

Early Retirement Incentive Program Study #4 and Amortization Period

LACERS

Ad Hoc Committee

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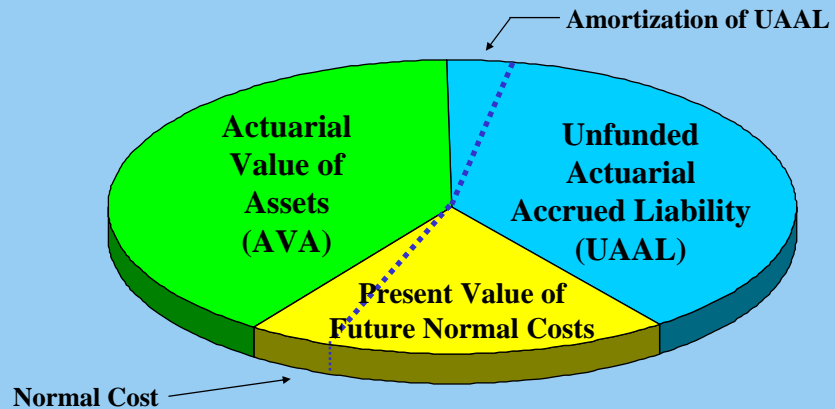
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Early Retirement Incentive (Window)

- Fourth in a series of studies requested by LA City (CAO and Mayor's Office)
 - ERI Program Study #4, July 30, 2009
- Five membership Groups each receive one of five benefit "Scenarios"
 - Groups 1 through 5 described on page 4
 - Benefit Scenarios A through E on page 5
- Two "take rate" alternatives
- Also "backfill" rates (used only for projections)

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Normal Cost and UAAL Cost



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Measuring the Cost of an ERIP

- Must consider changes in both contribution rate (% of pay) and in contribution amount
- Reduction in force generally lowers cost in dollars but increases cost rate
 - Same normal cost rate applied to smaller payroll
 - Same (pre-ERIP) UAAL cost dollars spread over smaller payroll means higher UAAL cost rate
- ERIP benefit increases UAAL cost dollars and UAAL cost rate (as a % of post-ERIP payroll)

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Effect of ERIP on UAAL, UAAL Cost

- UAAL and UAAL cost increases for two reasons
 - Members retire earlier than assumed, increasing value of pre-ERIP benefit
 - Member received additional benefit from extra age and/or service
- UAAL cost issues in first year (2009-10)
 - UAAL rate set in 2008 valuation to produce fixed UAAL cost based on pre-ERIP payroll
 - UAAL rate applied to lower payroll
 - Temporary savings underfunds pre-ERIP UAAL

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Effect of ERIP on Normal Cost, Payroll

- Normal Cost rate generally unchanged
- Normal Cost dollars decrease with payroll
- Normal Cost and payroll “savings” hard to specify
 - Would positions have been eliminated anyway?
 - For example, GFOA 2004 Recommended Practice: “Regarding financially driven ERIs, a cost/benefit analysis should compare long-term benefits and costs against the default scenario of a hiring freeze.”
 - Even if not, how long do “savings” continue?
 - As long as positions stay vacant? (“backfill” rates)
 - Only until ERIP members would have retired anyway?

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Basic Funding Considerations

- Increased benefits means increased costs
- Increase in UAAL increases the City contributions
 - Relatively easy to measure once members elect
- Possible offsets to increased City contributions
 - Increased member contributions
 - Either to LACERS or to City
 - Salary concessions
 - Pay reductions, deferred COLAs

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Valuation results (estimated for 2009)

- Alternative 1 Take Rates (2,229 ERIP members)
 - Payroll decrease: \$175 million
 - **UAAL increase*:** **\$250 million**
 - Change in Contribution rate:
 - Due to reduction in payroll: 1.46%
 - Due to ERIP benefit**:
 - Change in Contribution dollars:
 - Due to reduction in payroll: (\$24.95 million)
 - Due to ERIP benefit**:

* Excludes cash incentives of \$43 million

** Based on 15 year amortization

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Valuation results (estimated for 2009)

- Alternative 2 Take Rates (2,763 ERIP members)
 - Payroll decrease: \$215 million
 - **UAAL increase*:** **\$354 million**
 - Change in Contribution rate:
 - Due to reduction in payroll: 1.86%
 - Due to ERIP benefit**:
 - Change in Contribution dollars:
 - Due to reduction in payroll: (\$30.10 million)
 - Due to ERIP benefit**:

* Excludes cash incentives of \$51 million

** Based on 15 year amortization

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Preview of Alternative Periods

- 5 methods/rationales in LACERS staff report
 1. Period of salary savings compared to layoff scenario:
0 years (immediate payment since no salary savings)
 2. Average period of salary savings until expected retirement:
5 years
 3. Average period of salary savings until positions backfilled:
8 years
 4. Average period of additional ERIP benefit cashflows:
10 years
 5. Typical practice for general (non-ERIP) past service increase:
15 years

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Amortization Period for ERIP UAAL

- Current policy is 30 years for benefit improvements
- Model practice is linked to member demographics
 - Average future service or life expectancy
 - 15 years is typical for a past service benefit increase
- Special considerations for ERIP/Window benefits
 - Linked to period of ERIP related savings
 - For example, GFOA 2004 Recommended Practice:
“The incremental costs of an ERI should be amortized over a short-term payback period, such as three to five years. This payback period should match the period in which the savings are realized”

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Amortization Period for ERIP UAAL

- Consider salaries that would have been paid to ERIP members if they had retired when assumed
 - Measure average, salary weighted “duration”
 - Can also weight Groups/Scenarios by UAAL
 - Link amortization period to that duration
- Under Alternative 1 Take Rates (2,229 ERIP members)
 - Average savings is from 4.3 to 5.1 years of salaries
- Under Alternative 2 Take Rates (2,763 ERIP members)
 - Average savings is from 4.7 to 5.4 years of salaries
- Basis for staff recommendation of 5 years

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Alternative ERIP Amortization Period

- Alternatively, consider salaries savings from ERIP date as long as position stays vacant
 - Regardless of when member would have retired
- Depends critically on “backfill rate”
 - 7% for first year, 6% for 2nd to 15th year
 - 91% of the group replaced at 16th year
- Average duration of salary savings is about 8 years
 - Much less than 15 years because savings decrease immediately, only 9% savings remaining in 15 years

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Alternative ERIP Amortization Period

- Alternatively, consider duration of additional benefit payments under the ERIP
 - Compare expected payments before and after ERIP
 - Earlier retirements and additional age & service
- Average duration is about 10 years
 - Independent of “backfill rate”
 - Average is less than full length of payments because payments decrease over time

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Review of Alternative Periods

- 5 methods/rationales in LACERS staff report
 1. Period of salary savings compared to layoff scenario:
0 years (immediate payment since no salary savings)
 2. Average period of salary savings until expected retirement:
5 years
 3. Average period of salary savings until positions backfilled:
8 years
 4. Average period of additional ERIP benefit cashflows:
10 years
 5. Typical practice for general (non-ERIP) past service increase:
15 years

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Alternative ERIP Amortization Costs

- Alternative 1 Take Rates (2,229 ERIP members):
 - **UAAL Increase: \$250 million**
 - Amortization period: 5 8 10 15
 - Amortization cost: 2.86% 1.85% 1.51% 1.07%
- Alternative 2 Take Rates (2,763 ERIP members):
 - **UAAL Increase: \$354 million**
 - Amortization period: 5 8 10 15
 - Amortization cost: 4.10% 2.64% 2.15% 1.51%
- Actual costs depend on final group of actual ERIP members

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Funding ERIP with Member Contributions

- Suppose intent is to have members fund the ERIP
 - Increase in UAAL plus cash incentives
 - Well defined once actual ERIP elections are known
- Member cost could differ from City costs in report
 - Start date and timing of member contributions
 - Member contributions are refundable
 - Payback period for member funding of ERIP
 - Not necessarily the same as UAAL amortization period

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Alternative ERIP Member Payback Costs

- Alternative 1 Take Rates (2,229 ERIP members):
 - **UAAL Increase: \$250 million**
 - Payback period: 5 8 10 15
 - Additional member cost*: 3.10% 2.02% 1.66% **1.19%**
- Alternative 2 Take Rates (2,763 ERIP members):
 - **UAAL Increase: \$354 million**
 - Payback period: 5 8 10 15
 - Additional member cost*: 4.45% 2.90% 2.39% **1.70%**

* Actual costs depend on final group of ERIP members.
“Refundability” will increase above costs.

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UAAL amortization vs member payback period

- Two separate decisions, with some interrelation
 - UAAL amortization is between LACERS and City
 - Payback period is between City and members
- Already no perfect match between the two
 - One year lag for UAAL amortization
 - Two year lag for member repayments
- Possibly different rationale for payment periods
- Member payments at 0.75% do not fund entire UAAL
 - Other savings may be considered by City

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QUESTION

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