AGENDA FOR THE
PENSION REFORM COMMITTEE
MEETING OF
May 4, 2004
4:00 PM – 6:00 PM Meeting

401 B Street
Conference Room, 4th Floor

MINUTES

THE REGULAR MEETINGS OF THE PENSION REFORM COMMITTEE ARE SCHEDULED FOR EVERY TUESDAY AT 4:00 PM AT 401 B STREET, 4TH FLOOR

THE OPINIONS AND VIEWS OF THE COMMITTEE OR ITS MEMBERS, AND PRESENTATIONS MADE AND DOCUMENTS PROVIDED TO THE COMMITTEE OR ITS MEMBERS, MAY CONTAIN PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINIONS, 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 NRMSIRs ARE AUTHORIZED BYTHE CITY. THE CITY SHALL NOT BE RESPONSIBLE FOR THE ACCURACY, COMPLETENESS OR FAIRNESS OF UNAUTHORIZED STATEMENTS.

Item 1: Call to Order

Item 2: Roll Call

Members Present	Members Absent	Staff Present
April Boling	Richard Vortmann	Patricia Frazier
Robert Butterfield		Chris Morris
Stanley Elmore		Larry Grissom, SDCERS Staff
Judith Italiano		Paul Barnett, SDCERS Staff
William Sheffler		Pam Holmberg
Steve Austin		Mary Braunwarth
Kathleen Walsh-Rotto		
Tim Considine		

Item 3: Approval of Minutes

There was a motion for approval of the minutes for the April 20, 2004 Pension Reform Committee (Committee) meetings from Judie Italiano. The motion was seconded by Kathleen Walsh Rotto and passed unanimously with Tim Considine abstaining.

Item 6: Discussion on Meeting Schedule

Ms. Boling reported that the City Council had allocated time on the docket of May 24 or 25 to receive the Committee's preliminary report contingent on the completion of audits being conducted by the Retirement Board which are due in June. In order to meet this deadline, the Committee would need to complete and approve their report at the May 18 meeting. Ms. Boling asked the Committee to consider if they needed to have additional meetings in order to meet this deadline or if they should postpone the delivery date of their report. The next available date at Council would be June 15. The Committee discussed its options and decided to continue with their Tuesday meetings until their work on the report is complete, which may or may not be in time for the June 15 meeting. Ms. Boling asked if the Committee wanted to communicate anything to the City Council at this time given that their report would not be completed in May. The Committee agreed that communication at this time would not be necessary.

Item 5: Discussion on Final Report

Mr. Butterfield asked about a recent change to the employee pick up for managerial employees. Mr. Morris explained that the retirement pick up by the city was reduced by 5.8% beginning on July 1 for unclassified employees.

The Committee continued its discussion of the draft final report outline. All items for consideration will be included on the draft outline for later discussion and a final vote. Please see the attached updated outline.

Item 4: Actuarial Study

Rick Roeder distributed a letter (dated May 4, 2004) with responses to many of the Committee's questions and provided a presentation on the items in the letter. Mr. Roeder explained that his reports use actuarial assumptions specified in Manager's Proposal 2; are based on a level percent of payroll; and assume the City makes its contributions at the beginning of the fiscal year. Mr. Roeder's report included the following: impact of pick ups; alternate actuarial investment assumptions; calculation of the actuarial rate without COLA; amortization period alternatives; evaluation of asset smoothing methods; reduction to normal cost for future hires by extending final average compensation period from 1 to 3 years; impact of 13th check on funded position of plan; impact of other contingent benefits on funded status of plan; and the impact of service purchase subsidy on SDCERS. Please see the attached letter. The Committee asked for clarification on specific responses presented by Mr. Roeder.

Item 7: New Business

There were no comments.

Item 8: Comments by Committee Chairperson

There were no comments.

Item 9: Comments by Committee Members

There were no comments.

Item 10: Non-Agenda Public Comment

Virginia Silverman said she was concerned about any suggestion to eliminate the cost of living adjustment. She feels that there is not much cushion, especially for older retirees, to lose any money. She also asked if and when the Committee would be getting a presentation on vesting. Mr. Morris said it could be on the agenda within the next few weeks.

Patricia Karnes discussed the composition of the Retirement Board. She believes there could be a case made for a Board composed of 5 to 7 professionals with expertise in investments and fiduciary responsibilities. This could be a way to insure the safety of a $3 billion fund. She also felt that they might want to spin off retirement disability approvals to another board. There is a large amount of highly specialized information that needs to be understood and perhaps the retirement system could be better managed by experts in the field.

Ron Saathoff commented on Mr. Roeder's findings on the employee pick up and its effect on the deficit to the fund. Mr. Saathoff said the contribution amount would be the same, whether it was paid by the employee or the employer. There is no way of knowing if the City would have contributed any more to the retirement fund if they had not made the pick up. By increasing the retirement pick up, instead of granting wage increases, the City benefited by not having to pay roll-up costs.

Jim Gleason commented that the 13th check is a finite amount of money per employee, and as a percentage of the overall cost to the Retirement System, will decrease. It is a very small part of the total liability. He said there is a big need for the 13th check for older retirees that are the least paid in the System. He is also disturbed by the funding and structure of the Retirement System. The Committee can go to Council with recommendation regarding the funding of the System, but it is the Retirement Board that determines funding. The Retirement Board is an independent entity and makes all decisions regarding the System. The City Council can only enforce those decisions. The Committee needs to ensure that the Board and Council work together.

Item 11: Adjournment

The meeting was adjourned at 6:30.

The next meeting will be on Tuesday, May 11, 2004 at 4:00 PM at the same location.

DRAFT OUTLINE
FINAL REPORT TO COUNCIL
Updated May 4, 2004

INTRODUCTION

A. How we got here
1. Roeder report
2. 1996 start date
3. Order of magnitude
   a. Stock market
   b. Benefit enhancements
   c. Under funding

B. Where we are
1. April's presentation (4/19/04 to City Council)

RESOLUTIONS

I. Addressing the deficit
1. The Measurement
   a. Pick a date
      - report date – mid-late May 2004
        *Market value as of February 2004 (2/29/04 data as reviewed internally by Management)
   b. Value of contingent benefits and inclusions
   c. Address Corbett and 13th Check

2. Options

   a. POBs
   b. Hope (Market)
   c. Contributions from the City
   d. Real Estate Assets
   e. Decreasing number of participants
   f. Changing the assumptions
   g. Early retirement

II. Plan design
1. Changes to benefits for new hires
   a. High one year salary changed to high three year or five year.
   b. Changing to defined benefit plan
   c. Elimination of DROP
   d. Changes of the percentage per year, i.e. 2.5% to 2.0%

e. Changes to retirement age – up by one year
f. COLA decrease

2. Changes to Structure
   a. Separating from Pension Fund-Retiree Health Care.

III. Funding policy – Defined Benefit

1. Key Decision Points:

   a. Amortization of normal gains and losses (demographics)
   b. Smoothing vs. Market Value Measurements (yes, no, length of time)
   c. Shortfall in funded status at each measurement date
      * Minimum funding (floor)
      * Two or more layers
      * Optimal funding
   d. Amortization of past service cost
   e. Funding status ratios – including overfunded %
   f. Address Corbett and 13th check

IV. Funding Policy – OPEBs
V. Governance
VI. Improved disclosure/communication
VII. Transition summary

GABRIEL, ROEDER, SMITH & COMPANY

Consultants & Actuaries

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May 4, 2004

To: Pension Reform Commission

RE: Requested Tasks by the Pension Reform Commission

Dear Members of the Commission,

We are summarizing further results of our actuarial analysis. Item numbers referenced are consistent with our fee proposal letter. There are a couple additional deliverables which we will finish checking this week.

For ease of comparison, all changes, due to alternate scenarios are in percents of pay and use actuarial assumptions specified in Manager's Proposal 2. City contributions are assumed to be paid at the **beginning** of the fiscal year.

We typically use percents of pay in expressing changes. This is due to the City's history of payroll growth, assumed future payroll growth and the manner in which unfunded liabilities are amortized (18 years remaining as of June 30, 2003, financed as a level percent of payroll).

If it is desired to translate such percents, where indicated, into current dollars, then one of two numbers is useful:

June 30, 2003 Valuation Payroll	\$533,595,407
Projected June 30, 2004 Valuation Payroll	\$556,273,212

The projection is based on the 2003 valuation payroll and SDCERS' 4.25% inflation assumption.

2. Impact of Pick Ups

You have asked us to evaluate the cumulative amount of City pick ups of employee contributions since 1996 and any related actuarial impact if pick ups did not exist and the like amount of City contributions were instead applied to the unfunded actuarial accrued liability.

We have calculated the amounts of the pick ups for the fiscal year ends 1997-2003 to be $160,074,161. The cumulative value, inclusive of the time value of money, of such pick ups is $207,911,404 as of June 30, 2003. Because of the fixed rates in the Manager's Proposal 1 (as long as the City's funded ratio exceeded 82.3%), there would not have been year-to-year impact on the City's actual contribution due to the pick up. However, there would be significant impact on the June 30, 2003 actuarial rate, as follows if the amounts picked up were instead paid by the employees and the "freed up" pick ups were put into SDCERS.

	Current	No Pick Up	Decrease
Normal Cost	11.95%	11.95%	0.00%
Amortization	15.99%	13.12%	2.87%
TOTAL	27.94%	25.07%	2.87%
Unfunded Liability (millions)	$1,157	949	208
Funded Ratio	67.2%	73.1%	(5.9)%

The total amount of the negotiated pick up is not contributed by the City. Instead, a smaller amount is contributed to reflect anticipated savings from having to pay lesser refunds. Pick ups are not refundable to employees.

The establishment of the pick up program preceded the implementation of Manager's Proposal 1.

3. Alternate Actuarial Investment Assumptions

Calculate the 2003 actuarial rate by changing the following economic assumptions to:

Inflation	4.0%	(currently 4.25%)
Real Return	3.5%	(currently 3.75%)
Total Assumed Return	7.5%	(currently 8%)

	Current	New Assumptions	Increase
Normal Cost	11.95%	13.87%	1.92%
Amortization	15.99%	18.78%	2.79%
TOTAL	27.94%	32.65%	4.71%
Unfunded Liability (millions)	$1,157	1,382	225
Funded Ratio	67.2%	63.2%	(4.0)%

4. Calculate the actuarial rate without COLA

If all future 2% annual COLA increases were eliminated, the impact on the actuarial rate would be as follows:

	Current	No COLA	Decrease
Normal Cost	11.95%	7.83%	4.12%
Amortization	15.99%	7.56%	8.43%
TOTAL	27.94%	15.39%	12.55%
Unfunded Liability (millions)	$1,157	547	610
Funded Ratio	67.2%	81.3%	(14.1)%

Suppose the elimination of the 2% COLA were restricted to future retirees:

	Current	No COLA	Decrease
Normal Cost	11.95%	7.83%	4.12%
Amortization	15.99%	11.48%	4.51%
TOTAL	27.94%	19.31%	8.63%
Unfunded Liability (millions)	$1,157	830	327
Funded Ratio	67.2%	74.1%	(6.9)%

We have assumed **no** change in the employee contribution rate. It is likely that the issue of employee contribution rates being decreased would arise. This issue could become further complicated due to the significant pick ups currently in place.

There are legal issues involving "contract" impairment if this course is pursued for current members.

6. Amortization Period Alternatives

Recalculate the 2003 rate with a 30-year amortization period.

	Current	30-Year	Decrease
Normal Cost	11.95%	11.95%	0.00%
Amortization	15.99%	11.52%	4.47%
TOTAL	27.94%	23.47%	4.47%

Recalculate the 2003 rate with a 10-year amortization period.

	Current	10-Year	Increase
Normal Cost	11.95%	11.95%	0.00%
Amortization	15.99%	25.29%	9.30%
TOTAL	27.94%	37.24%	9.30%

Recalculate the 2003 rate with a 10-year/30-year amortization blend.

We have calculated a blended amortization rate which uses 10-year amortization of the $467.3 million identified as a benefit increase coincident with or following Manager's Proposal #1. It is sensible to amortize this amount over a shorter period of time since the average future working lifetime of the active employees, to whom the unfunded liability relates, is between ten and fifteen years.

The balance of the unfunded liability as of June 30, 2003, $689.9 million, is amortized over 30 years.

	Current	10/30 Blend	Increase
Normal Cost	11.95%	11.95%	0.00%
Amortization	15.99%	17.08%	1.09%
TOTAL	27.94%	29.03%	1.09%

7. Evaluation of Asset Smoothing Methods

Use existing asset smoothing methodology but shorten smoothing period to 1, 2 and 3 years as of June 30, 2003:

Shorten Ratio of Market to Book to One Year

Existing SDCERS Valuation Assets Attributed to City	$2,375,431,482
Valuation Assets With Revised Smoothing	$2,331,298,987
Net **Decrease** in Valuation Assets	$ 44,132,495
Revised Actuarial Rate	28.55%
Revised Funded Ratio	66.0%

Shorten Ratio of Market to Book to Two Years

Existing SDCERS Valuation Assets Attributed to City	$2,375,431,482
Valuation Assets With Revised Smoothing	$2,258,701,035
Net **Decrease** in Valuation Assets	$ 116,730,447
Revised Actuarial Rate	29.55%
Revised Funded Ratio	63.9%

Shorten Ratio of Market to Book to Three Years

Existing SDCERS Valuation Assets Attributed to City	$2,375,431,482
Valuation Assets With Revised Smoothing	$2,270,175,483
Net **Decrease** in Valuation Assets	$ 105,255,999
Revised Actuarial Rate	29.39%
Revised Funded Ratio	64.3%

8. Reduction to Normal Cost for Future Hires by Extending Final Average Compensation Period from 1 to 3 Years

Safety	-1.38%
General	- 0.90%
Total	-1.06%

This assumes **no** change in employee contributions.

9. Impact of 13th Check on Funded Position of Plan

You have asked us to evaluate the cumulative impact of the 13th Check. Our analysis evaluates the impact **since** 1996.

We have calculated the amounts of the 13th checks for the fiscal year ends 1997-2003 to be $23,111,139. The cumulative value, inclusive of the time value of money, of such pick ups is $30,315,418 as of June 30, 2003. Because of the fixed rates in the Manager's Proposal 1 (as long as the City's funded ratio exceeded 82.3%), there would not have been year-to-year impact on the City's actual contribution due to the pick up since 1996. However, there would be significant impact on the June 30, 2003 actuarial rate, as follows if the amounts paid were instead retained in the SDCERS trust.

	Current	No 13th Check	Decrease
Normal Cost	11.95%	11.95%	0.00%
Amortization	15.99%	15.57%	0.42%
TOTAL	27.94%	27.52%	0.42%
Unfunded Liability (millions)	$1,157	1,127	30
Funded Ratio	67.2%	68.1%	(0.9)%

We can identify the amounts of the 13th checks for as many years as SDCERS has retained records. We are still in the process of identifying such amounts for each year since program inception.

10. Impact of Other Contingent Benefits on Funded Status of Plan

You have asked us to evaluate the cumulative impact of contingent benefits other than 13th Check. Our analysis evaluates the impact **since** 1996.

We have calculated the amounts of other contingent benefits for the fiscal year ends 1997-2003 to be $91,908,589. The cumulative value, inclusive of the time value of money, of such benefits is $111,141,394 as of June 30, 2003. Because of the fixed rates in the Manager's Proposal 1 (as long as the City's funded ratio exceeded 82.3%), there would not have been year-to-year impact on the City's actual contribution due to the pick up since 1996. However, there would be significant impact on the June 30, 2003 actuarial rate, as follows if the amounts paid were instead retained in the SDCERS trust.

	Current	Other Benefits	Decrease
Normal Cost	11.95%	11.95%	0.00%
Amortization	15.99%	14.45%	1.54%
TOTAL	27.94%	26.40%	1.54%
Unfunded Liability (millions)	$1,157	1,046	111
Funded Ratio	67.2%	70.4%	(3.2)%

12. Impact of Service Purchase Subsidy on SDCERS

Just prior to higher service purchase rates going into effect in November, there was a deluge of requests from members (roughly 3,000) for cost information. Not all requests will result in purchase. It would not be unreasonable to guess that half of the current requests will result in purchase.

As of June 30, 2003, there were 2,339 members who purchased service since program inception.

The one year for which we have excellent information as to both liabilities and related contract purchase amounts is the year ending June 30, 2003.

Total Purchasers:	812
Average Age	49.1 years
Average Service Purchased	4.2 years
New City Liability	$46,000,959
Member Contract Value	$33,300,955
Actuarial Loss	$12,700,004

This means the average actuarial loss per year of service purchased was roughly $3,725.

If there are 1,500 members who have purchased service since June 30, 2003 or are in the pipeline, our guesstimate is that the added actuarial loss will be in the $22-$25 million range. The impact of this will not entirely be reflected in the June 30, 2004 valuation since staff indicates that request processing will continue for the balance of the calendar year.

We look forward to answering your questions.

Sincerely,

Rick Roeder

Rick Roeder, EA, FSA, MAAA

City of San Diego Employees' Retirement System
Summary of Contingent Benefits and Employee Pickups starting with the 1997 Fiscal Year End

	1997	1998	1999	2000	2001	2002	2003	Total	Accumulated to 6/30/2003 at 8%
CONTINGENT BENEFITS									
Retiree Health Insurance	0	4,368,879	5,400,264	5,413,222	7,207,619	8,882,138	11,450,200	42,722,322	51,998,201
Supplemental COLA	0	0	3,795,871	3,678,210	4,161,525	4,434,946	4,218,089	20,288,641	24,587,735
13th Check	2,967,750	3,095,818	3,202,469	3,313,608	3,422,381	3,508,909	3,600,204	23,111,139	30,315,418
Corbett Retro Payments	0	0	0	0	23,630,603	5,265,570	1,453	28,897,626	34,555,457
Total Contingent Benefits	2,967,750	7,464,697	12,398,604	12,405,040	38,422,128	22,091,563	19,269,946	115,019,728	141,456,812
EMPLOYEE PICKUPS	19,447,927	20,006,911	20,891,264	21,986,996	23,271,129	25,896,431	28,573,503	160,074,161	207,911,404