San Diego City Employees' Retirement System

GASB 67/68 Report
As of
June 30, 2014
for the
City of San Diego

Produced by Cheiron

December 2014

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LETTER OF TRANSMITTAL

December 1, 2014

Board of Administration
San Diego City Employees' Retirement System
401 West A Street, Suite 400
San Diego, CA 92101

Dear Members of the Board:

The purpose of this report is to provide accounting and financial reporting information under GASB 67 for the San Diego City Employees' Retirement System (SDCERS) and under GASB 68 for the City of San Diego. This report is for the use of SDCERS, the City of San Diego and their auditors in preparing financial reports in accordance with applicable law and accounting requirements. This report is not appropriate for other purposes, including the measurement of funding requirements for SDCERS, nor is it intended to benefit any third party, and Cheiron assumes no duty or liability to any such party.

In preparing our report, we relied on information (some oral and some written) supplied by SDCERS. This information includes, but is not limited to, the plan provisions, employee data, and financial information. We performed an informal examination of the obvious characteristics of the data for reasonableness and consistency in accordance with Actuarial Standard of Practice No. 23.

Future actuarial measurements may differ significantly from the current measurements due to such factors as the following: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; and changes in plan provisions or applicable law.

To the best of our knowledge, this report and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices that are consistent with the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this report. This report does not address any contractual or legal issues. We are not attorneys and our firm does not provide any legal services or advice.

David Holland, FSA, EA, MAAA
Consulting Actuary

Gene Kalwarski, FSA, FCA, EA, MAAA
Principal Consulting Actuary

SECTION I
BOARD SUMMARY

The purpose of this report is to provide accounting and financial disclosure information under Government Accounting Standards Board Statements 67 and 68 for the San Diego City Employees' Retirement System and the City of San Diego. This information includes:

- Projection of the Total Pension Liability from the valuation date to the measurement date,
- Calculation of the Net Pension Liability at the discount rate as well as discount rates 1% higher and lower than the discount rate,
- Changes in the Net Pension Liability,
- Schedule of Employer Contributions,
- Disclosure of Deferred Inflows and Outflows, and
- Calculation of the Annual Pension Expense for the City of San Diego.

Highlights

This report is the first report under GASB 67. The San Diego City Employees' Retirement System (SDCERS) consists of three single-employer pension plans. The results with respect to the City of San Diego (City) are contained in this report. The reporting date for SDCERS-City of San Diego is June 30, 2014. Measurements as of the reporting date are based on the fair value of assets as of June 30, 2014 and the Total Pension Liability as of the valuation date, June 30, 2013, updated to June 30, 2014. There were no significant events between the valuation date and the measurement date so the update procedures only included the addition of service cost and interest cost offset by actual benefit payments.

Beginning of year measurements are also based on the actuarial valuation as of June 30, 2013. Because the beginning and ending values are based on the same actuarial valuation and there were no significant events, no liability gains or losses due to experience are reported this year. In future years, liability gains and losses will be reported reflecting the liability gains and losses between actuarial valuation dates as well as any significant events during the update period.

Table I-1 below provides a summary of the key results during this reporting period.

SECTION I
BOARD SUMMARY

Table I-1
Summary of Results

	Measurement Date 6/30/2014	6/30/2013
Net Pension Liability	$ 1,535,536,794	$ 2,160,368,591
Deferred Inflows	428,429,550	0
Deferred Outflows	0	0
Net Impact on Statement of Net Position	$ 1,963,966,344	$ 2,160,368,591
Pension Expense ($ Amount)	$ 83,256,468	N/A
Pension Expense (% of Payroll)	16.67%	N/A

Under GASB Statement 27, the City of San Diego reported a Net Pension Obligation of $139,621,000 in its Statement of Net Position as of June 30, 2013. If the City of San Diego elects to use June 30, 2014 as its initial measurement date under GASB 68, the Net Pension Obligation would be reversed and a Net Pension Liability of $2,160,368,591 would be recognized as of the beginning of the reporting year.

As of the end of the reporting year, the City of San Diego would report a Net Pension Liability of $1,535,536,794 and Deferred Inflows of $428,429,550. Consequently, the net impact on the City’s Statement of Net Position due to SDCERS would be $1,963,966,344 at the end of the reporting year. In addition, any contributions between the measurement date and the reporting date would be reported as deferred outflows to offset the cash outflow reported.

For the measurement year ending June 30, 2014, the annual pension expense is $83,256,468 or 16.67% of payroll. This amount is not related to the City’s contribution to SDCERS ($279,658,715), but instead represents the change in the net impact on the City’s Statement of Net Position plus employer contributions ($1,963,966,344 – 2,160,368,591 + $279,658,715). A breakdown of the components of the net pension expense is shown in the report.

If the City of San Diego elects to use June 30, 2015 as their initial measurement date under GASB 68, the Net Pension Obligation would be reversed and a Net Pension Liability of $1,535,536,794 would be recognized as of the beginning of the reporting year. The NPL and Deferred Inflows and Outflows at the end of the reporting year and the collective annual pension expense would be determined by the measurements as of June 30, 2015.

SECTION II
DETERMINATION OF DISCOUNT RATE

The discount rate used to measure the Total Pension Liability was 7.25%.

We have assumed that the employees will continue to contribute to SDCERS at the current rates and the City will continue their historical practice (since 2006) of contributing to SDCERS based on an actuarially determined contribution, reflecting a payment equal to annual Normal Cost, an amount necessary to amortize the remaining Unfunded Actuarial Liability, and the amount needed to avoid negative amortization, if any.

We have not performed a formal cash flow projection as described under Paragraph 41 of GASB Statement 67. However, Paragraph 43 allows for alternative methods to confirm the sufficiency of the Net Position if the evaluations "can be made with sufficient reliability without a separate projection of cash flows into and out of the pension plan…" In our professional judgment, adherence to the actuarial funding policy described above will result in the pension plan's projected Fiduciary Net Position being greater than or equal to the benefit payments projected for each future period.

Therefore, the long-term expected rate of return on Plan investments was applied to all periods of projected benefit payments to determine the Total Pension Liability.

SECTION III
PROJECTION OF TOTAL PENSION LIABILITY

The Total Pension Liability (TPL) at the beginning of the measurement year is measured as of a valuation date of June 30, 2013. The TPL at the end of the measurement year, June 30, 2014, is measured as of a valuation date of June 30, 2013 and projected to June 30, 2014. In future years, both the beginning and end of year TPL will be measured as of a valuation date one year prior and projected to the appropriate date. There were no significant events during the projection period of which we are aware. Table III-1 below shows the projection of the TPL at discount rates equal to the rate used for disclosure and plus and minus one percent from the rate used for disclosure.

Table III-1
Projection of Total Pension Liability

Discount Rate	6.25%	7.25%	8.25%
Total Pension Liability, 6/30/2013			
Actives	$ 2,646,761,685	$ 2,275,193,142	$ 1,973,336,756
Deferred Vested	349,454,289	304,783,508	269,023,414
Retirees	5,430,278,836	4,975,550,088	4,589,760,225
Total	$ 8,426,494,810	$ 7,555,526,738	$ 6,832,120,395
Service Cost	$ 135,525,208	$ 107,002,939	$ 85,515,758
Benefit Payments	$ 384,979,706	$ 384,979,706	$ 384,979,706
Interest	$ 518,978,613	$ 537,875,335	$ 551,541,826
Change in Benefits	0	0	0
Change in Assumptions	0	0	0
Other Significant Events	0	0	0
Total Pension Liability, 6/30/2014	$ 8,696,018,925	$ 7,815,425,307	$ 7,084,198,273

SECTION IV
NOTE DISCLOSURES

Table IV-1 below shows the changes in the Total Pension Liability, the Plan Fiduciary Net Position (i.e., fair value of Plan assets), and the Net Pension Liability during the Measurement Year.

Table IV-1
Change in Net Pension Liability

	Increase (Decrease)		
	Total Pension Liability (a)	**Plan Fiduciary Net Position (b)**	**Net Pension Liability (a) - (b)**
Balances at 6/30/2013	**$7,555,526,738**	**$5,395,158,148**	**$ 2,160,368,591**
Changes for the year:			
Service cost	107,002,939		107,002,939
Interest	537,875,335		537,875,335
Changes of benefits			
Changes of assumptions			
Differences between expected and actual experience			
Contributions - employer		279,658,715	(279,658,715)
Contributions - member		65,466,703	(65,466,703)
Net investment income		935,051,595	(935,051,595)
Benefit payments	(384,979,706)	(384,979,706)	
Administrative expense		(10,466,941)	10,466,941
Net changes	**259,898,569**	**884,730,366**	**(624,831,797)**
Balances at 6/30/2014	**$7,815,425,307**	**$6,279,888,513**	**$ 1,535,536,794**

There were no changes in benefits or changes in assumptions during the year. Because the beginning and end of year TPL are both based on the same actuarial valuation, there are no differences between expected and actual experience reported this year.

Total contributions and investment income exceeded the service cost, interest cost and administrative expenses, resulting in a decrease in the Net Pension Liability (NPL) of approximately $625 million. The NPL remaining as of June 30, 2014, is approximately $1.5 billion.

The TPL as of June 30, 2013 was based upon the same data, actuarial methods and assumptions, and plan provisions as were used in the actuarial valuation as of June 30, 2013, and which are summarized in the Actuarial Valuation Report for SDCERS-City of San Diego as of June 30, 2013. The actuarial assumptions used in the June 30, 2013 valuation were based on the results of an actuarial experience study performed by Cheiron for the period July 1, 2007 – June 30, 2010, and the results of an economic experience study performed by Cheiron prior to the completion of the June 30, 2013 valuation. A summary of the key assumptions is as follows:

SECTION IV
NOTE DISCLOSURES

- Investment rate of return: 7.25%, net of investment expense
- Salary increases: 3.3% (following assumed freezes in FYs 2015-2018) plus merit component based on employee classification and years of service
- Cost-of-living adjustments: 2.0%
- Mortality: Healthy retired members use the RP-2000 Combined Mortality Table (male and female). For Safety female members, rates are set forward one year

Changes in the discount rate affect the measurement of the TPL. Lower discount rates produce a higher TPL and higher discount rates produce a lower TPL. Because the discount rate does not affect the measurement of assets, the percentage change in the NPL can be very significant for a relatively small change in the discount rate. Table IV-2 below shows the sensitivity of the NPL to the discount rate.

Table IV-2
Sensitivity of Net Pension Liability to Changes in Discount Rate

	1% Decrease 6.25%	Discount Rate 7.25%	1% Increase 8.25%
Total Pension Liability	$ 8,696,018,925	$ 7,815,425,307	$ 7,084,198,273
Plan Fiduciary Net Position	6,279,888,513	6,279,888,513	6,279,888,513
Net Pension Liability	$ 2,416,130,412	$ 1,535,536,794	$ 804,309,760
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	72.2%	80.4%	88.6%

A one percent decrease in the discount rate increases the TPL by approximately 11% and increases the NPL by approximately 57%. A one percent increase in the discount rate decreases the TPL by approximately 9% and decreases the NPL by approximately 48%.

SECTION V
REQUIRED SUPPLEMENTARY INFORMATION

The schedules of Required Supplementary Information generally start with one year of information as of the implementation of GASB 67, but eventually will need to build up to 10 years of information. Table V-1 below shows the changes in NPL and related ratios required by GASB.

Table V-1
Schedule of Changes in Net Pension Liability and Related Ratios

	FYE 2014	FYE 2013
Total Pension Liability		
Service cost (MOY)	$ 107,002,939	N/A
Interest (includes interest on service cost)	537,875,335	N/A
Changes of benefit terms		N/A
Differences between expected and actual experience		N/A
Changes of assumptions		N/A
Benefit payments, including refunds of member contributions	(384,979,706)	N/A
Net change in total pension liability	**259,898,569**	**N/A**
Total pension liability - beginning	**7,555,526,738**	**N/A**
Total pension liability - ending	**$ 7,815,425,307**	**N/A**
Plan fiduciary net position		N/A
Contributions - employer	$ 279,658,715	N/A
Contributions - member	65,466,703	N/A
Net investment income	935,051,595	N/A
Benefit payments, including refunds of member contributions	(384,979,706)	N/A
Administrative expense	(10,466,941)	N/A
Net change in plan fiduciary net position	$ 884,730,366	N/A
Plan fiduciary net position - beginning	**5,395,158,148**	**N/A**
Plan fiduciary net position - ending	**$ 6,279,888,513**	**N/A**
Net pension liability - ending	**$ 1,535,536,794**	**N/A**
Plan fiduciary net position as a percentage of the total pension liability	**80.35%**	**N/A**
Covered employee payroll	$ 499,463,072	N/A
Net pension liability as a percentage of covered employee payroll	307.44%	N/A

If an Actuarially Determined Contribution is calculated, the following schedule (Table V-2) is required. An Actuarially Determined Contribution is a contribution amount determined in accordance with Actuarial Standards of Practice. The full 10 years of information should be shown in this schedule if it is available. To the best of our knowledge, prior contribution amounts were determined in accordance with Actuarial Standards of Practice, so the full 10-year schedule is provided.

SECTION V
REQUIRED SUPPLEMENTARY INFORMATION

Table V-2
Schedule of Employer Contributions
Last 10 Fiscal Years
Dollar Amounts in Thousands

	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
Actuarially Determined Contribution	$ 275,400	$ 231,100	$ 231,200	$ 229,100	$ 154,200	$ 161,700	$ 137,700	$ 162,000	$ 170,071	$ 181,284
Contributions in Relation to the Actuarially Determined Contribution	275,400	231,143	231,200	229,297	192,533	162,475	165,581	169,126	271,349	122,089
Contribution Deficiency/(Excess)	$ 0	$ (43)	$ 0	$ (197)	$ (38,333)	$ (775)	$ (27,881)	$ (7,126)	$ (101,278)	$ 59,195
Covered-Employee Payroll	$ 499,463	$ 511,091	$ 514,265	$ 530,238	$ 536,591	$ 535,774	$ 512,440	$ 534,103	$ 557,631	$ 540,181
Contributions as a Percentage of Covered-Employee Payroll	55.14%	45.23%	44.96%	43.24%	35.88%	30.33%	32.31%	31.67%	48.66%	22.60%

Notes to Schedule

Valuation Date	6/30/2012
Timing	Actuarially determined contributions are calculated based on the actuarial valuation one year prior to the beginning of the plan year

Key Methods and Assumptions Used to Determine Contribution (for the most recent fiscal year):

Actuarial cost method	Entry Age
Asset valuation method	Expected Value Method
Amortization method	Closed; Level % (Police), Level $ (non-Police)
Discount rate	7.50%
Amortization growth rate	3.75%
Salary increases	3.75% (following an assumed freeze in FY 2013 and 2014) plus merit component based on employee classification and years of service
Cost-of-living adjustments	2.00%
Mortality	Healthy retired members use the RP-2000 Combined Mortality Table (male and female). For Safety female members, rates are set forward one year.

A complete description of the methods and assumptions used to determine contribution rates for the year ending June 30, 2014 can be found in the June 30, 2012 actuarial valuation report

SECTION V
REQUIRED SUPPLEMENTARY INFORMATION

Table V-3 below shows the annual money-weighted rate of return, net of investment expense, for SDCERS-City of San Diego, as described by GASB 67.

As directed by SDCERS, we have calculated a single money-weighted rate of return, net of investment expense, for the entire system, instead of calculating the return separately for each of the three plan sponsors.

Table V-3
Schedule of Investment Returns

	2014	2013
Annual money-weighted rate of return, net of investment expense	16.84%	N/A

SECTION VI
EMPLOYER REPORTING AMOUNTS

The City of San Diego is not required to implement GASB 68 until their reporting date of June 30, 2015. However, the amounts reported as of June 30, 2015 can be based on either the June 30, 2014 or 2015 measurement dates. The schedules in this section are provided in the event the City either elects to implement GASB 68 early or elects to use the 2014 measurement date for its 2015 reporting.

The impact of experience gains or losses and assumption changes on the TPL are recognized in expense over the average expected remaining service life of all active and inactive members of the System. However, there were no experience gains or losses, and there were no assumption changes during the measurement year.

The impact of investment gains or losses is recognized over a period of five years. During the measurement year, there was an investment gain of approximately $536 million. Approximately $107 million of that gain was recognized in the current year and an identical amount will be recognized in each of the next four years, resulting in a deferred inflow of resources of approximately $428 million.

Table VI-1 below summarizes the current balances of collective deferred outflows and deferred inflows of resources along with the net recognition over the next five years.

Table VI-1
Schedule of Collective Deferred Inflows and Outflows

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 0	$ 0
Changes in assumptions	0	0
Net difference between projected and actual earnings on pension plan investments	0	428,429,550
Total	**$ 0**	**$ 428,429,550**

Amounts reported as deferred outflows and deferred inflows of resources will be recognized in pension expense as follows:

Year ended June 30:	
2015	(107,107,388)
2016	(107,107,388)
2017	(107,107,388)
2018	(107,107,386)
2019	0
Thereafter	$ 0

SECTION VI
EMPLOYER REPORTING AMOUNTS

The annual pension expense recognized by the City of San Diego can be calculated two different ways. First, it is the change in the amounts reported on the City's Statement of Net Position that relate to SDCERS and are not attributable to employer contributions. That is, it is the change in NPL plus the changes in deferred outflows and inflows plus employer contributions.

Alternatively, the annual pension expense can be calculated by its individual components. While GASB does not require or suggest the organization of the individual components shown in Table VI-2 below, we believe it helps to understand the level and volatility of pension expense.

Table VI-2
Calculation of Pension Expense

Change in Net Pension Liability	$	(624,831,797)
Change in Deferred Outflows		0
Change in Deferred Inflows		428,429,550
Employer Contributions		279,658,715
Pension Expense	**$**	**83,256,468**
Pension Expense as % of Payroll		**16.67%**
Operating Expenses		
Service cost	$	107,002,939
Employee contributions		(65,466,703)
Administrative expenses		10,466,941
Total	$	52,003,178
Financing Expenses		
Interest cost	$	537,875,335
Expected return on assets		(399,514,657)
Total	$	138,360,678
Changes		
Benefit changes	$	0
Recognition of assumption changes		0
Recognition of liability gains and losses		0
Recognition of investment gains and losses		(107,107,388)
Total	$	(107,107,388)
Pension Expense	**$**	**83,256,468**

First, there are components that we refer to as operating expenses. These are items directly attributable to the operation of the plan during the measurement year. Service cost less employee contributions represents the increase in employer-provided benefits attributable to the year, and administrative expenses are the cost of operating SDCERS-City of San Diego for the year.

SECTION VI
EMPLOYER REPORTING AMOUNTS

Second, there are the financing expenses: the interest on the Total Pension Liability less the expected return on assets. Since the discount rate is equal to the long-term expected return on assets, the financing expense is just the interest on the Net Pension Liability.

The final category is changes. This category will drive most of the volatility in pension expense from year to year. It includes any changes in benefits made during the year and the recognized amounts due to assumption changes, gains or losses on the TPL, and investment gains or losses.

APPENDIX
GLOSSARY OF TERMS

1. **Actuarially Determined Contribution**

   A target or recommended contribution for the reporting period, determined in conformity with Actuarial Standards of Practice based on the most recent measurement available when the contribution for the reporting period was adopted.

2. **Actuarial Valuation Date**

   The date as of which an actuarial valuation is performed. This date may be up to 24 months prior to the measurement date and up to 30 months prior to the employer's reporting date.

3. **Deferred Inflow of Resources**

   An acquisition of net assets by a government employer that is applicable to a future reporting period. In the context of GASB 68, these are experience gains on the Total Pension Liability, assumption changes reducing the Total Pension Liability, or investment gains that are recognized in future reporting periods.

4. **Deferred Outflow of Resources**

   A consumption of net assets by a government employer that is applicable to a future reporting period. In the context of GASB 68, these are experience losses on the Total Pension Liability, assumption changes increasing the Total Pension Liability, or investment losses that are recognized in future reporting periods.

5. **Entry Age Actuarial Cost Method**

   The actuarial cost method required for GASB 67 and 68 calculations. Under this method, the actuarial present value of the projected benefits of each individual included in an actuarial valuation is allocated on a level basis over the earnings of the individual between entry age and assumed exit ages. The portion of this actuarial present value allocated to a valuation year is called the Service Cost. The portion of this actuarial present value not provided for at a valuation date by the actuarial present value of future service costs is called the Total Pension Liability.

6. **Measurement Date**

   The date as of which the Total Pension Liability and Plan Fiduciary Net Position are measured. The Total Pension Liability may be projected from the Actuarial Valuation Date to the Measurement Date. The Measurement Date must be the same as the Reporting Date for the plan.

APPENDIX
GLOSSARY OF TERMS

7. **Net Pension Liability**

   The liability of employers and nonemployer contributing entities to employees for benefits provided through a defined benefit pension plan. It is calculated as the Total Pension Liability less the Plan Fiduciary Net Position.

8. **Plan Fiduciary Net Position**

   The fair or market value of assets.

9. **Reporting Date**

   The last day of the plan or employer's fiscal year.

10. **Service Cost**

    The portion of the actuarial present value of projected benefit payments that is attributed to the current period of employee service in conformity with the requirements of GASB 67 and 68. The Service Cost is the normal cost calculated under the entry age actuarial cost method.

11. **Single-employer Pension Plan**

    A plan which is used to provide pensions to the employees of only one employer.

12. **Total Pension Liability**

    The portion of the actuarial present value of projected benefit payments that is attributed to past periods of employee service in conformity with the requirements of GASB 67 and 68. The Total Pension Liability is the actuarial liability calculated under the entry age actuarial cost method.