September 7, 2010

To: Members of the Board of Retirement

From: Ophelia Basgal, Actuarial Committee Chair

Subject: Summary of Actuarial Committee Meeting, September 7, 2010

The Actuarial Committee was called to order at 12:33 p.m. on September 7, 2010. Committee Members present were Ophelia Basgal, Chair, Dale Amaral, Keith Carson, Liz Koppenhaver, and George Wood. Other Board members present were Annette Cain-Darnes and Elizabeth Rogers, and Alternate Member David Safer.

Staff Members present were Catherine Walker, Acting Chief Executive Officer; Kathy Foster, Assistant Chief Executive Officer; Robert Gaumer, Chief Counsel; Victoria Arruda, Human Resources Officer; Harsh Jahdav, Internal Auditor; and J. P. Singh, Chief Financial Officer.

ACTION ITEMS

1. **Discussion and possible motion to recommend to the Board of Retirement to accept the Actuarial Valuation for the year ended December 31, 2009 for the proposed new Safety Tiers of the Sheriff's Department and adopt the recommended contribution rates for the proposed new Safety Tiers.**

This item is before the Board at this time because the new Safety Tiers are already part of a tentative side-letter agreement between the union and the County, but the agreement cannot be finalized, nor can the Board of Supervisors act until ACERA adopts contribution rates. The new tiers are for new safety employees in the Sheriff's Department (excluding Probation Officers) hired on or after July 1, 2010.

Andy Yeung and Paul Angelo of the Segal Company presented the highlights of Segal's study and recommendations, including demographic assumptions and recommended contribution rates. For the first time new Safety employees will have the opportunity to choose between two different retirement benefits: a 2% at age 50 formula, or a 3% at age 55 formula. Those electing 2% at 50 will not make cost-sharing contributions, while those electing 3% at 55 will make cost-sharing contributions of 5% for their first 5 years of employment and 3% after that.

In preparing this study Segal assumed that the demographic profile of new employees entering these tiers would match the profile of new safety employees, excluding probation officers, hired by the Sheriff's Department in the 3 years prior to the actuarial valuation as of December 31, 2009.

Segal explained the difference between the percentage of the cost-sharing contributions deducted from the employees and the percentage paid to the employer as shown in tables in the report. For instance, on page iii the aggregate member rate for new employees choosing 3% at 55 includes a 5% cost-sharing contribution, but the offset amount shown going to employers is only 4.85%. This is because the contribution by the employee is refundable to the employee along with other employee contributions if the employee leaves our pension fund and chooses to withdraw his or her contributions. Since some employees will elect to do so, the withdrawal of those funds has to be accounted for in the actuarial projections and is then reflected in the rates. Segal also noted that, since the new tier employees will pay 5% only for the first 5 years of their employment and then pay 3% for the remainder of their employment period, the net offset rate for the population as a whole will gradually decline as the proportion of employees paying the lower rate will increase over time. As this happens, the employer's contribution rate will go up, and in 5 years the rate will be roughly 36.3% which is very close to what the employer will now pay for employees under the 2% at 50 formula who pay no cost-sharing contribution.

Looking at the different employer contribution rates for the safety tiers, the current tier and the two new ones, the savings to the employer with the new tiers will come from the lower "normal cost" and in the case of the 3% at 55 rate, the offset from the employees cost-sharing contribution. The portion of the employer's contribution rate attributable to payment toward the unfunded accrued actuarial liability (UAAL) is the same for all three tiers, because the practice is to spread the UAAL across total payroll.

Liz Koppenhaver moved that the Committee recommend to the Board of Retirement to accept the Actuarial Valuation for the year ended December 31, 2009 for the proposed new Safety Tiers of the Sheriff's Department and adopt the recommended contribution rates for the proposed new Safety Tiers. George Wood seconded. The motion passed unanimously.

2. **Discussion and possible motion to recommend to the Board to change from an annual review of investment return, inflation and across-the board pay increase assumptions to a triennial review along with the other non-economic actuarial assumptions used in the annual Actuarial Valuation.**

Catherine Walker summarized conversations that she has had with Segal regarding the frequency of review and adoption of the economic actuarial assumptions used for

ACERA's annual actuarial evaluation. Some Trustees have asked Staff to look into whether these assumptions should be considered triennially at the same time the non-economic assumptions are reviewed. The change would probably result in some savings for ACERA.

Paul Angelo spoke for Segal. Many years ago some systems reviewed economic assumptions annually, but most actuarial firms and most pension systems have viewed these assumptions, along with the non-economic demographic assumptions, as long-term assumptions and most systems review them triennially. A change to 3-year review would be consistent with industry practice. Responding to a question from the Committee, Segal said that 3 to 5 years is the actuarial industry standard to review actuarial assumptions, but that the '37 Act requires review to be every 3 years or more frequently.

Segal also said that market volatility also is a reason to consider the longer review period. For instance, last year as a result of the market volatility of 2008 and 2009, rather than increase review of the assumptions, the Board elected to skip a year and use the same economic assumptions for the 2009 valuation as for 2008. Treating the economic assumption as a long-term assumption helps to maintain more stable rates. Segal noted that considering rate-of-return as a long term phenomenon, the question then is whether we learn anything significant about the rate of return in just one year, and the answer to that question is probably no.

The Committee asked about changes in GASB's thinking in light of pension funds' large losses, and high rates of unrealized losses and unfunded liabilities. Segal said that GASB is looking for systems to adopt long-term, realistic earnings rates, and that a 3-year review period is consistent with that. Mr. Angelo said that the actuaries, even on a longer review period such as 3 years, are never going to recommend a large, radical jump in the earnings rate assumption. Historically this Board has usually moved in .10% increments and it is very unlikely that the Board would approve a change of more than .25% even on a 3-year basis; and Segal would certainly not recommend anything like a .75% change.

The Committee expressed concern based on comments by some experts and analysts that "6% is the new 8%." It is likely that we will know if that is the case over the next few years. Even if a 2% shift were phased in over 3 years, it would still be a massive change. Segal said that in the event that there is a large shift in earnings rate, with a corresponding need to change contribution rates, the same result can be achieved by phasing in the change in contribution rates as would be achieved by phasing in the change in earnings rate.

The Committee, Segal and Staff discussed whether there would be a need for triggering events to be included in policy if there is a change to triennial review. County CAO Muranishi said that the County is generally supportive of the longer review period, but would favor a policy with some flexibility in the event of a major change in circumstances. She emphasized that if ACERA considers policy changes such as including triggering events, employers, including the County, should be provided notice of the discussions and be given adequate opportunity to provide their input for consideration.

After considerable discussion the Committee directed Staff to consider the 3-year review period as part of the review of the Liability Management Policy which Staff is recommending undertaking. The Committee said that assuming the motion to review the policy passes Staff should include the review of economic assumptions on a triennial basis, and the review should consider whether triggering events should be included. Staff is to provide adequate notice and opportunity for discussion with the County and other participating employers.

Segal said that it would be necessary for them to begin the process of reviewing the economic assumptions very soon if the Board does not take action to change the review period. The Committee suggested that as an alternative to deciding immediately whether to change to triennial review the Board could decide to skip the review of economic assumptions this year and use the same assumptions for the 2011 valuation that were used this year. Staff then will have time to make their recommendation and the Board can act before the valuation the year following.

George Wood moved that the Committee recommend to the Board of Retirement that the Board adopt for the Actuarial Valuation as of December 31, 2010, the same economic actuarial assumptions, including the assumed rate of return, used for the valuation as of December 31, 2009. Dale Amaral seconded. The motion passed unanimously.

3. **Discussion and possible motion to recommend to the Board authorization to review of the Liability Management Policy including both the funding policies and reserving policies contained therein.**

Staff has recommended a comprehensive review of the Liability Management Policy. Because of the complexity of the issues and the potential fiscal impact of some changes to be considered Staff requested authorization to use the services of the Segal Company in conducting the policy review and developing recommendations for the Committee.

Dale Amaral moved that the Committee recommend to the Board of Retirement to authorize staff review of the Liability Management Policy with the assistance of ACERA's Actuary. George Wood seconded. The motion passed unanimously.

INFORMATION ITEMS

In the July 2010 Actuarial Committee meeting the Committee and the County asked Staff and Segal to begin providing projections of future contribution rates. Segal presented the first of their projections. Segal said that it should be remembered that these projections are illustrations, not predictions. They are sensitivity studies that show how rates would vary under various assumptions about earnings rates. The year-to-date earnings rate was 1.39% as of July. In the future this type of projection will be included in the annual review and actuarial valuation.

Staff presented a timeline for the RFP process for the next Actuarial Audit. The proposed timing of the audit will allow the auditors to review the actuarial valuation as of December 31, 2010 and recommended contribution rates before the recommended rates would go into effect in 2012. It is expected that there will be a pool of 5 or 6 firms that may be interested in responding to the RFP. The pool will include firms that have audited Segal in the past.

TRUSTEE & PUBLIC INPUT

None.

RECOMMENDATIONS

1. The Committee recommends and I move that the Board of Retirement accept the Actuarial Valuation for the year ended December 31, 2009 for the proposed new Safety Tiers of the Sheriff's Department and adopt the recommended contribution rates for the proposed new Safety Tiers.

2. The Committee recommends and I move that the Board of Retirement adopt for the Actuarial Valuation as of December 31, 2010, the same economic actuarial assumptions, including the assumed rate of return, used for the valuation as of December 31, 2009.

3. The Committee recommends that the Board of Retirement authorize staff review of the Liability Management Policy with the assistance of ACERA's Actuary.

ADJOURNMENT

The meeting adjourned at 1:52 p.m.