June 17, 2010

To: Members of the Board of Retirement

From: Ophelia Basgal, Actuarial Committee Chair

Subject: Summary of Actuarial Committee Meeting, June 17, 2010

The Actuarial Committee was called to order at 12:39 p.m. on June 17, 2010. Committee Members present were Ophelia Basgal, Chair, Dale Amaral, Keith Carson, Liz Koppenhaver, and George Wood. Other Board members present were Elizabeth Rogers, and Alternate Members David Safer, and Darryl Walker.

Staff Members present were Catherine Walker, Acting Chief Executive Officer; Kathy Foster, Assistant Chief Executive Officer; Robert Gaumer, Chief Counsel; J. P. Singh, Chief Financial Officer; Betty Tse, Chief Investment Officer; Latrena Walker, Project and Information Systems Manager; and Victoria Arruda, Human Resources Officer.

ACTION ITEMS

1. Review and motion to recommend to the Board adoption of economic actuarial assumptions.

Acting CEO Catherine Walker introduced Paul Angelo of The Segal Company, ACERA's outside actuaries. Mr. Angelo presented and discussed Segal's report, "Review of Economic Actuarial Assumptions for the December 31, 2009 Actuarial Valuation," dated May 4, 2010.

In summary, Mr. Angelo said that Segal was recommending:

- Reducing the assumed rate of return on current and future assets from 8.00% to 7.90% per annum;
- Reducing the inflation assumption from 3.75% to 3.5%;
- Maintain the assumed salary increase assumption at 4.00%. This is the result of the recommended decrease in the inflation assumption, which also applies to salaries, and a recommended increase in the real across the board wage growth assumption from 0.25% to 0.50%.
- The terminal pay assumption was reviewed in the last triennial experience study, and will be reviewed again in November of this year in the next triennial study.

Mr. Angelo said that each year gains and losses are factored into the valuation based on actual experience as one-time events, and that gains and losses don't affect the assumptions unless a pattern develops over time that justifies reexamining an assumption. Handling gains and losses in this way helps to achieve the goal of "level funding," and more stable contribution rates. Although the annual factoring in of gains and losses does affect rates, it causes much less variability than would the adjusting of assumptions in response to each year's gains and losses.

In response to a question from the Committee, Mr. Angelo reviewed the recent history of the outside actuary's recommended assumed rates of return compared to what the Board adopted:

Year	Recommended	Adopted
2004	7.75%	7.8%
2005	7.8%	7.9%
2006	7.9%	8.0%
2007	8.0%	8.0%

Last year for the 2008 valuation Segal recommended that no change be made in the rate of return assumption, because market events in the previous year had been so extraordinary that there was no rational basis for examining and projecting what might happen in the near term. The Board adopted this recommendation and decided to wait until this year to consider the economic assumptions again.

Discussing the assumed rate of return, Mr. Angelo talked about the change in ACERA's asset allocation, which is more aggressive than the allocation has been in the past. The new allocation results in an increase in the nominal rate of return of 26 basis points. This increase, however, is nearly offset by the 25 basis point decrease in the inflation assumption. Furthermore, because the new asset allocation is more aggressive it also has a higher risk associated with it. Segal uses a risk adjustment factor which is unique to Segal's model to achieve a level of confidence that this Board has historically been comfortable with, which is 56%. Given the increase in risk associated with the new asset allocation, Segal has increased the risk adjustment factor this year from .38 to .51 in order to achieve an assumption that produces a 56% confidence level. Taken together Segal's calculation results in an assumed rate of return of 7.88%, which was rounded up to 7.9%.

Following Mr. Angelo's presentation based on the report there were comments and questions from Trustees and others. Ophelia Basgal commented that an item on the Committee work plan had been to consider changing to a triennial review of the economic assumptions, as is already the case for the non-economic assumptions. This work was put off when the market and economy were disrupted. Since the issue remains on the work plan, the Committee should move forward with considering it. Among other things this change would be another way to reduce volatility and fluctuations in contribution rates.

Keith Carson said that no change had been made in the economic assumptions last year because of the volatility of the markets, and asked what Segal's opinion is of the current level of volatility. Mr. Angelo answered that there is still volatility, but Segal believes things have calmed enough that it is reasonable to return to ACERA's normal actuarial practices.

Regarding the difference between recommending 7.9 and 8.0%, Mr. Angelo said that he could not say absolutely that 7.9 is right and 8.0 would be wrong, but that it is his position as our actuary that recommending 7.9% is the correct move because it will better position the fund for future events. The lower rate means that a coming good year will have a better effect on future rates, and a bad year will have a "less bad" effect. It is, in a sense, like insurance in that there is a cost associated with the lower assumption, but that it provides a reduced risk of bigger contribution rate increases going forward.

Acting CEO Catherine Walker reminded the Committee that in his May 20 memo to the Board, CEO Chuck Conrad had recommended the rate of return assumption be set at 8.00%. His reasoning was based on using a real rate of return assumption of 5.91% instead of the 5.79% recommended by Segal. His memo says, "The 12 basis point difference is well within the margin of predictable error for investment returns and aligns our assumption with the median assumption for statewide public funds nationwide...."

County CAO Muranishi commented that after the Committee and Board's discussions late year it had been the County's sense that the Board was moving toward triennial assumption setting, and she would like to have that issue raised again this year. Ms. Muranishi said that lowering the rate to 7.90% will increase the County's contribution by about $5 million. She is very aware, and the Board of Supervisors is aware, that contributions will double over the next few years. Rates have already nearly doubled over recent years from $70 million to $130 million per year. The County appreciates actions that the Board of Retirement has taken to lessen volatility, such as widening the corridor last year, which provided some short-term relief. The County has always honored its commitments for contributions and intends to continue to do so. The budget situation continues to be dire for the County. Ms. Muranishi concluded by saying that the County supports the ACERA Staff recommendation to maintain the assumed rate of return this year at 8.00%.

Liz Koppenhaver voiced her disappointment that there had not been a Committee meeting with Chuck Conrad present to explain his recommendation of 8.00% That being said, however, the schedule seems to dictate that the Committee adopt the economic assumptions at this meeting. Based on what was before the Committee, Ms. Koppenhaver moved that the Committee accept the recommended economic assumptions, including the rate of return of 7.90%. George Wood seconded the motion.

Keith Carson said that there had been another opportunity to hear Chuck Conrad's rationale in the meeting with participating employers on May 10, 2010, during which Mr. Conrad had also made the recommendation of maintaining at 8.00%. Dale Amaral said that his position in this situation is to defer to Mr. Conrad's experience and expertise, noting that this process is always contentious. Mr. Amaral supports going to a triennial review of economic assumptions, and supports maintaining the assumed rate of 8.00% for this year.

The motion passed by a vote of four yes (Bagal, Koppenhaver, Rogers, Wood), two no (Amaral, Carson), and no abstentions. This was a vote of the Board meeting as a Committee of the whole.

INFORMATION ITEMS

A proposed work plan for the Committee for the remainder of the year, and a template for future years, were presented by Staff.

RECOMMENDATIONS

The Committee recommends and I move that the Board of Retirement adopt the economic actuarial assumptions recommended by the actuary.

ADJOURNMENT

The meeting adjourned at 1:54 p.m.