



Summary and Answers to Frequently Asked Questions about the June 30, 2011 Actuarial Valuation for the City of San Diego

SUMMARY

The June 30, 2011 Actuarial Valuation (the “2011 Valuation”) for the City of San Diego incorporates the same actuarial methods used in the City’s June 30, 2010 Actuarial Valuation. The 2011 Valuation also incorporates a number of new actuarial assumptions approved by the SDCERS Board of Administration in September 2011 that were based on an experience study completed by Cheiron in July 2011. The new assumptions include the following:

1. The investment return assumption was lowered from 7.75% to 7.50%;
2. The wage inflation assumption was lowered from 4.00% to 3.75% (following a two-year freeze assumption);
3. Rates of termination were increased, and changed to be based on service as opposed to the age of a member;
4. Disability rates were decreased;
5. Mortality rates were decreased;
6. Rates of retirement were increased and changed to be based on age and service as opposed to just the service of a member;
7. The percent married assumption was increased; and
8. For the Cost-of-Living (COL) Annuity, the valuation was changed from load factors to a direct valuation of existing member accounts and load factors only for prospective contributions.

SDCERS uses the most widely accepted, industry-standard actuarial methods followed by public pension plans. *[See the Valuation beginning at page 44 for more details on assumptions and methods.]*

FREQUENTLY ASKED QUESTIONS

- 1. Based on the June 30, 2011 Actuarial Valuation for the City of San Diego, what is the City’s 2011 Unfunded Actuarial Liability (UAL)?**
Using the Entry Age Normal (“EAN”) funding method, the City’s UAL as of June 30, 2011 was \$2.178 billion. *[See the 2011 Valuation Letter of Transmittal.]*
- 2. How does the 2011 UAL compare to the 2010 UAL?**
It is \$32.8 million, or 1.5%, higher. The primary cause of the increase was due to revising the investment return assumption from 7.75% to 7.50%. However, the increase was less than expected as investment returns were better than expected, and liabilities grew less than expected. *[See the 2011 Valuation Letter of Transmittal and the 2011 Valuation at page 5.]*
- 3. What is the City’s 2011 funding ratio?**
As of June 30, 2011, the City’s funding ratio, which is the ratio of the actuarial value of

assets (after smoothing) over total actuarial liabilities, was 68.5%. Had the funding ratio been measured on a market value of assets basis, the ratio would be at 70.1% as of June 30, 2011. *[See the 2011 Valuation Letter of Transmittal and the 2011 Valuation at page 4.]*

4. How does this compare to the City's 2010 funding ratio?

It is 1.4% higher. As of June 30, 2010, the City's funding ratio was 67.1%. *[See the 2011 Valuation Letter of Transmittal and the 2011 Valuation at page 4.]*

5. What is the City's Annual Required Contribution (ARC) for FY 2013? (The ARC is the amount the City will have to contribute to SDCERS on or after July 1, 2012.)

If paid in full in July 2012 as expected, the City's ARC for FY 2013 will be \$231.3 million (approximately 45.0% of payroll). If the City pays the ARC evenly throughout FY 2013, the contribution will be \$239.8 million (approximately 46.6% of payroll). *[See the 2011 Valuation Letter of Transmittal]*

6. What was the City's ARC payment for FY 2012?

The City's FY 2012 ARC was \$231.2 million. *[See the 2011 Valuation Letter of Transmittal and the 2011 Valuation at page 6.]*

7. How is the City's FY 2013 ARC calculated?

The City's employer contributions are comprised of two components: the Normal Cost contribution and the UAL contribution.

Normal Cost represents, for each active City employee, the present value (as of June 30, 2011) of the portion of the employee's projected retirement benefit assigned to FY 2013. By paying the Normal Cost, the City pays a fixed percentage of salary to fund SDCERS for the value of benefits over each participant's career. If paid at the beginning of FY 2013, the City's Normal Cost is \$54.2 million (approximately 10.5% of payroll).

The UAL portion of the employer contribution is an amount the City pays each year to pay down unfunded liabilities accrued over past years. The UAL is paid off ("amortized") over a period of years. The City's total June 30, 2011 UAL of \$2.178 billion is split into several tiers, each using a different amortization period. These tiers are comprised of:

1. the \$1.187 billion remaining balance of the City's June 30, 2007 UAL now amortized over 16 years (\$94.8 million of the FY 2013 ARC);
2. the \$83.8 million UAL due to the impact of 2008 changes in actuarial assumptions that is amortized over 27 years (\$5.4 million of the FY 2013 ARC);
3. the \$13.6 million UAL due to the FY 2008 experience loss that is amortized over 12 years (\$1.4 million of the FY 2013 ARC);
4. the \$810.7 million UAL due to the FY 2009 experience loss that is amortized over 13 years (\$79.6 million of the FY 2013 ARC);
5. the \$25.9 million UAL due to the FY 2010 experience loss that is amortized over 14 years (\$2.5 million of the FY 2013 ARC);

6. the \$50.0 million reduction in the UAL due to the FY 2010 experience gain from the PSC correction adjustment that is amortized over 13 years (negative \$4.6 million of the FY 2013 ARC);
7. the \$140.9 million reduction in the UAL due to the FY 2011 experience gain that is amortized over 15 years (negative \$12.8 million of the FY 2013 ARC); and
8. the \$188.3 million UAL due to the impact of 2011 changes in actuarial assumptions that is amortized over 30 years (\$10.8 million of the FY 2013 ARC).

Adding the amortization amounts of each tier together results in a FY 2013 UAL amortization payment of \$177.0 million (approximately 34.5% of payroll). *[See the 2011 Valuation at page 25.]*

8. What was the market value of SDCERS' Trust Fund on June 30, 2011, and what was the City's portion of this amount?

The market value of the assets in SDCERS' Trust Fund on June 30, 2011 was \$5.204 billion. The City's portion of this amount was \$4.848 billion. *[See the 2011 Valuation at page 15.]*

9. How does this compare to the June 30, 2010 market values?

The June 30, 2011 values are 24.6% higher. The June 30, 2010 market value for the SDCERS Trust Fund was \$4.177 billion, and the City's portion of the Trust Fund was \$3.901 billion (\$947 million less than at June 30, 2011). This increase is almost entirely due to an increase in the market value of investments plus investment income, and reflects an investment return of 24.2% for the year. *[See the 2011 Valuation at pages 15 and 17.]*

10. What is the actuary's assumed investment return for the SDCERS Trust Fund?

For the 2011 Valuation, SDCERS' actuary assumed a long-term average investment return of 7.50% for Trust Fund assets. *[See the 2011 Valuation at page 44.]*

11. What were the annualized investment returns of Trust Fund assets?

SDCERS' annualized investment returns at market value for the one, three, five and ten-year periods ended June 30, 2011, as reported by Hewitt EnnisKnupp, SDCERS' Investment Consultant, were 24.2%, 4.4%, 4.8% and 6.9%, respectively. Annualized investment returns are different from the actuarial rate of return calculated by the actuary (e.g., 8.8% for the year ending June 30, 2011) because the actuary computes the actuarial return using the Expected Value of Assets smoothing method. *[See the 2011 Valuation at pages 16 and 17.]*

12. How does the Expected Value of Assets smoothing method work?

The Expected Value of Assets smoothing method dampens the volatility in asset values that can occur because of fluctuations in market conditions. Use of an asset smoothing method is consistent with the long-term nature of the actuarial valuation process.

The actuarial value of assets each year is equal to 100% of the expected actuarial value of

assets plus 25% of the difference between the current market value of assets and the expected actuarial value of assets. In no event will the actuarial value of assets ever be less than 80% of the market value of assets nor greater than 120% of the market value of assets. This asset smoothing corridor did not apply in the June 30, 2011 valuation, as the City's actuarial value of assets of \$4.739 billion was 98% of the City's market value of assets of \$4.848 billion. *[See the 2011 Valuation at page 16.]*

13. Are the City's retiree health care expenses included in the 2011 Valuation?

No. Health care expenses are a separate obligation of the City and they are not paid from retirement assets in the SDCERS Trust Fund.

14. How did the actuary handle the June 7, 2010 court case ruling on underpriced Purchase Service Credits?

In the June 30, 2010 Actuarial Valuation, the UAL was reduced by \$50.0 million, an estimate based on pure actuarial judgment with no specific data or information on the elections made by plan members. For the 2011 Valuation, the actuary had specific data for the majority of the members affected by the PSC correction and the actuary revised the financial impact reflecting members' actual elections. The revised financial impact increased the previously estimated UAL reduction from \$50 million to \$65 million. The associated UAL savings are being amortized over a 15-year period and reduce the ARC accordingly. The FY 2013 ARC was reduced by \$5.6 million. *[See the 2011 valuation at pages 6 and 25.]*