SDCERS June 30, 2013 Actuarial Valuation: City of San Diego
Frequently Asked Questions

At the request of the Board of Administration, Cheiron performed the June 30, 2013 actuarial valuation of the San Diego City Employees' Retirement System (SDCERS). The purpose of the actuarial valuation is to report on the financial condition of the system's Defined Benefit plans for its three plan sponsors – the City of San Diego, the San Diego Unified Port District and the San Diego County Regional Airport Authority. The following FAQ is intended to provide SDCERS' plan sponsors and members with information regarding the Valuation's results for the City of San Diego.

The Valuation and its contents were prepared in accordance with generally recognized and accepted actuarial principles and practices consistent with the Code of Professional Conduct and applicable Actuarial Standards of Practice sent out by the Actuarial Standards Board.

FREQUENTLY ASKED QUESTIONS

1. **Based on the June 30, 2013 Actuarial Valuation for the City of San Diego, what is the City's Unfunded Actuarial Liability (UAL)?**

   As of June 30, 2013, the City's UAL was $2.238 billion.

2. **How does the 2013 UAL differ from the 2012 UAL?**

   The City's UAL decreased by $41.6 million, to $2.238 billion from $2.279 billion. The decrease is primarily due to a freeze on inflationary pay increases through FY 2018 based on negotiated labor agreements, a reduction in the long-term inflationary pay assumption after 2018, and a FY 2013 investment return greater than expected; these factors reduced the UAL. A reduction in the actuarial discount rate assumption offset a portion the UAL reductions noted above.

3. **What is the City's funded ratio and how does this compare to the 2012 funding ratio?**

   As of June 30, 2013 the City's funding ratio was 70.4 percent, an increase of 1.8 percent from 68.6 percent as of June 30, 2012. The funded ratio is the ratio of the system's actuarial value of assets to its actuarial liabilities.

4. **What is the City's Actuarially Determined Contribution (ADC), formerly known as the Annual Required Contribution (ARC), for FY 2015?**

   The City of San Diego's FY 2015 ADC, formally known as the ARC, is $263.6 million. The decrease of $11.8 million from the $275.4 million paid in FY 2014 was primarily driven by the same factors as those influencing the UAL as noted in answer number two above. The FY 2015 ADC is due to be paid to SDCERS on or after July 1, 2014.

   The Governmental Accounting Standards Board recently issued Statement 67 that revises the standards for pension plan financial reporting. However, the new standard did not retain the concept of an ARC, which had previously been used by SDCERS as the plan's funding policy. In response, the SDCERS Board in November 2013 voted to formalize its funding policy based on the existing practices used to develop the ARC. The actuary replaced the term ARC with ADC to refer to the contribution determined by the actuary each year based on the adopted funding policy.

5. What was the City's annual pension contribution (ARC) in FY 2014?

The FY 2014 ARC was $275.4 million.

6. How is the City's ADC 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, 2013) of the portion of the employee's projected retirement benefit assigned to FY 2015. 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 2015, the City's Normal Cost is $45.7 million (approximately 10.0 percent 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, 2013 UAL of $2.238 billion is split into several tiers, each using a different amortization period. There are now a total of 14 tiers, and adding the amortization of each tier results in a FY 2015 UAL payment of $217.8 million. See Table IV-2 on page 26 of the City June 30, 2013 Actuarial Valuation for more information on these tiers.

7. How did Proposition B and the City's subsequent agreements with its six labor unions to freeze pensionable pay affect the ADC?

Proposition B closed the plan for General members and for Fire and Lifeguard Safety members. However, the plan remains open for sworn police officers. The Governmental Accounting Standards Board (GASB) rules in effect at the passage of Proposition B required the UAL associated with the closed General and Fire/Lifeguard Safety plan to be amortized evenly, rather than via increasing payments over time. The total UAL was unaffected by the passage of Proposition B; however, the amortization of the UAL into annual ADC payments was affected.

A level dollar amortization was applied to the closed plan portion of the UAL to follow GASB standards, while the portion of the UAL associated with the open police plan will continue to be amortized as a level percentage of pay. As a result, the FY 2014 ADC was higher by $27 million than it would have been without the passage of Prop B. The higher payments become less so each year, and after approximately six years, ADC payments will be lower than they would have been without the passage of Prop B.

As for the negotiated freeze on pensionable pay with its six labor unions, the City was able to lower its FY 2015 annual pension payment by approximately $24.6 million, with similar annual savings projected for the next 15 years.

8. Did the recent adjustment to the discount rate and inflationary pay assumptions impact the ADC and the UAL?

Yes. The Board's November 2013 decision to lower the assumed discount rate from 7.5 percent to 7.25 percent and to lower the inflationary pay assumption from 3.75 percent to 3.3 percent increased the ADC and the UAL by $9.3 million and $146.9 million, respectively. These increases were more than offset by the negotiated multi-year freeze on pay inflation, which reduced the ADC and UAL by $24.6 million and $194.9 million, respectively.

9. Are employee contribution rates impacted by changes in the discount rate and inflationary pay assumptions, and the multi-year pay freeze agreements?

Yes, employees of the City of San Diego will see a decrease in their biweekly contribution rates, effective in July 2014. As a percentage of pay, rates will be reduced by an average 0.65 percent for most General members, and be reduced by an average 0.84 percent for most Safety members. Table C-6 on page 64 of the June 30, 2013 actuarial valuation shows the new contribution rates for all members.

10. What was the market value of SDCERS' Trust Fund on June 30, 2013 and the City's portion of this amount?

The market value of the assets in SDCERS' Trust Fund on June 30, 2013 was $5.8 billion. The City's portion of this amount was $5.4 billion.

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

For the June 30, 2013 Valuation, SDCERS' actuary assumed a long-term average investment return of 7.25 percent for Trust Fund assets.

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

SDCERS' annualized investment returns for the one, three and ten year periods ended June 30, 2013, as reported by Hewitt EnnisKnupp were 13.6 percent, 12.5 percent and 8.1 percent. Annualized investment returns are different from the actuarial rate of return calculated by the actuary because the actuary computes the actuarial results using the Expected Value of Assets smoothing method.

13. **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. Assets are assumed to be used exclusively for the provision of retirement benefits and expenses.

The actuarial value of assets each year is equal to 100 percent of the expected actuarial value of SDCERS' June 30, 2013 assets, plus 25 percent 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 percent of the market value of assets nor greater than 120 percent of the market value of assets. In the June 30, 2013 valuation, the City's actuarial value of assets of $5.318 billion was 98.6 percent of the City's market value of assets of $5.395 billion.

14. Are the City's retiree health expenses included in the 2013 Valuation?

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