April 4, 2013

VIA ELECTRONIC MAIL

Mr. Mark Hovey
Chief Executive Officer
San Diego City Employees' Retirement System
401 West A Street, Suite 400
San Diego, CA 92101

Re: 5-Year Salary Freeze and Removal of POA Specialty Pays

Dear Mark:

As requested by the City, we have completed projections of the impact of a 5-year pensionable salary freeze on the actuarially required contribution (ARC). We have also estimated the ARC impact of removing $9.1 million in annual specialty pays from pensionable salary for Police Members. The enclosed charts show detailed projections of the estimated savings over 30 years starting with FY2014. The following is a description of the City's requests:

- Projected ARC if the City and **all** six of its labor organizations agreed to a 5-year pensionable salary freeze.
- Projected ARC if the City and **any** of its six labor organizations agreed to a 5-year pensionable salary freeze.
- Projected ARC if the City implemented a year-by-year pensionable salary freeze from FY2014 through FY2018.
- In the event the City and its labor organizations were to agree to a 5-year pensionable salary freeze, how much the Employees' Normal Cost percentage would change for General and Safety.
- Projected ARC if $9.1 million in annual specialty pays were removed from pensionable salary.

We accompany these charts with a list of the methods and assumptions used in our calculations. It's important to note that to the extent that the methods or assumptions are not realized, the actual impact of these items is likely to be different. In particular, we can say from past experience that when salary freezes or pay eliminations occur, several membership behavioral changes can occur which do affect the expected savings. For example, we have often observed some level of aggregate payroll growth due to alternative types of salary increases (e.g., merit pay step increases). Also, with sustained pay freezes membership turnover experience (e.g., termination of employment and retirement) may deviate from the expected, and recruiting new employees for the open Police plan may become more difficult. In addition, there may be significant pressure for larger salary increases at the end of the freeze since salary levels have been frozen for several years. Without performing an experience study, which can only be done after the fact, we cannot develop appropriate assumptions for these membership behavioral changes and as a result our cost estimates may not bear out.

Methods and Assumptions:

- Since the June 30, 2012 valuation already includes an assumed salary freeze for FY2014, there are no additional savings for the first year of the freeze in this analysis.
- It is assumed that if an agreement is reached, it will be reflected in the June 30, 2012 valuation and first affect the FY2014 ARC.
- If the pensionable salary freezes are imposed year by year, they will first impact the assumed increases granted at the start of FY2015, since a freeze is already assumed for FY2014. This means that the impact will first be measured in the June 30, 2014 valuation which determines the FY2016 ARC.
- This analysis assumes that the salary freeze only applies to the across-the-board increases granted each year, which are assumed to be 3.75% (0% for FY2014). It is assumed that members continue to receive merit increases (i.e., promotions).
- After the freeze is over, we assumed that across-the-board increases of 3.75% will occur thereafter.
- An agreement to freeze pensionable salary could be considered either an assumption change or a plan change, which are amortized over 30 years or 5 years under current SDCERS policy, respectively. For this analysis we have used an amortization period of 15 years, which lies roughly in-between those two periods, but the period ultimately used would be determined by the SDCERS Board.
- It is assumed that San Diego Proposition B remains in effect and SDCERS remains closed to new non-Police hires on or after July 20, 2012.
- The change in liability from the salary freeze that is attributable to the Police plan is amortized as a level percentage of salary, while the change that is attributable to the non-Police plans is amortized in level dollar amounts.
- This analysis only includes savings for the SDCERS defined benefit plan and excludes any savings that may occur in the DC plan for new hires. It also excludes any savings or costs that may occur in other City benefit programs (e.g., retiree healthcare) as a result of the salary freeze or the behavioral changes it may cause.
- To estimate the change in aggregate employee contribution rates for General and Safety members, we assumed that the change in the Gross Normal Cost rate resulting from a five-year agreement would be shared between members and the City, as a result of the substantially equal doctrine. If the freeze is imposed year by year, there is no anticipated reduction in the employee normal cost.
- The estimated employee normal cost reductions for General and Safety in the attached enclosures are based on the June 30, 2012 valuation data. Over time, these percentages will vary based on the demographic composition of the membership.
- It is assumed that salary freezes will apply to all members, including unrepresented members.
- This analysis assumes a stable Police population (average age and service not changing) with projected new hires entering the plan as appropriate. Salary freezes are assumed to apply uniformly across all active members.

- To estimate the impact of removing $9.1 million in specialty pays from pensionable salary for Police Members, we calculated the specialty pay as a percentage of pensionable salary and assumed pensionable salary would be reduced by the same percentage going forward.
- We have shown the impact of removing $9.1 million in specialty pays as an experience gain (amortized over 15 years). If this change is determined to be a plan change instead, the amortization period will be 5 years instead of 15, and the resulting pattern of plan sponsor cost savings will be higher in the first five years and lower in the following ten years. In addition, since there will be normal cost savings if this were determined to be a plan change, half of those savings would accrue to the members as a result of the substantially equal doctrine, and the attached Chart 4 will have to be revised.

In preparing our letter, we relied without audit, on information (some oral and some written) supplied by SDCERS and the City of San Diego. This information includes, but is not limited to, SDCERS' plan provisions, employee data (including bargaining unit codes), 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 #23.

To the best of our knowledge, this letter and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices which 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 letter. This letter does not address any contractual or legal issues. We are not attorneys and our firm does not provide any legal services or advice.

This letter was prepared for SDCERS and the City of San Diego for the purpose described herein. This letter is not intended to benefit any third party, and Cheiron assumes no duty or liability to any such party.

We are available to answer any questions you may have.

Sincerely,
Cheiron

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

David Holland, ASA, EA, MAAA
Associate Actuary

Enclosure

cc: Mary Lewis, CFO (w/ enclosure)

Chart 1
SDCERS - City of San Diego
5-Year Salary Freeze: Estimated ARC Reduction
All Labor Organizations (including unrepresented)
($ in millions)

	Method	
Fiscal Year	5-Year Agreement	Year by Year
2014	$ 25.2	$ -
2015	$ 26.9	$ -
2016	$ 28.4	$ 13.8
2017	$ 29.8	$ 24.3
2018	$ 30.3	$ 33.5
2019	$ 30.2	$ 41.4
2020	$ 30.2	$ 41.6
2021	$ 30.1	$ 41.9
2022	$ 30.1	$ 42.2
2023	$ 30.1	$ 42.5
2024	$ 30.1	$ 42.8
2025	$ 30.2	$ 43.2
2026	$ 30.3	$ 43.6
2027	$ 30.4	$ 44.0
2028	$ 30.5	$ 44.4
2029	$ 6.5	$ 40.7
2030	$ 6.4	$ 34.2
2031	$ 6.2	$ 28.9
2032	$ 6.2	$ 25.5
2033	$ 6.1	$ 16.9
2034	$ 6.1	$ 7.7
2035	$ 6.0	$ 7.9
2036	$ 6.0	$ 8.1
2037	$ 6.1	$ 8.3
2038	$ 6.2	$ 8.5
2039	$ 6.3	$ 8.7
2040	$ 6.4	$ 9.0
2041	$ 6.6	$ 9.3
2042	$ 6.8	$ 9.6
2043	$ 6.9	$ 9.9

Note: The difference in total nominal dollar amounts between the two methods is due to two factors: (1) no sharing of normal cost savings with employees in the year by year scenario, and (2) the time value of money.

Chart 2
SDCERS - City of San Diego
5-Year Salary Freeze: Estimated ARC Reduction by Labor Organization
($ in millions)

Method: 5-Year Agreement

Fiscal Year	DCAA	Local 127	Local 145	Local 911	MEA	POA	Unrep	Total
2014	$ 0.4	$ 3.3	$ 3.5	$ 0.4	$ 9.1	$ 6.2	$ 2.4	$ 25.2
2015	$ 0.4	$ 3.4	$ 3.7	$ 0.4	$ 9.5	$ 6.9	$ 2.5	$ 26.9
2016	$ 0.4	$ 3.6	$ 3.8	$ 0.4	$ 9.9	$ 7.6	$ 2.6	$ 28.4
2017	$ 0.5	$ 3.7	$ 3.9	$ 0.4	$ 10.2	$ 8.4	$ 2.7	$ 29.8
2018	$ 0.5	$ 3.7	$ 4.0	$ 0.4	$ 10.2	$ 8.9	$ 2.7	$ 30.3
2019	$ 0.5	$ 3.6	$ 3.9	$ 0.4	$ 10.1	$ 9.2	$ 2.7	$ 30.2
2020	$ 0.4	$ 3.6	$ 3.8	$ 0.4	$ 9.9	$ 9.4	$ 2.6	$ 30.2
2021	$ 0.4	$ 3.5	$ 3.8	$ 0.4	$ 9.8	$ 9.7	$ 2.6	$ 30.1
2022	$ 0.4	$ 3.4	$ 3.7	$ 0.4	$ 9.6	$ 10.0	$ 2.5	$ 30.1
2023	$ 0.4	$ 3.4	$ 3.6	$ 0.4	$ 9.4	$ 10.3	$ 2.5	$ 30.1
2024	$ 0.4	$ 3.3	$ 3.6	$ 0.4	$ 9.3	$ 10.6	$ 2.5	$ 30.1
2025	$ 0.4	$ 3.3	$ 3.5	$ 0.4	$ 9.2	$ 11.0	$ 2.4	$ 30.2
2026	$ 0.4	$ 3.3	$ 3.5	$ 0.4	$ 9.0	$ 11.3	$ 2.4	$ 30.3
2027	$ 0.4	$ 3.2	$ 3.4	$ 0.3	$ 8.9	$ 11.7	$ 2.3	$ 30.4
2028	$ 0.4	$ 3.2	$ 3.4	$ 0.3	$ 8.8	$ 12.1	$ 2.3	$ 30.5
2029	$ 0.0	$ 0.4	$ 0.4	$ 0.0	$ 1.1	$ 4.2	$ 0.3	$ 6.5
2030	$ 0.0	$ 0.3	$ 0.4	$ 0.0	$ 1.0	$ 4.3	$ 0.3	$ 6.4
2031	$ 0.0	$ 0.3	$ 0.3	$ 0.0	$ 0.9	$ 4.5	$ 0.2	$ 6.2
2032	$ 0.0	$ 0.3	$ 0.3	$ 0.0	$ 0.8	$ 4.6	$ 0.2	$ 6.2
2033	$ 0.0	$ 0.2	$ 0.2	$ 0.0	$ 0.6	$ 4.7	$ 0.2	$ 6.1
2034	$ 0.0	$ 0.2	$ 0.2	$ 0.0	$ 0.5	$ 4.9	$ 0.1	$ 6.1
2035	$ 0.0	$ 0.2	$ 0.2	$ 0.0	$ 0.5	$ 5.1	$ 0.1	$ 6.0
2036	$ 0.0	$ 0.1	$ 0.1	$ 0.0	$ 0.4	$ 5.3	$ 0.1	$ 6.0
2037	$ 0.0	$ 0.1	$ 0.1	$ 0.0	$ 0.3	$ 5.5	$ 0.1	$ 6.1
2038	$ 0.0	$ 0.1	$ 0.1	$ 0.0	$ 0.2	$ 5.7	$ 0.1	$ 6.2
2039	$ 0.0	$ 0.1	$ 0.1	$ 0.0	$ 0.2	$ 5.9	$ 0.0	$ 6.3
2040	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.1	$ 6.1	$ 0.0	$ 6.4
2041	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.1	$ 6.4	$ 0.0	$ 6.6
2042	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.1	$ 6.6	$ 0.0	$ 6.8
2043	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 6.8	$ 0.0	$ 6.9

Chart 3
SDCERS - City of San Diego
5-Year Wage Agreement
Average Estimated Employee Normal Cost % Reduction*
(based on June 30, 2012 valuation data)

General	Safety
0.70%	1.03%

* Employee contribution rates vary by plan and by entry age. The figures in this chart represent weighted averages. The reductions in the chart represent 7.00% and 7.07% of the current member contributions for General and Safety, respectively.

Chart 4 SDCERS - City of San Diego Removal of $9.1 Million in Annual Police Specialty Pays ($ in millions)		
Fiscal Year	**Estimated ARC Reduction**	
2014	$	4.4
2015	$	4.5
2016	$	4.7
2017	$	4.9
2018	$	5.1
2019	$	5.3
2020	$	5.6
2021	$	5.8
2022	$	6.0
2023	$	6.3
2024	$	6.5
2025	$	6.8
2026	$	7.0
2027	$	7.3
2028	$	7.6
2029	$	2.0
2030	$	2.1
2031	$	2.2
2032	$	2.3
2033	$	2.4
2034	$	2.5
2035	$	2.6
2036	$	2.7
2037	$	2.8
2038	$	2.9
2039	$	3.0
2040	$	3.1
2041	$	3.2
2042	$	3.4
2043	$	3.5

Note: the estimated ARC reduction assumes the removal of specialty pays is an experience gain. If treated as a plan change, the ARC reduction will be less as a result of the substantially equal doctrine.