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COUNCILMEMBER  
DONNA FRYE

David B. Wescoe  
Administrator/CEO

September 18, 2007

Councilmember Donna Frye  
The City of San Diego  
202 C Street, MS 10A  
San Diego, CA 92010

Subject: Your September 10, 2007 Memo concerning 415(b) limits

Dear Councilmember Frye:

Your September 10 memo asked me how the \$22.8 million reduction in the City's UAAL "due to the Preservation of Benefit Plan" was determined.

First of all, I want to clarify your question. The reduction in the City's UAAL was due to the removal of liabilities in excess of IRS 415(b) limits. The City Council established the Preservation of Benefit (POB) plan in 2001 to pay the City-promised benefits to its retirees that exceed the 415(b) limits, not to lower the City's UAAL.

The \$22.8 million reduction in the UAAL represents the present value of the expected actuarial liability for active members' future pensions in excess of 415(b) limits. The actuarial assumptions used to arrive at this amount are identified on pages 52-59 of Cheiron's June 30, 2006 Actuarial Valuation Report for the City (copies enclosed). These assumptions are applied to the number of active plan participants, their salaries and years of service to determinate an actuarially-developed projected liability.

As I stated in my July 24 letter to Kevin Smith, the reason we cannot identify individual active members' liabilities in excess of the 415(b) limits is because they are active employees. Therefore, they are not receiving any pension benefits and can not be in violation of any IRS benefit limits. Any excess liabilities are anticipated to occur in the future (after future pay increases, service credits, etc.) based on the long-term assumptions on the plan as stated in Cheiron's June 30, 2006 Actuarial Valuation.

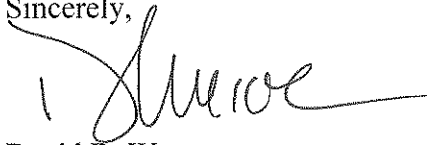
As for City retirees, my July 18 and July 24 letters to Kevin Smith accurately indicated that SDCERS did not know which retirees were in excess of 415 limits because the IRS had not given its necessary guidance on this matter. Cheiron has recently received that guidance and will be making those calculations for retired members in its June 30, 2007 Actuarial Valuation for the City.

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You should understand that whatever Cheiron's result, any increase in the City's POB Plan will be offset by an identical reduction in the City's UAAL, so the net impact for the City is zero.

If you have any additional questions, please let me know.

Sincerely,

A handwritten signature in black ink, appearing to read "D. Wescoe", with a long horizontal flourish extending to the right.

David B. Wescoe

Encl: pp. 52-59, SDCERS June 30, 2006 Actuarial Valuation for the City of San Diego

cc: Honorable Mayor Sanders  
Honorable Members of the City Council  
Jay Goldstone  
Andrea Tevlin  
Stanley Keller

**APPENDIX B  
ACTUARIAL ASSUMPTIONS AND METHODS**

**A. Actuarial Assumptions**

**1. Investment Return Assumption**

SDCERS assets are assumed to earn 8% net of expenses.

**2. Inflation Rate**

An inflation assumption of 4.25% compounded annually is used for projecting the total annual payroll growth for amortization of the UAL. It also represents the difference between the investment return rate and the assumed real rate of return.

**3. Interest Credited to Member Contributions**

8.0%, compounded annually.

**4. Salary Increase Rate**

Inflation component                      4.25%

The additional merit component:

<b>Years of Service at Valuation Date</b>	<b>General</b>	<b>Safety</b>
0	4.50%	7.50%
1	3.50%	6.50%
2	2.50%	5.50%
3	1.50%	3.00%
4	0.50%	1.50%
5+	0.50%	0.50%

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**5. Cost-of-Living Increase in Benefits**

Assumed to be 2% per annum, compounded annually.

There is a closed group of 81 Special Safety Officers for whom we assume an annual adjustment equal to inflation (4.25% per year.)

**6. COLA Annuity Benefit**

For active members, there is a 2.5% load on valued benefits to anticipate the impact of the annuitized employee COLA contributions at retirement.

**7. Member Refunds**

All or part of the employee contribution rate is subject to potential "pick up" by the employer. That "pick up" and the related accumulated interest are not to be refunded to employees at termination. The liability for potential refunds is reduced to reflect this.

**8. Rates of Termination**

<b>Service</b>	<b>Age</b>	<b>General</b>	<b>Safety</b>
0	All	5.63%	2.20%
1	All	5.53	2.20
2	All	4.33	2.15
3	All	4.33	2.05
4	All	4.24	2.00
5 & Over	20	4.62	2.12
	25	4.62	2.12
	30	3.13	1.48
	35	2.32	0.93
	40	1.60	0.39
	45	1.34	0.20
	50	1.03	0.07
	55	0.77	0.03
	60	0.00	0.00

20% of terminating employees, with 10+ years of service at termination, are assumed to subsequently work for a reciprocal employer and receive 4.75% pay increases per year.

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**9. Rates of Disability**

<b>Age</b>	<b>General</b>	<b>Safety</b>
20	0.06%	0.54%
25	0.08	0.60
30	0.10	0.65
35	0.16	0.71
40	0.22	0.90
45	0.33	1.15
50	0.50	1.25
55	0.75	1.50
60	0.97	--

70% of the general disabilities and 85% of the safety disabilities are assumed to be industrial disability retirements. Non-industrial disability retirement is subject to a service requirement.

**10. Rates of Mortality for Active Lives**

General members follow the Uninsured Pensioner 1994 (UP1994) set back 5 years (male and female). Set back 5 years is when a member currently age 50 uses the age 45 mortality rate. Safety members follow the Male UP 1994 set back 5 years.

<b>Age</b>	<b>General</b>		<b>Safety</b>
	<b>Male</b>	<b>Female</b>	
20	0.04%	0.02%	0.04%
25	0.05	0.03	0.05
30	0.07	0.03	0.07
35	0.09	0.04	0.09
40	0.09	0.05	0.09
45	0.12	0.08	0.12
50	0.17	0.10	0.17
55	0.28	0.15	0.28
60	0.48	0.25	0.48
65	0.86	0.48	0.86
70	1.56	0.93	1.56

All active member deaths are assumed to be duty-related for safety members and not duty-related for other members.

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**11. Rates of Mortality for Retired Healthy Lives**

All retired healthy members use the Uninsured Pensioner 1994 (UP1994) table set back 2 years (male and female).

<b>Age</b>	<b>Male</b>	<b>Female</b>
40	0.10%	0.06%
45	0.15	0.09
50	0.23	0.13
55	0.39	0.21
60	0.68	0.36
65	1.23	0.72
70	2.14	1.26
75	3.35	1.97
80	5.40	3.41
85	8.87	5.90
90	13.65	10.09

**12. Rates of Mortality for Retired Disabled Lives**

Disabled General members use Uninsured Pensioner 1994 (UP1994) male only table set forward five years. Disabled Safety members use Uninsured Pensioner 1994 (UP1994) male only table set forward two years.

<b>Age</b>	<b>General</b>	<b>Safety</b>
20	0.07%	0.06%
25	0.09	0.08
30	0.09	0.09
35	0.12	0.10
40	0.17	0.13
45	0.28	0.20
50	0.48	0.35
55	0.86	0.60
60	1.56	1.09
65	2.55	1.94
70	4.00	3.06

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13. Rates of Retirement

Age	General	Elected Officials	Safety
50	--	--	10%
51	--	--	10
52	--	--	10
53	--	15%	10
54	--	1	20
55	20%	5	40
56	10	3	40
57	10	4	40
58	15	5	50
59	15	6	80
60	20	60	85
61	25	25	90
62	50	37	100
63	40	23	100
64	25	34	100
65	50	68	100
66	40	69	100
67	40	74	100
68	40	80	100
69	40	90	100
70	100	100	100

In addition, if a Safety member has both attained age 55 and completed at least 30 years of service, 100% retirement is assumed.

For vested deferred members, we assume that retirement will occur provided they have at least 10 years of service (4 years for Elected Officers) on the later of attained age or:

*General Members:* Earlier of age 62 or age 55 and 20+ years of service.

*Elected Officers:* Earlier at age 55 or age 53 and 8+ years of service.

*Safety Members:* Earlier of age 55 or age 50 and 20+ years of service.

If the inactive member is not vested, the liability is the member's contributions with interest.

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**14. Family Composite Assumptions**

80% of men and 50% of women were assumed married at retirement. Female spouse is assumed to be 4 years younger than the male spouse.

**15. Member Contributions for Spousal Continuance**

All active members contribute towards a 50% survivor continuance. However, members who are unmarried at retirement may either be refunded that specific part of their contributions, or they may leave such contributions on account and receive an incremental benefit that is the actuarial equivalent of such contributions.

**16. Deferred Member Benefit**

For the Deferred Vested and Non-Vested participants, the benefit was estimated based on information provided by SDCERS staff. The data used to value the estimated deferred benefit were date of birth, date of hire, date of termination, and last pay. Based on the data provided, service credit, highest average salary, and deferred retirement age were estimated. The estimates were used to compute the retirement benefit, upon which the liabilities are based. For those members without sufficient data or service, accumulated member contribution balances, with interest, were used as the actuarial accrued liability.

**17. Other**

The contribution requirements and benefit values of a plan are calculated by applying actuarial assumptions to the benefit provisions and member information, using the actuarial cost methods described in the following section.

Actual experience of SDCERS will not coincide exactly with assumed experiences, regardless of the choice of the assumptions, the skill of the actuary and the precision of the many calculations made. Each valuation provides a complete recalculation of assumed future experience and takes into account all past differences between assumed and actual experience. The result is a continual series of adjustments to the computed contribution rate. From time to time it becomes appropriate to modify one or more of the assumptions, to reflect experience trends, but not random year-to-year fluctuations.



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**B. Actuarial Methods**

**1. Funding Method**

The Projected Unit Credit Method is used to determine costs. Under this funding method, a total contribution rate is determined which consists of two elements: the normal cost rate and the unfunded actuarial liability (UAL) rate.

The normal cost is the present value of the amount of benefits allocated to the participant during the year. This amount is the increase in all participants' accumulated plan benefit during the year. For the City of San Diego, the normal cost rate is determined by taking the sum of the normal cost for all participants divided by the total annual payroll and subtracting that expected member contributions.

In addition to contributions required to meet a plan's normal cost, contributions are required to fund a system's unfunded actuarial liability. The actuarial liability is defined as the total of the cumulative benefit allocated to each participant on the date of the valuation. The unfunded actuarial liability is the actuarial liability for all members less the actuarial value of a system's assets.

The unfunded actuarial liability is amortized by annual payments. The payments are determined so that they will be a level percentage of pay, assuming payroll increases 4.25% per year. The UAL measured as of June 30, 2006 is amortized over a 27-year period as mandated by the Gleason judgment.

**2. Asset Valuation Method**

For the purposes of determining the City of San Diego's contribution to SDCERS, we use an actuarial value of assets. The asset adjustment method dampens the volatility in asset values that could occur because of the 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 is a weighted average giving 25% weight to the current market value and 75% weight to the prior year's actuarial value increased by expected interest and contributions and decreased by benefit payments and expenses. This is mathematically equivalent to recognizing 100% of the actuarially assumed interest rate, plus contribution, less payment each year and 25% of the portion of each year's returns that have not already been reflected in asset values. This method will start in the June 30, 2007 valuation. The actuarial value of assets for the June 30, 2006 valuation is determined to be the market value as of June 30, 2006.

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**3. Changes Since Last Valuation**

As was stated several times in this Report, there have been a number of changes in actuarial methods and procedures since the June 30, 2005 actuarial valuation:

- A move from a “book value based” asset smoothing method to the “expected asset value” smoothing method. For June 30, 2006, the actuarial value of assets was set to market value (see Section II).
- The asset apportionment method between SDCERS’ three plan sponsors, (City of San Diego, Unified Port District, and San Diego County Regional Airport Authority) was changed from an allocation method based on various approximations, to one that will directly reflect as of June 30, 2005 and forward, the actual cash flows attributable to each plan sponsor since June 30, 2005.
- All “contingent” liabilities (Corbett pre-July 1, 2000 retirees and the 13<sup>th</sup> check) are now reflected in the June 30, 2006 valuation liabilities.
- SDCERS assets and liabilities as of June 30, 2006 now reflect both the future liabilities for DROP retirements and supplemental COLA as well as the asset reserves held for such liabilities. Previously, both amounts were excluded from SDCERS reported assets and liabilities.
- All future benefits payable from the SDCERS Trust Fund are capped at the maximum benefit level allowable under Internal Revenue Service Code Section 415.
- Benefits and resulting liabilities for current and future disabled participants have been reduced to reflect the legal decision that the Corbett judgment and plan document do not authorize a 10% increase to non-service eligible disability retirees.
- Minor adjustments in the allocation of liabilities amongst the three plan sponsors were made to ensure that when participants have service with more than one contributing employer the resulting liability allocation is equitably determined.