DEFINED BENEFIT PLAN
2% @ 62

LOS ANGELES CITY EMPLOYEES'
RETIREMENT SYSTEM

Proposed New Tiers of Benefit for New Entrants
(Pension Plan and Retiree Medical Plan)

SEGAL

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October 14, 2010

Mr. Thomas Simonovski
Senior Labor Relations Specialist
City of Los Angeles
200 N. Main Street, Room 1200
City Hall East
Los Angeles, CA 90012-4190

Dear Thomas:

We are pleased to submit our study of a proposed benefit for new members of the Los Angeles City Employees' Retirement System (LACERS).

As the proposed tier would only be offered to new employees, for which actual data is not available, we have assumed in this valuation that their demographic profiles (e.g., entry age, composition of male versus female, etc.) can be approximated by the data profile of current active members hired in the three years prior to the most recent valuation as of June 30, 2009. No current inactive vested members, retirees or beneficiaries have been included in this valuation. With the exception of the service retirement assumptions and the Entry Age Normal funding method recently adopted by the Board of Retirement for new tier of benefit, this study uses the same actuarial assumptions and methodologies adopted by the Board for use in the June 30, 2009 valuation. A brief description of the methodology used to select the service retirement assumptions for the proposed new tier is provided in Section 1.

The actuarial calculations were completed under the supervision of Andy Yeung, ASA, MAAA, Enrolled Actuary and Patrick Twomey, ASA, MAAA, Enrolled Actuary. Both are Members of the American Academy of Actuaries and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion herein.

Sincerely,

THE SEGAL COMPANY

By:

Paul Angelo, FSA, MAAA, EA	*Andy Yeung, ASA, MAAA, EA*
Senior Vice President and Actuary	*Vice President and Associate Actuary*

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SECTION 1

REVIEW SUMMARY

SECTION 2

VALUATION RESULTS

SECTION 3

SUPPORTING EXHIBITS

CONTRIBUTION RECOMMENDATIONS

- To estimate the potential cost impact, this study assumes that the demographic profiles of the members entering the new tier would be comparable to current active members hired in the three years prior to the June 30, 2009 actuarial valuation. For comparison purposes only, we have calculated the employer Normal Cost contribution rates for the pension and the health plans and the employee Normal Cost contribution rates (i.e., fixed rate of 6.0% to the pension plan for employees hired on or after January 1, 1983 and 0.0% for the health plan) for members hired in the three years prior to the June 30, 2009 actuarial valuation, under the current benefit formulas and compared these rates with the employer Normal Cost contribution rates and the aggregate employee Normal Cost contribution rates under the proposed tier of benefit.

  We are in the process of preparing the June 30, 2010 valuation that would establish the employer and the employee contribution rates for the 2011/2012 fiscal year. We will be reflecting the current ERIP Ordinance to show a higher employee contribution rate in that valuation. Please refer to "Benefit Provisions" in Section 1 of this report for a more detailed discussion of that change.

- We have shown the employer Normal Cost rates for the pension and health plans under the proposed tier in Section 2B of this report. If the proposed tier is adopted by the City, we assume that the LACERS Board of Retirement would be requested to adopt a tier-specific employer Normal Cost rate for each of the current and the new tiers of benefit for the pension and health plans. This means that the aggregate employer Normal Cost rates for the pension and health plans would gradually decline as a higher proportion of the total future active employee payroll would be subject to the lower employer Normal Cost rates required for the new tier of benefit.

- In addition to the employer Normal Cost rates provided in Section 2B, it is anticipated that the employer would have to continue to contribute the same Unfunded Actuarial Accrued Liability (UAAL) rates of 8.19% and 2.53% of <u>total</u> payroll for the pension and health plans, respectively, determined in the June 30, 2009 valuation assuming contributions made at the beginning of the fiscal year. This is because the UAAL rates were determined as a level percent of pay including payrolls for all current members plus new entrants who entered LACERS after June 30, 2009.

ASSUMPTIONS AND METHODOLOGIES

- Most of the actuarial assumptions used in this study are the same as those adopted by the Retirement Board for use in the June 30, 2009 valuation. Under the current formula, the retirement rates (probabilities) are structured to anticipate lower incidences of retirement for members who have not yet attained age 55 with 30 years of service and who can only retire with a reduced early pension benefit while using relatively higher retirement rates for members after they attain age 55 with 30 years of service since they can receive an unreduced pension benefit.

  Under the current pension formula, normal retirement age to receive an unreduced retirement benefit is based on attaining the minimum of: (1) age 55 with 30 years of service, (2) age 60 with 10 years of service or (3) age 70. A subsidized early retirement benefit is paid for those members attaining age 55 with 10 years of service or any age (under 55) with 30 years of service. The reduction is 1.5% for each year of retirement between 55 and 60 and 3.0% for each year of retirement before age 55.

- Under the proposed tier, normal retirement age to receive an unreduced retirement benefit is age 62 with 10 years of service. While a member can still retire at age 55 with 10 years of service, this benefit is fully reduced to reflect the additional cost of the early retirement benefit. This is calculated using a set of simplified actuarial equivalent assumptions which amounts to a reduction of 6.0% for each year of retirement before age 62.

  We have lowered the retirement rates before age 62 to reflect both the lowering of the retirement benefit from 2.16% per year of service to 2.00% per year of service and the higher early retirement reduction factors that would apply under the proposed tier. Also, in the June 30, 2009 valuation, separate sets of retirement assumptions would apply before and after members attain eligibility for unreduced benefits upon attaining age 55 with 30 years of service. For the proposed tier, we have retained the current structure of having two sets of retirement assumptions; however, the higher retirement assumptions are now applied only to members after they attain the maximum retirement benefit of 75% of salary upon attaining age 62 with about 38 years of service. The detailed retirement rates are provided in Section 3, Exhibit I.

- The funding method used by the Board of Retirement for the current benefit formula is called the Projected Unit Credit (PUC) method. Under the PUC method, the City's Normal Cost rates for the current tier would be about the same from one annual actuarial valuation to the next provided that the average attained age of the active employee population remains relatively stable between valuations. As new employees enter the proposed tier, the average attained age of the remaining active employees in the current tier will increase. This will result in a gradual increase in the City's Normal Cost rates for the current tier even though there is no change in the benefit for the current tier. As the increase in the City's Normal Cost rates for the current tier is more closely related to the PUC funding method than to the proposed tier of benefit, we have not analyzed such cost impact for the current tier in this report.

The Board of Retirement has recently approved the Entry Age Normal (EAN) method for use in setting the contribution rates for any new tier of benefit. Under the EAN method, the Normal Cost rates for an individual employee is expected to stay level as a percent of payroll throughout that employee’s career.

When the City compares the cost of the current tier with the proposed tier, the same discussion provided above regarding the change in the City’s Normal Cost rates under the PUC funding method for all the active members covered under the current tier may have to be taken into consideration. In order to provide the City with an “apples-to-apples” comparison of the cost under the current and the proposed tiers, we have also calculated the City’s Normal Cost for the current tier under the EAN method.

The Normal Cost rates for new entrants (with an average age of 36 based on members hired during the last three years) under the current tier calculated using both the PUC and the EAN methods and under the proposed tier calculated using only the EAN method are provided in Section 2B.

BENEFIT PROVISIONS

- A comparison of the major benefit provisions under the current and the proposed tiers is provided in Section 3, Exhibit I.
- Under the current tier, pension benefits are calculated based on the highest average salary earned during any 12-month period and salary would include base salary plus regularly assigned bonuses or premium pay. Under the proposed tier, pension benefits would be calculated based on the average salary earned during the last 36-month period and salary would include only base salary, excluding assigned bonuses or premium pay.

  We have not been provided with the data to analyze the relationship between the base salary and the regularly assigned bonuses or premium pay used in the June 30, 2009 valuation. However, information was previously provided by the City for use in analyzing that relationship for the data used in the June 30, 2008 valuation. As agreed to by the City, we have continued to use the relationship observed in the June 30, 2008 valuation data in this current study. Based on our earlier analysis, it is assumed in this study that there would be a 2% difference between the base salary and the total of the base salary plus the assigned bonuses or premium pay.

  Under the current tier, the base salary plus the assigned bonuses or premium pay are used in developing both the benefit liability and the salary base for setting the City and the employee contribution rates. For the proposed tier, we have used only the base salary in developing the benefit liability. For comparison purposes, we have calculated a set of contribution rates assuming contributions would continue to be made on the base salary plus the assigned bonuses or premium pay. This allows a consistent comparison with the contribution rates developed for the current plan.

  However, we are assuming that in practice, if the proposed tier is adopted, the City and the employee would be assessed contributions based on the base salary and no contributions would be assessed for the assigned bonuses or premium pay. The contribution rates developed using this assumption are also provided in Section 2B of this report.
- Under the current pension formula, normal retirement age to receive an unreduced retirement benefit is based on attaining the minimum of: (1) age 55 with 30 years of service, (2) age 60 with 10 years of service or (3) age 70. A subsidized early retirement benefit is paid for those members attaining age 55 with 10 years of service or any age with 30 years of service. The reduction is 1.5% for each year of retirement between 55 and 60 and 3.0% for each year of retirement before age 55.

  Under the proposed tier, normal retirement age to receive an unreduced retirement benefit is age 62 with 10 years of service. While a member can still retire at age 55 with 10 years of service, this benefit is fully reduced to reflect the additional cost of the early retirement benefit. This is calculated using a set of simplified actuarial equivalent assumptions which amounts to a reduction of 6.0% for each year of retirement before age 62.

- In the June 30, 2009 valuation, employees hired on or after January 1, 1983 under the current tier pay a fixed rate of 6.0% of payroll to fund part of the Normal Cost contribution rates for the pension plan but do not participate in the payment of any Normal Cost for the health plan. The employees also do not pay any of the cost to amortize the UAAL for the pension and the health plans.

  According to the current Early Retirement Incentive Program (ERIP) Ordinance, that 6.0% Normal Cost rate paid by the employee will increase to 7% in the June 30, 2010 valuation. According to that Ordinance, the employee rate for active members (including new hires under the current tier) is scheduled to increase to 7% beginning July 1, 2011 and ending June 30, 2026 (a 15-year period), or until the “ERIP Cost Obligation” is fully paid, whichever comes first. Since the contribution rate shown under the current tier is based on the results from the June 30, 2009 valuation (which established the contribution rate for the 2010/2011 fiscal year), we have not included the additional 1% member contribution discussed above.

GOVERNMENT SERVICE BUYBACK PROGRAM

- Besides the pension and the health benefits payable at retirement, the proposed tier also includes a modification to the amount required for a member to purchase service under the Government Service Buyback (GSB) Program.

  Under the current GSB program, a member can purchase service for periods of uncompensated maternity leave or service credit previously earned at another governmental agency by either (a) transferring the accumulated contributions currently on deposit at the other employer or (b) paying an amount equal to the member’s contribution rate at LACERS (i.e., 6.0% to the pension plan for employees hired on or after January 1, 1983) times the current annual salary. Under the proposed tier of benefit, the purchase price would be set so that it would be cost neutral to the plan.

- In general, there would be a cost to the City associated with the current GSB program because the contributions paid by the employee would not include the employer’s component of the total Normal Cost required to pay for such service credit. If an employee purchases service through a transfer from any governmental agency plan, the residual cost to the City is dependent on the amount of employee contributions that were previously paid plus the interest credited to the employee account by the other plan.

  In practice, the cost to the City may be offset somewhat to the extent that other terminated employees who are vested withdraw their contributions at LACERS to have their benefits paid by another governmental agency plan.

- Besides the pension plan, there may also be a cost to the health plan unless the member has already accrued the prerequisite current 25 or 20 years of service to receive 100% of the health subsidy before and after age 65 excluding GSB service purchase.

- In determining the employer contribution rate in the ongoing actuarial valuation, there is no explicit assumption to anticipate any future GSB purchases meaning that the costs of future GSB purchases are not prefunded but rather reflected as actuarial losses and amortized as part of the cost for the UAAL after the GSB purchases were made.

  Therefore, any changes in the GSB program would not result in any immediate cost savings but it should result in a reduction in the amount of future actuarial losses and the associated UAAL rate increases.

- In order to provide the City with an order-of-magnitude impact on the future UAAL rate, the City has provided us with the data for those members who have purchased service through the GSB program from August 1989 to 2009. As there were significantly higher number of purchases made immediately after the implementation of the program at around 1989, we have limited our review to only those purchases that took place during January 1, 2004 to March 31, 2009 (the latest date GSB purchases were included in the report prepared by the City for a previous cost study prepared as of June 30, 2008). There were 1,049 purchases made during the period of about 5¼ years. Of those purchases, only 711 members were still reported as active members in the June 30, 2008 valuation.

- As we do not have the necessary data to estimate the cost to the City for the GSB for those members who have already retired, we have only studied the cost for those members who were still active as of the June 30, 2008 valuation[1]. Also note that the cost to the City for the GSB may tend to increase as members defer their decision to purchase GSB towards retirement because of adverse selection.

  The cost to the City to provide for the GSB purchases is provided in Section 2, Exhibit C. The City should be aware that this annual cost is only the current year UAAL rate increase from one year of GSB purchases, even though the actuarial losses from those GSB purchases are amortized and paid over a period of 15 years.

  On the other hand, the above cost is based on the average number of purchases made by all active members and not just by those hired during the last three years (as we have assumed in preparing the other costs of this study). Therefore, the annual reduction in cost to the UAAL may be overstated in the short term since only new entrants hired into the proposed tier would be affected by the new GSB rules.

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[1] *While we have continued to use the results of an earlier analysis of the GSB prepared as of June 30, 2008 to prepare this report, we do not anticipate that updating the results to June 30, 2009 (used in the rest of this report) would lead to a significantly different conclusion.*

- There is an additional requirement that under the proposed plan, GSB purchases have to be cost neutral to the City. In order for the GSB to be cost neutral, the purchase price paid by an employee has to be equal to the increase in the present value of the pension and the health benefits that are expected to be received by that employee.

  In practice, it would not be possible to guarantee absolute cost neutrality. This is because employees are allowed to purchase GSB services anytime before they retire from LACERS, so that numerous assumptions have to be made in projecting both the timing and the level of anticipated benefits (e.g., retirement age, final compensation, martial status, etc.). Please note that even if the City were to restrict the purchases to be made only at retirement, there are still some risks that the purchases may not be cost neutral as employees may outlive the life expectancy assumption or the actual market return may be less than the investment return assumption used in the purchase price calculations.

  One way to minimize the most significant potential cost impacts associated with these purchases would be to accept the initial purchase prices calculated as preliminary estimates and have the final purchase prices be updated using a "true-up" process at retirement. This has most of the same advantages as allowing purchases only at retirement, and would be similar to the Public Service Purchase program currently in place at the Los Angeles Fire and Police Pension Plan.

  However, the City should be aware that there would be administration and communication issues associated with this kind of true-up process. The City may want to discuss those issues with LACERS before proceeding to finalize the GSB purchase design.

A. Demographics as of June 30, 2009

	Hired During the Last Three Years
Active members in valuation*:	
Average entry age	35.9
Projected average compensation – base salary only**	$55,188
Projected average compensation – base salary plus assigned bonuses or premium pay	$56,314
Approximate number of new employees hired in each year	1,400

* *The data used for this study is based on the June 30, 2009 valuation and it includes the data for members hired in the three years prior to the June 30, 2009 valuation date.*

** *This is calculated by assuming that the 2% difference between the base salary and the total of the base salary plus the assigned bonuses or premium pay observed for the data used in the June 30, 2008 valuation would remain unchanged for the data reported for the June 30, 2009 valuation.*

B. Comparison of Contribution Rates Before and After Change in Benefit Formula Based on Using Demographics of Employees Hired During the Last Three Years with an Average Attained Age of 36.

Under Current Benefit Formula	Employer Rate		Member Rate	
	% of Payroll[1]	Estimated Average Annual Amount[2]	% of Payroll (paid bi-weekly)	Estimated Average Annual Amount[2]
Under Projected Unit Credit Method				
Pension Plan – Normal Cost	6.02%	$3,388	6.00%	$3,379
Health Plan – Normal Cost	2.99%	$1,684	0.00%	$0
Total – Normal Cost	9.01%	$5,072	6.00%	$3,379
Under Entry Age Normal Method				
Pension Plan – Normal Cost	11.68%	$6,580	6.00%	$3,379
Health Plan – Normal Cost	4.28%	$2,408	0.00%	$0
Total – Normal Cost	15.96%	$8,988	6.00%	$3,379

Under Proposed Benefit Formula – Using Base Salary for Benefit Liability But Base Salary Plus Assigned Bonuses or Premium Pay to Calculate Contribution Rate

	Employer Rate		Member Rate	
	% of Payroll	Estimated Average Annual Amount[2]	% of Payroll	Estimated Average Annual Amount[2]
Pension Plan – Normal Cost	4.01%	$2,259	8.82%	$4,967
Health Plan – Normal Cost	0.03%	$14	1.96%	$1,104
Total – Normal Cost	4.04%	$2,273	10.78%	$6,071

Under Proposed Benefit Formula – Using Base Salary for Both Benefit Liability and to Calculate Contribution Rate

	Employer Rate		Member Rate	
	% of Payroll	Estimated Average Annual Amount[3]	% of Payroll	Estimated Average Annual Amount[3]
Pension Plan – Normal Cost	4.09%	$2,259	9.00%	$4,967
Health Plan – Normal Cost	0.03%	$14	2.00%	$1,104
Total – Normal Cost	4.12%	$2,273	11.00%	$6,071

(1) *The employer normal cost rates shown are assumed to be paid on July 15.*

(2) *These per member amounts are based on June 30, 2009 average annual base salary plus assigned bonuses or premium pay of $56,314 for active members hired within the past three years.*

(3) *These per member amounts are based on June 30, 2009 average annual base salary of $55,188 for active members hired within the past three years.*

C. Reduction in Annual UAAL Rate from Change in GSB Program ($ in millions):

1	Number of GSB purchases made between January 1, 2004 and March 31, 2009 (5 ¼ years)	1,049
2	Number of members in Item 1 still reported as active June 30, 2008 valuation	711
3	Total GSB purchase price for 711 active members (adjusted with interest to June 30, 2008)	$12.0
4	Increase in present value of benefits for pension plan due to GSB purchases for 711 active members	$45.2
5	Increase in present value of benefits for health plan due to GSB purchases for 711 active members	$7.5
6	Increase in UAAL due to GSB purchases for 711 active members from the past 5 ¼ years (Item 4 + Item 5 - Item 3)	$40.7
7	Increase in UAAL due to GSB purchases for 1,049 active members from the past 5 ¼ years (Item 6 x Item 1 / Item 2)	$60.0
8	Increase in UAAL due to average number of GSB purchases in 1 year (Item 7 / 5.25)	$11.4
9	Increase in UAAL rate for one year of GSB purchases	0.05%
10	Increase in UAAL annual costs for one year of GSB purchases (``based on June 30, 2008 projected payroll of $1,977.6 million)	$1.0

EXHIBIT I

Actuarial Assumptions and Plan Summary for Current and Proposed Tiers

Actuarial Assumptions: The service retirement assumptions that are used in determining results under the current and the proposed tiers are shown on the next page. All other actuarial assumptions are the same as those adopted by the Retirement Board for use in the June 30, 2009 actuarial valuation.

Retirement Rates:

	Rate (%)			
	Current Tier		Proposed Tier	
Age	**Non-55/30**	**55/30**	**Non-62/38**	**62/38**
50	10	0	0	0
51	5	0	0	0
52	5	0	0	0
53	5	0	0	0
54	15	0	0	0
55	10	20	15	0
56	10	15	3	0
57	10	15	4	0
58	10	15	4	0
59	10	15	5	0
60	10	15	10	0
61	10	16	10	0
62	10	17	20	75
63	10	18	15	75
64	10	19	15	75
65	15	20	16	100
66	15	20	17	100
67	15	20	18	100
68	15	20	19	100
69	15	20	20	100
70	100	100	100	100

Plan Provisions: In the following table, we have provided a high level comparison of the pertinent benefits from the current and the proposed tiers. Please note that unless included in the table, all the other plan provisions are assumed to be the same as those used in the June 30, 2009 valuation.

Plan Design	Current Tier	Proposed Tier
Retirement Formula	Final Compensation * Service Credit * Retirement Factor	
Retirement Factor	2.16% per year of service	2.0% per year of service
Retirement Allowance (Maximum)	100% of Final Compensation	75% of Final Compensation
Normal Retirement	Age 55 and 30 years of service; or Age 60 and 10 years of service; or Age 70	Age 62 with 10 years of service
Early Retirement	Age 55 with 10 years of service; or Any age with 30 years of service	Age 55 with 10 years of service
Early Retirement Reduction Factor	3% per year of service before age 55; and 1.5% per year of service after age 55	6% per year of service before 62
	Sample Retirement Factors:	Sample Retirement Factors:
	Age 50: 1.67% Age 55: 2.00% Age 57: 2.06% Age 60: 2.16% Age 62: 2.16%	Age 50: Not eligible for retirement Age 55: 1.16% Age 57: 1.40% Age 60: 1.76% Age 62: 2.00%
Deferred Vested Retirement	Age 70 with 5 years of service; or Age 60 with 5 years of service and 10 years have elapsed from first date of membership; or Age 55 with 30 years of service	Age 62 with 10 years of service
	Benefit Amount: Same as for Normal Retirement	Benefit Amount: Same as for Normal Retirement
	Age 55 with 5 years of service and 10 years have elapsed from first date of membership; or Age 55 with 10 years of service	Age 55 with 10 years of service
	Benefit Amount: Same as for Early Retirement	Benefit Amount: Same as for Early Retirement

Plan Design	Current Tier	Proposed Tier
Employee Contribution Rate	6% (pension plan only) for members hired on or after January 1, 1983. However, for the 15-year period between July 1, 2011 and June 30, 2026, a 7% contribution will be made.	11% (9% towards pension and 2% towards health).
Final Compensation	Average of highest 12 months; includes base salary plus regularly assigned bonuses or premium pay	Average of last 36 months; base salary only and excludes regularly assigned bonuses or premium pay
COLA	Based on CPI subject to a maximum of 3% per year	Only after 2 years of retirement, based on CPI subject to a maximum of 2% per year
COLA Bank	Yes	No
Retiree Medical Subsidy	Defined benefit; $1,123 per month cap for calendar year 2010; adjusted by Kaiser 2-party rate	Defined benefit; $563 per month cap for calendar year 2010; adjusted by CPI (general price inflation) and subject to a maximum of 3% of CPI
Retiree Medical Vesting Schedule	Pre-65: 4% of subsidy per year of service; 100% after 25 years	Pre-65: 40% of subsidy after 10 years of service; 3% additional subsidy per year of service thereafter; 100% after 30 years of service
	Post-65: 75% of premium for 10-14 years of service; 90% of premium for 15-19 years of service and 100% of premium for 20 plus year of service	Post-65: Same as pre-65
Medical Part B Subsidy	Part B premium will be reimbursed subject to certain conditions	Part B premium will be no longer be reimbursed
Retiree Dental Subsidy	Defined benefit; $36.16 per month cap for calendar year 2010; adjusted with medical inflation	Defined benefit; $36.16 per month cap for calendar year 2010; adjusted with CPI and subject to a maximum of 3% of CPI
Retiree Dental Vesting Schedule	4% of subsidy per year; 100% after 25 years	4% of subsidy per year; 100% after 25 years

Plan Design	Current Tier	Proposed Tier
Government Service Buybacks	Cost is based on member's contribution rate of 6%; no limit on the number of years of service purchased	Required actuarial adjustment to ensure cost neutrality; subject to a maximum of 4 years of service purchased

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