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MEETING DATE

APR 13 2011

AGENDA ITEM

5

April 7, 2011

Ms. Marilyn Leedom
Chief Executive Officer
Contra Costa County Employees' Retirement Association
1355 Willow Way, Suite 221
Concord, CA 94520

**Re: Contra Costa County Employees' Retirement Association
Methodology Choices for the Treatment of Terminal Pay in Actuarial Valuation**

Dear Marilyn:

We are providing information and requesting direction on some methodology choices for the treatment of terminal pay in the annual actuarial valuation. We also provide information on the levels of recent terminal pay, both by tier and by cost group, under both the "current" and "new" terminal pay policies. Note that for purposes of this letter and the annual actuarial valuation we use "terminal pay" as a broad term that includes such items as vacation sellbacks, administrative leave sellbacks and terminal pay items during the final average pay period.

Summary of Open Methodology Choices

A detailed discussion of the methodologies that we will apply and the open methodology choices where we need direction are provided in the body of this letter. In summary, there are really only two major methodology choices that need to be made by the Board:

- For future actuarial valuations, should the current terminal pay assumption structure by tier be continued or should we develop terminal pay assumptions separately for each cost group?
- Given the substantial reduction in terminal pay that applies to members with membership dates on or after January 1, 2011, should we continue to include terminal pay as a component of the member contribution rates for these members?

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Background

In 1997, the Board adopted a policy that determined which pay items are considered compensation for retirement purposes. Under that policy, various types of terminal pay were included in the determination of compensation for retirement purposes. This policy still applies to members with membership dates before January 1, 2011.

In March 2010, the Board adopted a change to this policy for members with membership dates on or after January 1, 2011. Under this amended policy, certain terminal pay elements are no longer included in the determination of compensation for retirement purposes.

In January 2011, we were directed by the Board to proceed with developing a set of employer and member contribution rates that would apply only on behalf of members with membership dates on or after January 1, 2011.

We then requested and received data from retirement association staff that contained information on terminal pay for members that retired during 2008, 2009 or 2010. We were provided both:

- The amount of terminal pay the member actually received at retirement under the policy that applies to members with membership dates before January 1, 2011.
- The amount of terminal pay the member would have hypothetically received at retirement under the new policy that applies to members with membership dates on or after January 1, 2011.

Terminal Pay Experience and Assumptions

Exhibit A summarizes the data on terminal pay (as a percentage of final average pay excluding such terminal pay) for the three-year period from 2008 through 2010 under both the current and the new policy (as if it was hypothetically in effect at these members' retirement dates).

This exhibit also shows the current terminal pay assumptions (as a percentage of final average pay excluding such terminal pay) that apply to members with membership dates before January 1, 2011 and those that we propose using for members with membership dates on or after January 1, 2011. In this exhibit, we have followed the structure of the current terminal pay assumptions, which is to have a different terminal pay assumption for each tier.

Note that there is a significant decrease in terminal pay under the new policy, but it does not appear to be completely eliminated.

Impact of Terminal Pay on Contribution Rates

The contribution rates determined in the actuarial valuation reflect the anticipated impact that terminal pay will have on expected future benefit payments. The member Basic contribution rate is not affected by the terminal pay assumption (i.e. it is an employer only cost) and there is only a relatively small Cost-of-Living (COL) component for members. As a result, the great majority of the contribution rate impact of the terminal pay assumption is borne by the employer.

The portion of the aggregate employer and member contribution rates from the December 31, 2009 actuarial valuation due to the application of the terminal pay assumption is shown in the table below:

Portion of Contribution Rate from December 31, 2009 Actuarial Valuation due to the Application of the Terminal Pay Assumption			
	Basic	COL	Total
Employer	3.42%	1.01%	4.43%
Member	0.00%	0.34%	0.34%
Total	3.42%	1.35%	4.77%

Since the Board action to change the terminal pay policy for new members significantly reduces terminal pay, we would expect to see significant reductions in the above components of the employer and member contribution rates for members affected by the new policy, due to the application of the new terminal pay assumptions.

Recent Information Concerning Further Changes to Terminal Pay

While we were in the process of determining the employer and member contribution rates that would apply on behalf of members with a membership date on or after January 1, 2011, we were informed about another change made by the County that would apply to some of their employees and may apply to more of their employees depending on the outcome of collective bargaining.

These changes would eliminate vacation sellbacks for applicable County members with membership dates on or after April 1, 2011. This would further lower the hypothetical terminal pay under the new policy as compared to what is shown in Exhibit A. We also understand that there is another change in terminal pay that may affect a small group of County members with membership dates before January 1, 2011.

We will proceed using the same terminal pay methodology and assumptions for all members with membership dates on or after January 1, 2011. This will mean that the same employer and member contribution rates will apply to all such members. We are aware that there may be slight differences in terminal pay depending upon whether the membership date was in the first three months of 2011 or thereafter. However, we believe it is not practical to create a separate

set of employer and member contribution rates for a very small subset of the members (i.e. those with membership dates in the first three months of 2011).

We also do not believe it is practical to create different sets of member and employer contribution rates each time a small change to a terminal pay policy is made. The change made starting January 1, 2011 was significant and that is why separate rates are warranted. Any smaller changes in terminal pay experience that occur in future years will be handled through assumption changes at future experience studies as appropriate.

Possible Methodologies for the Treatment of Terminal Pay in Actuarial Valuation

Based on the above information and also in consideration of the depooling action taken by the Board in 2009, the Board should consider whether or not it is appropriate to develop terminal pay assumptions separately for each cost group (rather than only by tier as is the current practice). In addition, given the substantial reduction in terminal pay that applies to members with membership dates on or after January 1, 2011, the Board should consider whether to continue to include terminal pay as a component of the member contribution rates for these members.

Regarding the first issue, Exhibit B contains terminal pay information similar to that shown in Exhibit A, except that it is now shown for each cost group instead of only by tier. A summary of the employers that are included in each cost group is shown in Exhibit C.

Note that certain districts that use the County payroll system are included with the County cost groups in Exhibit B. This is why some cost groups (for example Cost Group #8) do not show any retiring members during this period. Also, for retiring members with service in more than one tier, their terminal pay is determined separately for each tier's benefit and these amounts are then allocated separately to each applicable cost group in this exhibit.

The rest of this discussion details the two different methodology choices for how terminal pay should be valued in the annual actuarial valuation. Our intent is to receive direction from the Board in April on which of each methodology choice to adopt. Then we will calculate any applicable employer and member rates with the intention of bringing these results to the Board for the May 2011 meeting.

- **Methodology Choice #1** – For future actuarial valuations (starting with the December 31, 2010 valuation), should the current terminal pay assumption structure by tier be continued or should we develop terminal pay assumptions separately for each cost group?

Options and/or Recommendations – We do not necessarily have a strong opinion as ultimately benefits will be adequately funded under either option. Exhibit B clearly shows that there can be significant variations in terminal pay for employers in the same tier, but different cost groups. This means that continuing the current structure based on averages by tier may result in more actuarial gains and losses (that are funded over 18 years) for

some employers as compared to more immediate cost recognition under an assumption structure based on cost group.

Terminal pay assumptions that are separate for each cost group would seem to be more consistent with the depooling action taken by the Board in 2009. Even then there still will be some averaging involved in determining the assumptions for each cost group as some cost groups have more than one employer (such as cost groups #1 and #2 that have numerous small districts in addition to the County).

However, also note that there will be less experience available by cost group (since some of the cost groups have a relatively small number of members) as compared to by tier. This means the data will be less statistically reliable, if broken down into cost groups.

Our only specific recommendation on this matter is that if the methodology that uses terminal pay assumptions by cost group is adopted, it should be applied consistently to both current and new members starting no earlier than the December 31, 2010 actuarial valuation.

Regardless of the Board's choice for future valuations, for those members with membership dates on or after January 1, 2011, we will base both the employer and member contribution rates for the first six months of 2011 and for the 2011/2012 County fiscal year on the demographics of members in the December 31, 2008 and December 31, 2009 valuations, respectively. For this purpose, we will use the terminal pay assumptions shown in Exhibit A by tier.

- **Methodology Choice #2** – Whether a portion of member contribution rates should continue to reflect the application of the terminal pay assumption for members with membership dates on or after January 1, 2011.

Options and/or Recommendations – As was shown earlier, even under the current terminal pay policy only a relatively small portion of current member contribution rates is attributable solely to the terminal pay assumption and that portion is only in the Cost-of-Living (COL) component. And then, terminal pay appears to have been reduced significantly for new members under the new policy.

For these reasons, consideration should be given to eliminating any terminal pay component in the calculation of the member contribution rates for members with membership dates on or after January 1, 2011. However, this would shift to the employer the small portion of the cost due to terminal pay that would otherwise continue in the member contribution rates.

For all matters pertaining to interpretations of the Government Code, we would defer to legal counsel on what is allowable, especially in regards to Methodology Choice #2 above.

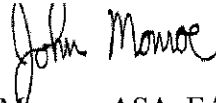
Ms. Marilyn Leedom
April 7, 2011
Page 6

Please let us know if you have any questions, and we look forward to discussing this with your Board.

Sincerely,



Paul Angelo, FSA, EA, MAAA
Senior Vice President and Actuary



John Monroe, ASA, EA, MAAA
Vice President and Associate Actuary

JZM/jmc

Exhibit A

**Contra Costa County Employees' Retirement Association
Comparison of Terminal Pay Under Old Policy versus New Policy for Those With a Membership Date on or After January 1, 2011
Illustration of Policies Based on New Retirements Between January 1, 2008 and December 31, 2010**

Terminal Pay as a Percentage of Final Average Pay (Excluding Such Terminal Pay)

Year	General Tier 1	General Tier 2	General Tier 3	Safety Tier A	Safety Tier C
	Average Terminal Pay	Average Terminal Pay	Average Terminal Pay	Average Terminal Pay	Average Terminal Pay
<i><u>Actual Terminal Pay under Old Policy</u></i>					
2008	12.84%	3.27%	7.51%	9.56%	N/A
2009	13.37%	4.17%	8.20%	11.76%	N/A
2010	<u>15.74%</u>	<u>3.14%</u>	<u>6.81%</u>	<u>13.13%</u>	<u>N/A</u>
Average	14.17%	3.55%	7.53%	11.57%	N/A
<i><u>Hypothetical Terminal Pay under New Policy</u></i>					
2008	3.73%	0.67%	1.47%	1.04%	N/A
2009	3.14%	0.62%	1.28%	1.36%	N/A
2010	<u>4.49%</u>	<u>0.49%</u>	<u>1.17%</u>	<u>1.92%</u>	<u>N/A</u>
Average	3.83%	0.60%	1.30%	1.45%	N/A
Current Assumptions	12.00%	3.50%	7.50%	11.25%	3.75%
Applies to members with membership date <u>before</u> January 1, 2011					
Possible Proposed Assumptions	3.50%	0.50%	1.25%	1.50%	0.50%
Applies to members with membership date <u>on or after</u> January 1, 2011					

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Exhibit C

Summary of Cost Groups and Employers

GENERAL

Cost Group	Employer Name	Benefit Structure
(1)	County General	Tier 1 Enhanced
	Local Agency Formation Commission	Tier 1 Enhanced
	CC Mosquito and Vector Control District	Tier 1 Enhanced
	Bethel Island Municipal District	Tier 1 Enhanced
	First 5 - Children & Families Commission	Tier 1 Enhanced
	Contra Costa County Employees' Retirement Association	Tier 1 Enhanced
	Superior Court	Tier 1 Enhanced
	East Contra Costa Fire Protection District	Tier 1 Enhanced
	Moraga-Orinda Fire District	Tier 1 Enhanced
	Rodeo-Hercules Fire Protection District	Tier 1 Enhanced
	San Ramon Valley Fire District	Tier 1 Enhanced
(2)	County General	Tier 3 Enhanced
	In-Home Supportive Services Authority	Tier 3 Enhanced
	Contra Costa Mosquito and Vector Control District	Tier 3 Enhanced
	Superior Court	Tier 3 Enhanced
(3)	Central Contra Costa Sanitary District	Tier 1 Enhanced
(4)	Contra Costa Housing Authority	Tier 1 Enhanced
(5)	Contra Costa County Fire Protection District	Tier 1 Enhanced
(6)	Rodeo Sanitary District	Tier 1 Non-Enhanced
	Byron Brentwood Cemetery	Tier 1 Non-Enhanced

Exhibit C

Summary of Cost Groups and Employers (continued)

SAFETY

Cost Group	Employer Name	Benefit Structure
(7)	County Safety	Tier A Enhanced
(8)	Contra Costa County Fire Protection District East Contra Costa Fire Protection District	Tier A Enhanced Tier A Enhanced
(9)	County Safety	Tier C Enhanced (Deputy Sheriff new hires)
(10)	Moraga-Orinda Fire District	Tier A Enhanced
(11)	San Ramon Valley Fire District	Tier A Enhanced
(12)	Rodeo-Hercules Fire Protection District	Tier A Non-Enhanced