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John McCoy
LEG SCERS Pension Funding RES
October 17, 2011
Version # 3

RESOLUTION 31334

A RESOLUTION affirming the City's intent to fully fund its required contributions to the Seattle City Employees' Retirement System (SCERS).

WHEREAS, the City provides and manages a defined-benefit pension for its non-uniformed employees to serve as a source of retirement income, along with Social Security; and

WHEREAS, the City, as plan sponsor, and SCERS' employee members are jointly responsible for providing sufficient funds support the pension system's costs and have elected to pre-fund these pension obligations as they are accrued, which allows the money to be invested in the interim and generate a substantial share of the total cost of the benefit through investment returns; and

WHEREAS, SCERS, like most public pension plans, suffered significant investment losses due to the financial crises of 2008 and resulting recession, which lowered its funded ratio, on a mark-to-market basis, from 92% on January 1, 2008 to 62% by January 1, 2010; and

WHEREAS, in the wake of those 2008 investment losses, the City and its employee unions agreed to raise employee contributions into SCERS from 8.03% of regular (non-overtime) payroll in 2010 to 10.03% by 2012; and

WHEREAS, per SMC 4.36.110.C, the City is required to match the employee contributions, with the result that the total contribution increased from 16.06% of regular (non-overtime) payroll in 2010 to 20.06% by 2012; and

WHEREAS, SMC 4.36.110.C also requires the City to pay, in addition to the matching contributions, "the actuarially determined City contribution" to guarantee benefits, but the code does not further specify timeframes or funding targets; and

WHEREAS, in 2010, the SCERS actuary concluded, after a review of demographic data, economic assumptions, and financial performance, that additional contributions above 20.06% of regular payroll would be required to amortize the system's unfunded liabilities over 30 years, a commonly used funding goal; and

WHEREAS, the SCERS Board of Administration adopted an asset smoothing policy in 2011 in which the effects of investment performance are phased in over five years to mitigate funding rate volatility, a practice typically found in other public pension systems; and

WHEREAS, on a smoothed basis and with strong investment performance in 2010, SCERS' funded ratio improved to 74%, but despite that, the actuary again concluded that additional contributions above 20.06% of regular payroll would be required in 2012 and later to amortize the system's unfunded liabilities over 30 years; and

WHEREAS, the City desires to improve SCERS' financial position and put the system back on a path toward full funding; NOW THEREFORE,

BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF SEATTLE, THE MAYOR CONCURRING, THAT:

Section 1. The City will fully fund its actuarially required contributions to SCERS in the 2012 Adopted Budget and thereafter. The City will base its contribution rate on a five-year smoothed asset valuation as described in the most recent actuarial report, and the rate will be sufficient to amortize the system's unfunded liabilities in 30 or fewer years.

Section 2. To that end, the 2012 Adopted Budget includes sufficient appropriation for the City to pay 11.01% of regular (non-overtime) payroll into SCERS. This is greater than the employee contribution of 10.03%. It brings the combined contribution to 21.04%, which is the actuarially required amount for 2012 as described in January 1, 2011 Actuarial Valuation and the October 12, 2011 cost update letter from Milliman Actuaries.

Section 3. The City endorses the actuarial assumptions and methods adopted by the SCERS Board of Administration and utilized in the January 1, 2011 valuation. These include:

A. The entry age normal actuarial cost method
B. An investment return rate of 7.75%
C. A five-year smoothed method for asset valuation
D. Generational mortality tables that take future life expectancy improvements into account
E. Expected average membership growth of 1% per year
F. Other economic and demographic assumptions as described in the valuation.

Section 4. Each year, and in the event the SCERS Board of Administration should wish to change its actuarial assumptions and methods, the City requests that the Board consult with the Mayor and the City Council by the tenth day of July regarding the impacts of such changes on funding requirements, as described in SMC 4.36.180.A, to allow sufficient time to make budget preparations.

Section 5. The City will update its contribution rate to SCERS annually to a level not less than the actuarial required contribution for that year as determined by the most recent valuation. The City may elect to exceed the required contribution rate in any given year in the interest of funding stability or to amortize the system's unfunded liabilities in fewer than 30 years.

Adopted by the City Council the ____ day of ____________________, 2011, and signed by me in open session in authentication of its adoption this________ day of ______________________, 2011.

____

President __________of the City Council

THE MAYOR CONCURRING:

____

Michael McGinn, Mayor

Filed by me this ____ day of ________________________, 2011.

____

Monica Martinez Simmons, City Clerk

(Seal)

John McCoy
LEG SCERS Funding Policy FISC
October 17, 2011
Version #3

Form revised: May 6, 2011

2012 BUDGET LEGISLATION FISCAL NOTE

Department:	Contact Person/Phone:	CBO Analyst/Phone:
Legislative	John McCoy 5-0768	Greg Hill 4-8049

Legislation Title: A RESOLUTION affirming the City's intent to fully fund its required contributions to the Seattle City Employees' Retirement System (SCERS).

Summary of the Legislation: This resolution affirms the City's commitment to pay all actuarially required amounts into SCERS, the City's defined benefit pension system for non-uniformed employees. It clarifies how the City intends to meet its obligations to pay actuarially required amounts per Seattle Municipal Code section 4.36.110.C, specifying a five-year smoothed asset valuation method, a 30-year amortization period, and other key actuarial assumptions.

Background: In 2008, SCERS, like most public pension plans, suffered significant financial losses to its investment portfolio, due to the market crises and resulting recession. The losses created a long-term imbalance in funding, though there is no danger that SCERS will run out of money to pay benefits in the short to medium term since it still has more than $1.8 billion in assets remaining. Like many public employers, the City of Seattle raised contribution rates for itself and for employees in 2011 and 2012 to improve SCERS' financial position and begin the process of amortizing the system's unfunded liabilities.

The SCERS Board of Administration reviewed its actuarial assumptions and methods in 2011 and adopted the policy of smoothing out investment performance over five years, which is the most common practice in public pension plans. Previously, SCERS marked its assets to market each year for funding purposes. Smoothing has the benefit of mitigating purely transitory volatility in asset prices. It also generates a natural, gradual multi-year path for contribution changes in response to significant changes to asset values. The Board also adopted new economic and demographic assumptions, which affected its estimates of system liabilities and required contributions slightly.

The City had previously employed an *ad hoc* system of gradualism in making contribution rate changes, rising from 16.06% of regular payroll in 2009 to 18.06% in 2010 and 20.06% in 2011. The City always intended for its contribution rate to rise still further in subsequent years, based on updated actuarial estimates and future investment performance. This resolution sets a more structured gradualism policy that meshes with the Board's recent policy actions. Specifically, the City will base its contribution rate on a five-year smoothed asset valuation and a 30-year amortization period. The resolution also affirms that the 2012 Budget will appropriate a total of 21.04% of regular payroll for SCERS (10.03% from employees and 11.01% from the City), which is higher than the rate previously legislated and equal to the required contribution rate for 2012. Further increases to the contribution rate are expected in 2013 and 2014, as the effects of 2008 are fully phased into the asset valuation. This resolution commits the City to fully fund those higher contributions in future budgets.

Please check one of the following:

____ **This legislation does not have any financial implications.**

_X_ **This legislation has financial implications.**

See Attachment 2 for expenditure projections.

Other Implications:

a) Does the legislation have indirect financial implications, or long-term implications?
Yes. See Attachment 2.

b) What is the financial cost of not implementing this legislation? Costs would depend on what actions the City took absent this contribution policy. An *ad hoc* gradualism policy for contribution increases may have roughly the same costs. Failure to raise contribution rates would result in higher contribution rates later. Rating agencies may also see the failure to raise rates further as a sign of financial stress and downgrade the City's credit rating, leading to higher debt-service costs.

c) Does this legislation affect any departments besides the originating department?
Yes. All City departments with employees who are in SCERS are affected by these costs.

d) What are the possible alternatives to the legislation that could achieve the same or similar objectives? The City could continue its *ad hoc* contribution gradualism policy, but there would not be a specific actuarial basis for the contribution rate in any given year, and that policy may be more difficult to explain to outside evaluators, such as bond rating agencies. Alternately, the City could immediately raise contributions to the ultimate 30-year amortization rate, but this would require additional budget cuts, revenue increases, or both.

e) Is the legislation subject to public hearing requirements? No

f) Other Issues:

Please list attachments to the fiscal note below:

Attachment 1 – October 12, 2012 Cost Update Letter from Milliman Actuaries
Attachment 2 – Fiscal Impact of Increased Retirement Contributions

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October 12, 2011

Retirement Board
Seattle City Employees' Retirement System
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Re: Projected Total Contribution Rate Reflecting Proposed New Member Contribution Interest Crediting Rate

Dear Members of the Board:

As requested by SCERS staff, we are providing you with a revised schedule of the projected total contribution rate for SCERS, reflecting the revised member contribution crediting policy adopted by the Board on October 5, 2011. This analysis compares to Section 8 of our January 1, 2011 actuarial valuation. The purpose of this letter is to provide these revised projections reflecting the new interest crediting policy.

Member Crediting Policy Revision

On October 5, 2011, the Board adopted a revised member contribution interest crediting rate policy. The interest crediting rate has a financial impact for SCERS because, in addition to the impact on the refund benefit, SCERS has a minimum benefit that is equal to twice the value of the member contribution account (SMC Sections 4.36.200, 4.36.210 and 4.36.260). Currently this minimum applies fairly frequently (although less than half the time), particularly in cases of deferred retirements, older retirees, and retirees with many years of service who reach the 30-year maximum based on the regular formula benefit. It will become even more significant in the future as the member contribution rate is increasing to 10.03% (from 8.03%), so the members' accounts will be larger relative to what they are now.

The revised member crediting policy adopted by the Board stipulates that:

1) Each year, the Board will set a rate of interest for all contributions made after December 31, 2011.
2) The target for this rate will be the prior 12 months' average yield on 30-year US Treasury Bonds plus 0.25%, with a maximum credit interest rate equal to 5.75%.

For the 2012 calendar year, all member contributions made on or prior to December 31, 2011 will continue to be credited 5.75% interest, and all member contributions made after December 31, 2011 will be credited 4.47% annual interest.

Member Crediting Policy Revision—Actuarial Valuation Assumption

The revised member crediting policy targets a moving rate for the interest credited to member contributions made after December 31, 2011. Therefore, it is necessary to develop an actuarial assumption for the credited rate of interest to member contributions made after that date for valuation purposes.

Although the recent economic environment has been one of low inflation and low yields on US Treasuries, the actuarial assumptions used in the valuation take a long-term view of economic and demographic environments.

Based on an analysis of forecasted yields on 30-year US Treasury Bonds over a 15 to 30 year time horizon, and taking into consideration both the 0.25% premium targeted by SCERS, as well as the 5.75% cap on the credited rate, we recommend using a 5.00% long-term actuarial assumption for the rate credited to post-December 31, 2011 member contributions. We have used this assumption in our analysis.

We will continue to assume 5.75% credited interest on all member contributions made on or prior to December 31, 2011.

Revised Projected Total Contribution Rate

In our letter dated September 6, 2011, we outlined the potential actuarial cost impact to SCERS, based on the January 1, 2011 actuarial valuation, if various new member crediting policies were adopted. As shown in that letter, the scenario in which 5.00% was credited to member contributions made on or after December 31, 2011 resulted in the following changes to certain key valuation measurements:

Change in Key Measurements*
Crediting Rate Changed for Contributions Made After 12/31/2011

Member Account Interest Crediting Rate	Normal Cost Rate	Contribution Rate To Amortize UAAL Over 30 Years	Total Increase/(Decrease) in Rate Needed	Funded Ratio
5.0%	-0.20%	-0.06%	-0.26%	0.2%

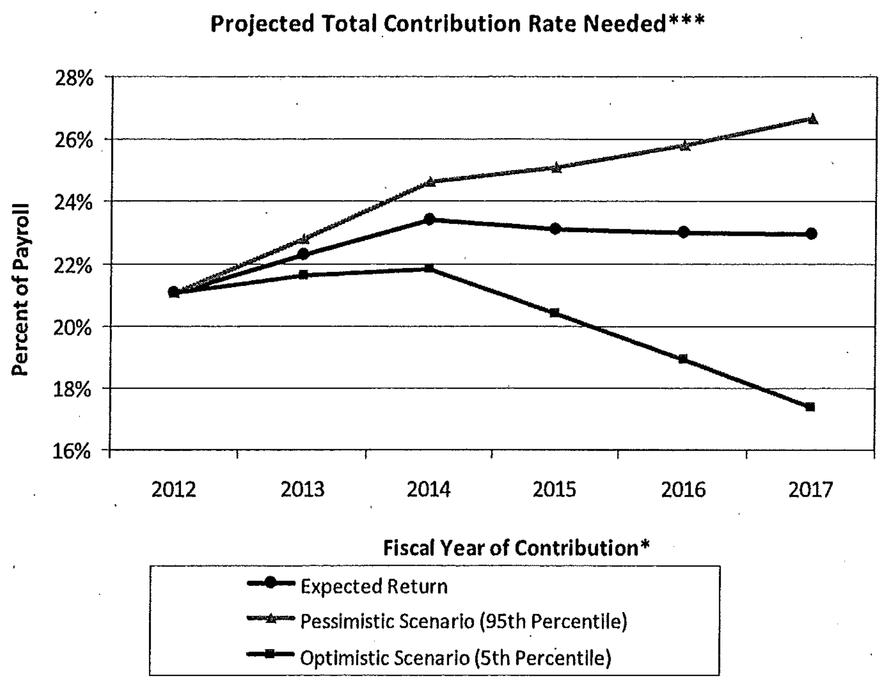
**Changes relative to the January 1, 2011 actuarial valuation results.*

In Section 8 (Contribution Rate Projections and Increases) of the January 1, 2011 actuarial valuation report, we performed a 5-year projection of the Total Contribution Rate needed to amortize the Unfunded Actuarial Accrued Liability (UAAL) over 30 years on a rolling basis. This projected was performed under 3 different scenarios:

1) Assuming that the investment return assumption is met in each future year.
2) Assuming that the assets return at the 5th percentile.
3) Assuming that the assets return at the 95th percentile.

The result is effectively a 90% confidence interval (based on asset returns) of the projected contribution rates in these years.

In this letter, we have performed a similar projection using the results of revised January 1, 2011 actuarial valuation calculations, which reflect the new member crediting policy and the associated cost savings. The results of this revised projection are shown below.



Projected Total Contribution Rate Needed**

Contribution Year"	95th Percentile	Assuming 7.75% Future Returns	5th Percentile
2012	21.04%	21.04%	21.04%
2013	22.80%	22.27%	21.61%
2014	24.62%	23.41%	21.84%
2015	25.11%	23.12%	20.41%
2016	25.82%	22.98%	18.92%
2017	26.69%	22.94%	17.39%

** Contribution year lags calculation year by 1. For example: Contribution Year 2012 is based on the 2011 valuation results, amortized over 30 years beginning in 2011, if the increase takes place in 2012.*

*** Assumes actual total contribuiton rate is 18.06% in 2011 and 20.06% in 2012 and later.*

****Projected total rate needed to pay Normal Cost, and amortize projected UAAL over 30 year period.*

Please note that the numeric exhibit shown in the valuation report Section 8 (page 32 of the January 1, 2011 valuation) inadvertently reversed the 5th and 95th percentile column labels, so that should be taken into consideration when comparing this exhibit with the one shown in the valuation report. The 95th percentile refers to the lower asset returns, and higher Total Contribution Rate numbers. The graph shown on that page, as well as all other percentile numbers shown throughout the report, were labeled correctly.

As in the valuation report, the following percentile returns were assumed for this projection, based on analysis of SCERS' investments:

Compounded average return for period

	Percentile	
	5th	*95th*
1-Year Period	*29.2%*	*-9.5%*
2-Year Period	*22.7%*	*-4.6%*
3-Year Period	*19.9%*	*-2.4%*
4-Year Period	*18.2%*	*-1.0%*
5-Year Period	*17.1%*	*-0.1%*

Prospective-Only Crediting Rate Changes: Comments on Cost Effect over Time

As discussed in our September 6, 2011 letter, when the member crediting rate is changed only for future contributions, a portion of the Total Contribution Rate savings to SCERS will tend to increase over time.

The savings in the Total Contribution Rate is comprised of two components:

1) Normal Cost savings, and
2) UAAL Contribution Rate savings.

The Normal Cost savings shown in this letter reflect the savings for the current population of SCERS participants. These participants will in general be receiving some interest crediting at 5.75% and some interest crediting at the new reduced rate. However, for new entrants who become participants of SCERS after December 31, 2011, none of their contributions will receive the old 5.75% crediting rate. Therefore, over the entire career of these new entrants, the individual normal cost savings will be greater than the individual career normal cost savings for current participants.

Over a long-term time horizon, participants entering SCERS after December 31, 2011 will comprise a larger and larger proportion of the total SCERS population. As this occurs, the projected normal cost savings being realized by SCERS will increase. Any increase in normal cost savings will only occur to the extent new entrants enter the plan.

The effect of such potential increase in savings is not expected have a material impact over the projection period shown in this letter. We have not pre-recognized any of the potential increase in future savings over the 5-year period following the valuation.

Actuarial Certification

The cost estimates shown in this letter reflect the data, methods and assumptions used for the January 1, 2011 actuarial valuation except where noted. These cost estimates are subject to the uncertainties of a regular actuarial valuation; the costs are inexact because they are based on assumptions that are themselves necessarily inexact, even though we consider them reasonable. Thus, the emerging costs may vary from those presented in this letter to the extent actual experience differs from that projected by the actuarial assumptions.

The cost estimates presented in this letter are based on the January 1, 2011 actuarial valuation report. In preparing that report, we relied without audit on information (some oral and some in writing) supplied by SCERS' staff. This information includes, but is not limited to, statutory provisions, employee data, and financial information. We used SCERS' benefit provisions as stated in our January 1, 2011 Actuarial Valuation report, except for the adjustment to the interest crediting rate.. In our examination, after discussion with SCERS and certain adjustments, we have found the data to be reasonably consistent and comparable with data used for other purposes. Since the valuation results, as well as the estimates shown in this letter, are dependent on the integrity of the data supplied, the results can be expected to differ if the underlying data is incomplete or missing. It should be noted that if any data or other information is inaccurate or incomplete, our determinations might need to be revised.

The emerging costs will vary from those presented in this letter to the extent that actual experience differs from that projected by the actuarial assumptions. Future actuarial measurements may differ significantly from the current measurements presented in this letter due to a number of factors. Due to the scope of this assignment, we did not perform an analysis of the potential range of such measurements. Actuarial computations presented in this letter are for purposes of studying the impact of alternative asset smoothing methods. Determinations for other purposes may be significantly different from the results contained in this letter.

Milliman's work is prepared solely for the internal business use of SCERS. To the extent that Milliman's work is not subject to disclosure under applicable public records laws, Milliman's work may not be provided to third parties without Milliman's prior written consent. Milliman does not intend to benefit or create a legal duty to any third party recipient of its work product. Milliman's consent to release its work product to any third party may be conditioned on the third party signing a Release, subject to the following exceptions:

(a) The System may provide a copy of Milliman's work, in its entirety, to the System's professional service advisors who are subject to a duty of confidentiality and who agree to not use Milliman's work for any purpose other than to benefit the System.

(b) The System may provide a copy of Milliman's work, in its entirety, to other governmental entities, as required by law.

No third party recipient of Milliman's work product should rely upon Milliman's work product. Such recipients should engage qualified professionals for advice appropriate to their own specific needs.

The consultants who worked on this assignment are pension actuaries. Milliman's advice is not intended to be a substitute for qualified legal or accounting counsel.

On the basis of the foregoing, we hereby certify that, to the best of our knowledge and belief, this letter is complete and accurate and has been prepared in accordance with generally recognized and accepted actuarial principles and practices.

I, Nick Collier, am a member of the American Academy of Actuaries and an Associate of the Society of Actuaries, and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

Respectfully submitted,

Nick Collier

Nick J. Collier, ASA, EA, MAAA
Consulting Actuary
NJC/nlo

Fiscal Impact of Increased Retirement Contributions

Under the proposed funding policy, the actuarially required contributions to the Seattle City Employees' Retirement System (SCERS) are slated to increase to 23.41% of regular (non-overtime) payroll by 2014 before declining slightly (see Attachment 1, p. 3). At an employee contribution of 10.03%, that leaves a City share as shown in the first shaded column of the table below.

Table 1 – Employer Contributions per Current Policy and Per Updated 2011 Actuarial Projections

		Current Policy		2011 Projection		
Year	Covered Payroll (estimated)	Employer Contribution Rate	Employer Contribution $ (All funds)	Employer Contribution Rate	Employer Contribution $ (All funds)	Difference (All funds)
2012	$ 558,500,000	10.03%	$ 56,017,550	11.01%	$ 61,490,850	$ 5,473,300
2013	$ 586,425,000	10.03%	$ 58,818,428	12.24%	$ 71,778,420	$ 12,959,993
2014	$ 615,746,250	10.03%	$ 61,759,349	13.38%	$ 82,386,848	$ 20,627,499
2015	$ 646,533,563	10.03%	$ 64,847,316	13.09%	$ 84,631,243	$ 19,783,927
2016	$ 678,860,241	10.03%	$ 68,089,682	12.95%	$ 87,912,401	$ 19,822,719
2017	$ 712,803,253	10.03%	$ 71,494,166	12.91%	$ 92,022,900	$ 20,528,734

Raising the City's contributions above the previously legislated rate of 10.03% will cost an additional $20.6 million in annual City appropriations to SCERS by 2014. This cost is split between the City's General Subfund and its other funds such as Seattle City Light and Seattle Public Utilities, which have large shares of SCERS membership. Contributions, once raised, will remain in place indefinitely, as these rates are designed to amortize SCERS' unfunded liabilities over 30 years.

Estimation Note: The covered payroll series in the above analysis is estimated from part-year 2011 actuals and then trended forward by payroll growth in the 2012 Proposed Budget. After that, the series is consistent with SCERS' actuarial assumptions for wage and membership growth. Because of this, it may not agree with City Budget Office projections for these same years. As noted in Attachment 1, these rates will vary with investment performance. Returns above the 7.75% assumption will tend to lower the required contribution rate, while returns below that level will tend to raise it.