

## **SDCERS NAVIGANT REPORT COMMITTEE/STAKEHOLDER MEETING**

July 12, 2006 - Meeting Notes by Virginia Silverman

### **INTRODUCTION/PRELIMINARY**

Committee members in attendance: Mark Sullivan (Chair), Richard Kippeprman, Thomas Hebrank, William Sheffler, Wayne Kennedy, and Peter Preovolos (SDCERS Board President).

The Stakeholder representative in attendance was Virginia Silverman, representing CSDREA. Also in attendance was a representative from Council President Scott Peters' office.

Chairman Mark Sullivan introduced the discussion topic - Actuarial Practices - by commenting that the single most important concept for adequate funding of the pension plan is actuarial soundness. He said that the Navigant consultants had found problems with existing actuarial practices and made recommendations for change. He introduced Steve Stanton from Navigant Consulting, Inc. to present the history and overview of SDCERS' actuarial practices.

### **HISTORICAL REVIEW OF ACTUARIAL PRACTICES: NAVIGANT CONSULTING, INC.**

Steve Stanton of Navigant Consulting, Inc. gave a brief overview of Navigant Consulting findings, and presented concepts and sources of actuarial soundness, including; review of relevant laws (state, local and federal); actuarial principles, factors impacting actuarial soundness, and the responsibility of the SDCERS Board to ensure actuarial soundness.

#### **Findings by Navigant Consulting (and Reish Luftman) on City and SDCERS actuarial practices.**

- 1) The City sought to reduce its contributions to SDCERS at least since 1991, and has contributed less than the Actuarial Required Contribution (ARC) since at least 1996.
- 2) The City and SDCERS have relied upon Surplus Undistributed Earnings (the 'Waterfall') to pay certain contingent benefits, including Corbett and 13th Check, and also administrative expenses.
- 3) Actuarial valuations have excluded benefits granted to retirees related to the Corbett Settlement.
- 4) MP1 and MP2 failed to assure the integrity of Retirement System assets, caused the plan to be underfunded, and violated the City charter and other applicable laws.
- 5) Any existing underfunding not corrected by the Gleason settlement requires the SDCERS Board to consult with its actuary and legal counsel on how the liability will be satisfied.

#### **Concepts and Sources of Actuarial Soundness**

- 1) Actuarial Soundness applies to both annual contributions and the funded status of the pension plan. State and City laws emphasize the level of contributions rather than the funded status.
- 2) The actuary calculates annually the Annual Required Contribution (ARC) necessary to fund benefits earned by participants during their working careers. The actuary also reports on the funded ratio/status of the pension fund at the end of each fiscal year.

- 3) The SDCERS Board relies on the actuary to determine actuarial assumptions and methods, but has the responsibility to understand and approve (or reject) those assumptions and methods.
- 4) Actuarial soundness is defined, regulated and monitored by various sources, including: State, City and Federal laws; Actuarial principles and standards of practice; Accounting pronouncements (e.g. Government Accounting Standards Board/ GASB) and municipal rating agencies.
- 5) One definition of actuarial soundness is: "The financial objective of the pension plan shall be to establish and receive contributions which will remain approximately level from year to year and will not have to be increased for future generations of citizens. This objective is achieved when contributions received each year by the pension fund are sufficient both, (1) to fully cover the cost of benefit commitments being made to employees for their service being rendered in such year and (2) to make a level payment which, if paid annually over a reasonable period of future years, will fully cover the unfunded cost of benefit commitments for service previously rendered."

### **State, Local and Federal Laws**

1) California Constitution:

"The retirement board of a public pension or retirement system...shall have the sole and exclusive power to provide for actuarial services..."

2) California Government Code:

"Any pension or retirement system adopted shall be on a sound actuarial basis and provide contributions by both city and the employee members of the system.

"Contributions shall be in amounts which will accumulate... a fund sufficient to carry out the promise to pay benefits to the individual on account of his service as a member of the system..."

"All state and local public retirement systems shall, not less than triennially, secure the services of an enrolled actuary....."

3) San Diego City Charter:

"The City shall contribute an amount substantially equal to that required of the employees for normal retirement allowances, as certified by the actuary...."

4) San Diego Municipal Code:

"The Board may employ an actuary as needed. Each year...the Board will employ an Actuary to make a valuation of the system's assets and liabilities. At least once every five years, the Board will employ an Actuary to conduct a thorough investigation of the mortality, service and compensation experience of Members....along with an actuarial valuation of the systems' assets and liabilities...the Board will also determine the assumed rate of interest earnings for the Retirement Fund."

"The City shall contribute to the Retirement Fund a percentage of compensation earnable as determined by the System's Actuary pursuant to the annual actuarial valuation."

5) Court Precedents:

California courts have ruled that employees in a public retirement system have the right to an actuarially sound system.

## **Actuarial Principles**

- 1) Actuarial soundness is not specifically defined because it varies, depending on the facts and circumstances of each actuarial system. There is no bright line of what constitutes actuarially sound funded status.
- 2) For public plans the actuary calculates the Annual Required Contribution (ARC) which includes amortization (payment) of the unfunded actuarial liability (UAL). The UAL takes into consideration actual activity such as investment earnings, benefit payments, and employee turnover, to determine if assumptions deviate from actual assets and liabilities.

## **Accounting Pronouncements - Governmental Accounting Standards Board (GASB)**

- 1) GASB sets rule to establish the minimum Annual Required Contribution (ARC) for public plans, and requires that public plans report the ARC. GASB also requires that public plans report any time the actual contribution is less than the ARC.
- 2) Generally, the ARC cannot be less than the total of the normal cost, plus the annual payment to fund the unfunded accrued liability (UAL) over no more than 30 years.
- 3) GASB Statement NO. 25 sets out specific guidelines for public sector defined pension plans -- a set of parameters for a pension plan's funding methodology:
  - a. the actuarial valuation should occur annually;
  - b. the actuarial valuation should include all benefits covered by the plan.
  - c. the actuarial assumptions selected should be in conformance with the standards established by the Actuarial Standards Board;
  - d. The actuarial cost method should be one of the six methods listed in GASB No. 25.
  - e. The actuarial valuation of assets and the investment return assumptions should be based upon the market values of the plan assets and long term investment experience; and
  - f. The ARC should include the normal cost and a provision for amortizing the UAAL.

## **Retirement Board's Responsibility**

- 1) Public Employees have contractual rights to promised pension benefits and an actuarially sound retirement system. The Board has a fiduciary responsibility to ensure that these contractual obligations are met.
- 2) Under the San Diego Municipal Code, the SDCERS Board has an obligation to:
  - a. Employ an actuary to perform an ARC
  - b. Perform an investigation of the mortality, service and compensation experience atleast once every five years
  - c. Determine the assumed rate of return (currently 8%);
  - d. Adopt changes in actuarial assumptions;
  - e. Revise member contribution rates as it deems necessary; and
  - f. Ensure that the City contributes the percentage of compensation as determined by the actuarial valuation.
- 3) The Board also has a responsibility to monitor actuarial gains and losses and their impact, the current financial status of SDCERS and projected financial trends in the actuarial valuation. For effective monitoring, the Board should pose questions to the actuary, such as:
  - a. The reasons for the gains and losses and their impact on future contributions;
  - b. The continuing appropriateness of the actuarial assumptions -- should they be changed?

- c. Is the data reliable (particularly regarding any identified problems or uncertainties)?
- d. Projected contributions and reasons for any anticipated changes from current levels.
- e. Any actuarial 'qualifications' such as the fact that not all benefits are being considered in the valuation (such as Corbett payments to retirees).

4) The Board should perform experience studies every three years and any findings or recommendations that deviate from actual experience should be discussed with the actuary.

5) The Board should consider continuing to have actuarial audits performed every five years, and to seek advice from an independent actuary and independent experts as circumstances dictate.

## **SDCERS ACTUARY (CHEIRON) - DISCUSSION OF ACTUARIAL ISSUES AND RESPONSE TO NAVIGANT FINDINGS**

### **Cheiron Response to Navigant Recommendations**

Gene Kalwarski of Cheiron, Inc. - the current SDCERS actuary - participated by phone in a question and answer discussion on the six recommendations on actuarial issues in the Navigant Report. He expressed full agreement with all six Navigant Report recommendations, which include

- 1) The SDCERS Board should work with the actuary to determine a reasonable definition of 'actuarial soundness,' and set a schedule for periodic assessment of actuarial soundness.
- 2) This actuarial report should also provide for projected assets, liabilities and contributions based on assumptions then in use by SDCERS. (Already included in Cheiron's June 30, 2005 report.)
- 3) The actuarial report should include any benefit increases which have been granted and become effective during the five year period.
- 4) The Board rules should be amended to require that the actuary deliver the report and comment on his conclusions in open sessions. (Cheiron presented the June 30, 2005 report in open session May, 2006.)
- 5) The SDCERS Board should render a formal billing to the City after the annual valuation, for the amount of the Annual Required Contribution (ARC). (Cheiron agrees but suggests that the billing occur no later than 30 days after the Board certifies the actuarial valuation).
- 6) The current practice of using 'reserves' to cover benefits and/or employer/employee contributions should be eliminated. (Cheiron has already advised the SDCERS Board and the City Council to discontinue this practice.)

### **Cheiron - Next Steps and Recommendations**

#### **Next Steps for Cheiron**

- 1) Complete studies related to the eight Cheiron recommendations (see below) made following completion of the June 30 2005 Actuarial Valuation.
- 2) Work with SDCERS to develop a funding policy that ensures actuarial soundness.
- 3) Fully implement changes related to all the above by the end of the current year; (June 30, 2007 - date when Gleason settlement expires.)

## Cheiron's Recommendations

### Recommendations 1, 2 - Change Asset Methods

- . Asset Smoothing
- . Asset Apportionment Among Employers  
(Consistent with prudent actuarial practices)

### Recommendations 3,4,5 - Properly Reflect Plan Liabilities

- . Corbett Disability Benefits
- . Benefits in excess of IRC Section 415
- . Contingent Benefits  
(Consistent with Navigant recommendation #3)

### Recommendation 6 - Stop using Surplus Undistributed Earnings

(Consistent with Navigant recommendation #6)

### Recommendations 7, 8 - Study Revised Approach to Funding

- . Entry Age Normal vs. Planned United Credit
- . Options to amortize the UAL  
(Consistent with prudent actuarial practices and the still-to-be-developed funding policy)

## QUESTIONS AND COMMENTS

Question: Sullivan - If there is a salary freeze, as the Mayor proposes, is the SDCERS Board required to act upon or include that factor in the Annual Actuarial Valuation? Answer: (Stanton) If the Board believes wages will be frozen, then modify the AAV. The future can't be ignored, however most actuarial work is based on the past.

Question: Sheffler - It's not possible to make assumptions on the future? A. (Stanton?) shouldn't flip flop back and forth.

Question: Hebrank - Is the Waterfall outside the plan (that is his understanding).

Comment: Prevolos - The Board should contact the Plan Sponsor (City) when the Plan Sponsor takes some action detrimental to the plan (e.g., benefit increases without proposal to pay for them.) There is a lack of understanding of the Board's obligation to caution or warn the Plan Sponsor of unwise actions.

Question: Sheffler - Re: Navigant Recommendation #5, billing by SDCERS to City by January 31. That date is significantly earlier than valuations in the past. Is that date achievable?

Comment: Sheffler - Anything done in drafting the policy on actuarial soundness should be done in open meeting, or the Board could be subject to litigation.

Comment: Kennedy - Re: Annual Actuarial Valuation, the Board needs time to review the report before the meeting. The last time it was distributed to the Board only on the morning of the meeting.

Comment: April Boling (Chair of the Pension Reform Committee):

Ms. Boling said she recognized that drafting a policy in public session can be difficult, but that it was done by the Pension Reform Committee, always in open session.

Boling said that regarding a 'bill' to the City; that the bill should not be expressed as a total dollar amount, but as a percentage/rate per pensionable hour. Further, she said there needs to be a way to determine if the City has actually paid the full amount.

(Gene Kalwarski responded that there will be an evaluation of the actual City contributions vs. the 'Bill.' He also said that it could be wrong on the other side, that the City might pay more than required.) Both Boling and Kalwarski agreed that the numbers could be 'gamed' and Kalwarski said that was the reason he used a specific number rather than a percentage.

Comments: Roxanne Story Parks (SDCERS Interim Counsel).

Roxanne said that some benefits were adopted by resolution, rather than ordinance, and are not officially in the plan because there were not adopted by ordinance. She cited as an example, the meet and confer agreement that persons hired after July 1, 2005 may not purchase service credit. However it is not in an ordinance as yet.

She said that SDCERS will only administer benefits adopted by ordinance and in the Muni Code. In addition, she is requesting the City to notify SDCERS 45 days in advance of any proposed new ordinances dealing with the pension plan.

Comment: Prevolos - He suggested a SDCERS representative sit in on meet and confer negotiations as an observer, so SDCERS will know what is going on. (Others did not agree to this suggestion.)

## **APPROVAL OF ACTIONS/NEXT MEETING**

### **Proposed Actions Requested (by SDCERS Staff)**

- 1) Discussion of actuarial study areas and development of a policy to ensure sound actuarial funding. Postponed to next meeting.
- 2) Recommend approval of resolution requiring all changes to City Retirement benefits be adopted by ordinance and that SDCERS be officially notified prior to the docketing of any proposed ordinance. Approved 6-0
- 3) Recommend approval of change to Board Rule 1.41 requiring actuary to deliver annual valuation reports to Board in Open Session. Approved 6-0
- 4) Recommend approval of change to Board Rule 1.44 requiring SDCERS to render formal billing to each plan sponsor annually, following delivery of the actuarial valuation report. Approved 6-0.
- 5) Recommend to City Council changes to Municipal Code Article 4 Division 15: investment earnings, supplemental benefits and adjustments (the Waterfall). Continued to next meeting.

### **Comments from Stakeholders**

Virginia Silverman spoke in support of having discussion of actuarial policy in open meetings.

### **Next Meeting**

The next Navigant Committee meeting will be on Wednesday, August 17, 2006 at 1:00 p.m.

