2.65% per year of service at the deemed Normal Retirement Age of 62. Actuarially reduced early retirement factors will be available at age 55 for those with at least 20 years of service. The early retirement reduction factors are the same as we used in our August 13 study report and are reflected in the appendix.

Future Safety hires will receive a benefit of 3.29% (this is equal to the 2.99% benefit formula multiplied by 1.1 to reflect the 10% augmentation to final average compensation) per year of service at the deemed Normal Retirement Age of 57. Actuarially reduced early retirement factors will be available at age 52 for those with at least 20 years of service.

There is an element in this Scenario in which we asked for clarity: what level of employee contributions are to be used. As we were not given a definitive answer, we are using **unchanged** employee contributions for this Scenario. The rationale for using unchanged

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

employee contribution rates is as follows: at the age which the PRC deems to be the Normal Retirement Age, there is no change in the benefit multiplier. In practice, **some adjustment** to the General employee rate could be considered to have a more equal sharing of normal costs between the City and the employee (unless pick ups are viewed in a different light than currently).

The following results do not have an amortization component of cost as it is presumed that new members enter the system with no accrued liability.

These are our results, expressed as percents of active member pay, under the Projected Unit Credit (PUC) funding method SDCERS uses:

SCENARIO #1: Isolating Impact of Early Retirement Factors

Future General Hires (Excluding Elected Officials)

	2003 Valuation (Mid-year contributions assumed)	PUC
Gross Normal Cost	20.32%	17.38%
Less		
Employee Contributions (weighted)	10.54%	10.53%
Equals		
City Normal Cost	9.78%	6.85%
Valuation Pay	$356,055,141	

Future Safety Hires

	2003 Valuation (Mid-year contributions assumed)	PUC
Gross Normal Cost	30.56%	25.33%

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Less

Employee Contributions (weighted)	12.86%	12.86%

Equals

City Normal Cost	17.70%	12.47%

SCENARIO #2: Impact of 20% Reduction in Multipliers

Future General Hires (Excluding Elected Officials)

	2003 Valuation	PUC
	(Mid-year contributions assumed)	
Gross Normal Cost	20.32%	16.15%
Less		
Employee Contributions (weighted)	10.54%	8.42%
Equals		
City Normal Cost	9.78%	7.73%
Valuation Pay	$356,055,141	

Future Safety Hires

	2003 Valuation	PUC
	(Mid-year contributions assumed)	
Gross Normal Cost	30.56%	24.26%

Less

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Employee Contributions (weighted)	12.86%	10.29%
Equals		
City Normal Cost	17.70%	13.97%

Valuation Pay $176,697,345

In this instance, we believe it is clear to reduce the employee contribution rates by 20% to reflect the intent of the Municipal Code language on the "50/50" split on Normal Cost between the employee and the City. Thus, the net numbers will not be comparable between Scenarios #1 and #2 due to this differing treatment.

Scenario #3: Eliminating Performance Pay from Includable Pension Compensation

On August 19, Pat Frazier gave us base salaries of $583.6 million that correlate to the $605 million dollar figure they have been using for annual pension payroll. As there was no breakdown between Safety and General, we will assume a uniform 3.5% reduction in evaluating the impact.

The normal cost rates would be the same but they would apply to smaller amounts of payroll. We applied the weighted City normal cost rate of 12.42% in the 2003 valuation to projection valuation payroll (based on June 30, 2003 valuation payroll and the long-term inflation assumption of 4.25% per annum) and derived a reduction in the normal cost by roughly $2,370,000. Our sense is that this somewhat understates the true costs since most performance pay bonuses would likely be available to those in management and other more senior positions.

If this had always been excluded from payroll and active member accrued liabilities declined by 3.5% as a result, the impact on the accrued liabilities as of June 30, 2003 would have been roughly $60 million dollars.

As always, we look forward to answering your questions.

Sincerely,

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Rick Roeder, EA, FSA, MAAA

Cc: Larry Grissom
Paul Barnett
Lamont Ewell

GLOSSARY

TERM	DEFINITION
Accrued Benefit	The amount of an individual's benefit (whether or not invested) accrued as of a specified date, determined in accordance with the terms of a pension plan and based on compensation and service or participation to that date.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Term	Definition
Accrued Liability	see ACTUARIAL ACCRUED LIABILITY
Accumulated Benefit Obligation (ABO)	The ACTUARIAL PRESENT VALUE of pension benefits attributed by a pension benefit formula to employee service rendered before a specified date and based on service and compensation (if applicable) prior to that date; see also PROJECTED BENEFIT OBLIGATION
Accumulated Plan Benefit	see ACCRUED BENEFIT
Actuarial Accrued Liability	That portion, as determined by a particular ACTUARIAL COST METHOD, of the ACTUARIAL PRESENT VALUE of pension plan benefits and expenses which is not provided for by future NORMAL COSTS.
Actuarial Assumption	The value of a parameter, or other choice, having an impact on an estimate of a future cost, or other actuarial item, under evaluation.
Actuarial Calculations	Calculations that make use of ACTUARIAL ASSUMPTIONS and ACTUARIAL METHODS.
Actuarial Cost Method	A procedure for determining the ACTUARIAL PRESENT VALUE of pension plan benefits and expenses and for developing an ACTUARIALLY EQUIVALENT allocation of such value to time periods, usually in the form of a NORMAL COST and an ACTUARIAL LIABILITY; see also ACTUARIAL METHOD.
Actuarial Equivalent	see ACTUARIALLY EQUIVALENT
Actuarial Gain or Loss	A measure of the difference between actual experience and that expected based upon a set of ACTUARIAL ASSUMPTIONS, during the period between two ACTUARIAL VALUATION dates, as determined in accordance with a particular ACTUARIAL COST METHOD.
Actuarial Liability	see ACTUARIAL ACCRUED LIABILITY
Actuarial Method	A procedure by which DATA are analyzed and ACTUARIAL ASSUMPTIONS used to estimate a future cost or other actuarial item; see also ACTUARIAL COST METHOD.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Actuarial Present Value	The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of ACTUARIAL ASSUMPTIONS; see also ACTUARIALLY EQUIVALENT, PRESNT VALUE.
Actuarial Report	A document, or other presentation, prepared as a formal means of conveying the actuary's professional conclusions and recommendations, of recording and communicating the methods and procedures, and of ensuring that the parties addressed are aware of the significance of the actuary's opinion or findings.
Actuarial Valuation	The determination, as of a VALUATION DATE, of the NORMAL COST, ACTUARIAL ACCRUED LIABILITY, ACTUARIAL VALUE OF ASSETS, and related ACTUARIAL PRESENT VALUES for a pension plan.
Actuarial Value of Assets	The value of cash, investments and other property belonging to a pension plan, as used by the actuary for the purpose of an ACTUARIAL VALUATION.
Actuarially Equivalent	Of equal ACTUARIAL PRESENT VALUE, determined as of a given date with on the basis of the same set of ACTUARIAL ASSUMPTIONS.
actuary	A person professionally trained in the technical and mathematical aspects of insurance, pensions and related fields. The actuary estimates how much money must be contributed to a pension fund each year in order to support the benefits that will become payable in the future.
Amortization Payment	That portion of the pension plan contribution which is designed to pay interest on and to amortize the UNFUNDED ACTUARIAL ACCRUED LIABILITY, or other liability.
Ancillary Benefit	A benefit or coverage which is incidental to a larger program and the cost of which is not material to the total program cost.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Asset Risk	The risk that the amount or timing of items of cash flow connected with assets will differ from expectations or assumptions as of the VALUATION DATE for reasons other than a change in investment rates of return. Asset risk includes the risk of default or other financial nonperformance; distinguished from CREDIT RISK, INVESTMENT-RATE-OF-RETURN RISK, MARKET RISK, and REINVESTMENT RISK.
Asset Valuation Basis	The method used to determine the stated value of a particular asset.
COLA	see COST OF LIVING ADJUSTMENT
Contingent Benefits	Indeterminate benefits as to either their amount or their occurrence, in the context of this report, these are benefits that are not part of the pension plan as originally conceived.
Contingent Liability	Indeterminate liabilities as to either their amount or their occurrence
Cost of Living Adjustment (COLA)	An increase or decrease in a benefit in the course of payment, that is intended to reflect a change in living costs since the last prior adjustment.
Credibility	Statistical reliability (of experience data) as a basis for making projections.
Credit Risk	Risk associated with the possibility of a loss on an investment security, either in whole or in part; distinguished from ASSET RISK, INVESTMENT-RATE-OF-RETURN RISK, MARKET RISK, REINVESTMENT RISK.
Data	Statistical or other information that is generally numerical in nature or susceptible to quantification.
Death Benefit	A benefit payable as a direct result of the death of an insured individual or a covered participant.
Defined Benefit Plan	A retirement plan with contributions dependent on benefits defined in the plan.
Defined Contribution Plan	A retirement plan with benefits dependent on contributions defined in the plan.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Term	Definition
EA	see ENROLLED ACTUARY
EANC	see ENTRY AGE NORMAL COST METHOD
Employee Retirement Security Act (ERISA)	A statute enacted in 1974, and amended subsequently, that established the Pension Benefit Guaranty Corporation and established limits and minimum standards for eligibility, vesting, benefit levels, and funding for qualified pension plans in the U.S.
Enrolled Actuary	A designation granted by the U.S. Joint Board for Enrollment of Actuaries to persons satisfying requirements established by ERISA for performing actuarial services for qualified defined-benefit pension plans.
Entry Age Normal Cost Method	A cost method under which the normal cost to fund the benefits under the plan is set as a level percentage of compensation from the date a participant becomes eligible to enter the plan until retirement.
ERISA	see EMPLOYEE RETIREMENT INCOME SECURITY ACT
Experience Factors	Those elements which reflect actual experience.
Experience Gain or Loss	see ACTUARIAL GAIN OR LOSS
Exposure	Extent of RISK and/or possibility of LOSS
Fair Market Value (FMV)	The value of property established between a willing buyer and a willing seller in an arm's length transaction.
FASB	Financial Accounting Standards Board
full actuarial funding	annual payment of NORMAL COST plus AMORTIZATION of UNFUNDED ACCRUED ACTUARIAL LIABILITY
Funding Method	see ACTUARIAL COST METHOD
GAAP	Generally Accepted Accounting Principles
GASB	Government Accounting Standards Board
Investment Risk	Uncertainty surrounding the realization of a specified investment income stream.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Investment-Rate-Of-Return Risk	The risk that investment rates of return will depart from expectations or assumptions as of the VALUATION DATE, causing a change in the amount or timing of asset or obligation cash flows; distinguished from ASSET RISK, CREDIT RISK, MARKET RISK, and REINVESTMENT RISK.
Market Interest Rates	Yields that are available on new money invested at a particular time.
Market Risk	Uncertainty regarding the future market value of an asset; distinguished from ASSET RISK, CREDIT RISK, INVESTMENT-RATE-OF-RETURN RISK, and REINVESTMENT RISK.
Mortality Table	A statistical table showing the death rate of each age.
Normal Actuarial Cost	see NORMAL COST
Normal Cost	That portion of the actuarial present value of pension plan benefits and expenses which is allocated to a valuation year by the ACTUARIAL COST METHOD, excluding any payment in respect of an unfounded actuarial accrued liability.
Obligation	Any tangible or intangible commitment by, requirement of, or liability of a plan or an insurer that can reduce receipts or generate disbursements.
Open Group Cost Method	An Actuarial cost method under which ACTUARIAL PRESENT VALUES associated with expected future entrants are considered.
Participant	An individual covered by a benefit plan.
Pay-As-You-Go	A method of financing a benefit plan under which the contributions to the plan are generally made at about the same time and in about the same amount as benefit payments and expenses becoming due.
PBO	see PROJECTED BENEFIT OBLIGATION
Pension Obligation Bonds	Public indebtness issued by the City that is used explicitly to fund pension plan obligations
POB	Pension Obligation Bond

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Present Value	The value today of an amount receivable or payable in the future, reflecting the TIME VALUE OF MONEY; see also ACTUARIAL PRESENT VALUE.
Projected Benefit Obligation	The ACTUARIAL PRESENT VALUE as of a date of all benefits attributed by the pension benefit formula to employee service rendered prior to that date, including recognition of changes in future compensation levels if appropriate; see also ACCUMULATED BENEFIT OBLIGATION.
Projected Benefits	Pension benefit amounts which are expected to be paid at various future times under a particular set of ACTUARIAL ASSUMPTIONS, taking into account such items as the effect of advancement in age and past and anticipated future compensation and service credits.
Projected Unit Credit Cost Method	A cost method under which the normal cost to fund the benefits under the plan is set as the present value of the benefit earned during the year, including an allowance for future salary increases. Under this method the cost of each member’s benefit increases annually.
PUC	see PROJECTED UNIT CREDIT COST METHOD
Reserve	An amount determined as of a VALUATION DATE to provide for future payments.
service purchase	the practice of a member paying a fixed amount for additional pension benefits or credits, which were not earned during their term of service in the system.
Terminal Funding	A method of funding a pension plan under which the entire ACTUARIAL PRESENT VALUE of benefits for each individual is contributed to the plan's fund at the time of withdrawal, retirement, or benefit commencement.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Time Value of Money	The principle that an amount of money available at an earlier point in time has different usefulness and value than the same amount of money at a later point in time.
UAAL	see UNFUNDED ACTUARIAL ACCRUED LIABILITY
Unfunded Accrued Liability	see UNFUNDED ACTUARIAL ACCRUED LIABILITY
Unfunded Actuarial Accrued Liability	The excess of the ACTUARIAL ACCRUED LIABILITY over the ACTUARIAL VALUE OF ASSETS. (UAAL)
Unfunded Actuarial Liability	see UNFUNDED ACTUARIAL ACCRUED LIABILITY
Valuation Assets	see ACTUARIAL VALUE OF ASSETS
VBO	Vested Benefit Obligation
Vested Benefit Obligation	vested portion of the ACCUMULATED BENEFIT OBLIGATION

BIBLIOGRAPHY

Section	Description	Date of Document
Formation		
	Memo from Mayor Dick Murphy regarding the establishment of the Pension Reform Committee	07/11/2003
	Resolution 298359 establishing the Pension Reform Committee	09/09/2003
	Memo from Mayor Dick Murphy introducing the Pension Reform Committee members with biographies.	09/24/2003

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Interim Report		
	Interim Report of Pension Reform Committee to City Council	01/22/2004
	Interim Report of Pension Reform Committee to City Council	04/19/2004
Resolution		
	Resolution 298819 accepting the Pension Reform Committee status report.	01/26/2004
Projections and Solutions		
	Amortization rate tables	03/09/2004
	UAAL - Projection	06/01/2004
	15 Year amortization v. 30 year amortization	06/01/2004
	Pension Obligation Bonds 30 years v. 29 years	06/01/2004
	Mortgage 15 years v. 30 years	06/01/2004
	30 year UAAL amortization - baseline and different funding options	06/01/2004
	UAAL amortization - 30 year baseline and different funding options	06/08/2004
Draft Report Outline		
	Draft Outline of Final Report to Council	12/02/2003
	Form of Report/Required Resources	12/02/2003
	Draft Outline of Final Report to Council	02/18/2004
	Draft Outline of Final Report to Council	04/21/2004
	Draft Outline of Final Report to Council	05/25/2004
	Draft Outline of Final Report to Council	06/01/2004
	Draft Outline of Final Report to Council	06/15/2004
Draft Final Report		
	Draft Pension Reform Committee Report to the City of San Diego	07/25/2004
	Draft Pension Reform Committee Report to the City of San Diego	07/28/2004
	Draft Pension Reform Committee Report to the City of San Diego	08/13/2004
	Draft Pension Reform Committee Report to the City of San Diego	08/17/2004
	Draft Pension Reform Committee Report to the City of San Diego - Draft Power Point Presentation	08/17/2004
	Draft Pension Reform Committee Report to the City of San Diego	09/07/2004
	Draft Pension Reform Committee Report to the City of San Diego - Draft Power Point Presentation	09/07/2004
Scope of work - Actuarial Studies		
	Pension Reform Committee Actuarial Task Considerations	01/20/2004
	Letter from Rick Roeder regarding the scope and fee of actuarial work assignments.	02/16/2004

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

	Letter from Rick Roeder regarding the scope and fee of actuarial work assignments.	02/19/2004
	Letter from Rick Roeder regarding the scope and fee of actuarial work assignments.	03/02/2004
	Letter from Rick Roeder regarding the scope and fee of actuarial work assignments.	03/04/2004
	Letter from Rick Roeder regarding the scope and fee of actuarial work assignments.	05/04/2004
Actuarial Reports		
	Interim Valuation - Market Value - GRS Consultants and actuaries	04/09/2004
	Interim Valuation - Market Value - GRS Consultants and Actuaries - Revised	04/15/2004
	Value of Benefit Increase- GRS Consultants and Actuaries	04/20/2004
	Sources of UAAL - $1.16 billion unfunded liability - GRS Consultants and Actuaries	05/18/2004
	Retiree Medical Analysis - GRS Consultants and Actuaries	06/14/2004
	Compilation of work performed by GRS Consultants and Actuaries - Pension Reform Commission Actuarial Reports: Retiree Medical Analysis, Sources of Unfunded Liability, Summary of Actuarial Rates with Issuance of Pension Obligation Bonds, Actuarial Analysis - Valuation Payroll, Value of Benefit Increases, Interim Valuation - Market Value	07/06/2004
	Study on Pension Reform Commission's Proposed New Benefit Structure for Future Hires	08/13/2004
	Actuarial Gains (Losses) for Pay Increases and Further Analysis of Corbett Liabilities	08/17/2004
	Study to isolate impact of elements of Pension Reform Committee Proposed New Benefit Structure	08/31/2004
Retirement Board Audits		
	Request for proposals from the SDCERS Retirement Board for Audits	07/28/2003
	Interim Actuarial Audit Findings from Mercer Human Resource Consulting	02/13/2004
	Interim Investment Operations Audit Findings report form Mercer Investment Consulting	02/16/2004
	Actuarial Audit Report from Mercer Human Resources Consulting.	05/25/2004

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Retirement Board Investment Reports		
	Callan Associates Inc. Investment Measurement Service Quarterly Review - San Diego City Employees' Retirement System	09/30/2003
	Callan Associates Inc. Investment Measurement Service Quarterly Review - San Diego City Employees' Retirement System	12/31/2003
	Callan Associates Inc. Investment Measurement Service Quarterly Review - San Diego City Employees' Retirement System	06/30/2004
Presentations		
	Ralph M. Brown Act.	10/01/2003
	SDCERS - Overview	10/14/2003
	Meet and Confer	11/04/2003
	Actuarial 101 & SDCERS	11/18/2003
	Distribution of Earnings	12/02/2003
	Defined Contribution Savings Plans	12/09/2003
	SPSP and 401k plans plus average age, salary, age of new entrant, salary of new entrant and number of years served upon termination of employees.	12/18/2003
	Pension Obligation Bonds	01/06/2004
	Comparison of compensation packages between the City, the County and other Cities within the County.	01/13/2004
	Unfunded liability after the issuance of pension obligation bonds, comparison of different public entities	01/16/2004
	Inventory of City-owned property	02/17/2004
	Composition of retirement boards throughout California	02/17/2004
	Normal cost - comparison of for safety members of various California public agencies.	03/02/2004
	Normal Cost Survey - comparison of general members of various California public agencies.	03/09/2004
	Retiree Health Insurance	03/23/2004
	CalPERS - memo from Lawrence Grissom regarding system	04/06/2004
	SDCERS History of Investment Performance	04/20/2004
	Retirement Vested Interests	05/18/2004
	Pension Obligation Bonds	05/19/2004

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

	Proposed Charter Changes/Amendments	06/07/2004
	Operating Budget FY 2005	07/29/2004
Background		
	Retirement Board role revisions -Memorandum of Law	07/30/1993
	San Diego City Employees' Retirement System Annual Actuarial Valuation	06/30/1995
	San Diego City Employees' Retirement System Annual Actuarial Valuation	06/30/1996
	City of San Diego 401(k) Plan	01/01/1997
	Ex-officio - letter from Frandzel and Share regarding authority of a member of the Retirement System Board to designate a staff member to sit in their place	05/06/1997
	Ex-officio member - letter from Arter & Hadden regarding authority of the Retirement System Board to designate a staff member to sit in their place	06/03/1997
	San Diego City Employees' Retirement System Annual Actuarial Valuation	06/30/1997
	Ex-Officio Board Members, designation of alternates	07/18/1997
	San Diego City Employees' Retirement System Annual Actuarial Valuation	06/30/1998
	San Diego City Employees' Retirement System Annual Actuarial Valuation	06/30/1999
	Corbett Settlement - Notice of entry of judgment of WILLIAM J CORBETT; DONALD B ALLEN; LEONARD LEE MOREHEAD; AND GORDON L WILSON; individually, and on behalf of all others similarly situated v. CITY EMPLOYEES' RETIREMENT SYSTEM	05/22/2000
	San Diego City Employees' Retirement System Annual Actuarial Valuation	06/30/2000
	San Diego City Employees' Retirement System Annual Actuarial Valuation	06/30/2001
	City of San Diego Supplemental Pension Savings Plan	07/01/2001
	San Diego City Employees' Retirement System Handbook	01/01/2002
	San Diego City Employees' Retirement System Annual Actuarial Valuation	06/30/2002
	Deferred Compensation Plan	07/11/2002
	Comprehensive Annual Financial Report - San Diego City Employees' Retirement System	11/01/2002
	Retirement System - Resolution 297336 regarding modifications	11/18/2002

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

	Employer Contributions agreement between the City of San Diego and the San Diego City Employees' Retirement System	11/18/2002
	San Diego City Employees' Retirement System - The Report of an Experience Investigation covering the period 7/1/1997 to 6/30/2001	01/09/2003
	Blue Ribbon Committee Report - response - City Finances dated February 2002 Regarding Pension and Health Insurance Funding	02/05/2003
	San Diego City Employees' Retirement System Annual Actuarial Valuation	06/30/2003
	Blue Ribbon Committee on City Finances - San Diego City Employees Retirement System	10/24/2003
	San Diego Employees' Retirement System Executive Summary, June 30, 2003 Actuarial Valuation	12/18/2003
	Retirement System - Article 4 - City Employees' Retirement System	
	Retirement System - City Charter Articles - Article IX - City Employees' Retirement System	
Miscellaneous		
	State Retirement Systems: Funding Levels and Asset Allocation - 2003 Wilshire Report	03/12/2003
	Putnam Funds - correspondence with the SDCERS investment managers	10/27/2003
	Financial Accounting Series - Statement of Financial Accounting Standards No. 132 - Employers' Disclosure about Pensions and Other Postretirement Benefits	Dec-03
	Retirement Board's audits - List of questions that could be answered within the scope	12/02/2003
	Letter to SanFord Bernstein Co regarding scope of work for their analysis of the SDCERS investment fund performance	01/07/2004
	Letters to Keith Enerson, Phil LaVelle, Diann Shipione and Michelle Corbin to be invited to submit a factual presentation in writing of information that would be helpful to the Committee regarding SDCERS	01/27/2004
	Retirement Fund Financial Statements - memo to SDCER's Board of Administration from Cecilia San Pedro	02/05/2004
	Bonds - Standard and Poor's ratings of City of San Diego	03/02/2004
	Investment performance - Letter from SanFord Bernstien	03/02/2004
	State Retirement Systems: Funding Levels and Asset Allocation - report from Wilshire Research - 2004	03/12/2004
	City of San Francisco regarding recent labor contracts - e-mail from Alice Villagome, Deputy Director, Employee Relations Division	03/16/2004

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

	State of California's Bonds, The - Report from Bernstein Municipal Bond Research	

ATTACHMENT 1

ADDITIONAL INFORMATION TO CITY COUNCIL

APRIL 19, 2004

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

THIS DOCUMENT MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINION, ESTIMATES AND OTHER BACKWARD-LOOKING RECONSTRUCTIONS OR FORWARD LOOKING STATEMENTS, ARE NOT TO BE CONSTRUED AS REPRESENTATIONS OF FACT, AND ARE QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT. ONLY STATEMENTS MADE BY THE CITY IN AN OFFICIAL RELEASE OR SUBSEQUENT NOTICE OR ANNUAL REPORT, PUBLISHED IN A FINANCIAL NEWSPAPER OF GENERAL CIRCULATION AND/OR FILED WITH THE MSRB OR THE NSMSIRs ARE AUTHORIZED BY THE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.