

CITY EMPLOYEES' RETIREMENT SYSTEM

City of Los Angeles

California

ANNUAL REPORT

FOR THE FISCAL YEAR ENDED JUNE 30, 1978

Room 505, City Hall South

111 East First Street

Los Angeles, California 90012

CITY OF LOS ANGELES

CALIFORNIA



TOM BRADLEY
MAYOR

**BOARD OF
ADMINISTRATION**

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Harry Johnson
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**CITY EMPLOYEES'
RETIREMENT SYSTEM**
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GORDON A. TURNBAUGH
MANAGER-SECRETARY

To the Mayor and City Council
of the City of Los Angeles

Attached is the annual report of the Board of Administration of the City Employees' Retirement System for the fiscal year ended June 30, 1978, in accordance with the provisions of Section 64 of the City Charter.

FINANCIAL INFORMATION

Retirement System investments changed substantially in character during the 1977-78 fiscal year. After intensive consultation with its three investment counselors, the Board decided to move toward more defensive allocation of its funds in anticipation of a period of rising interest rates. Because increased interest rates tend to depress long-term fixed-income investments more than medium- and short-term investments, it was determined that incoming funds should be committed primarily to short-term instruments, and that long range fixed-income investments should be shortened in maturity wherever possible. Since increased interest rates also weigh heavily on equities, it was decided to decrease the exposure in stocks, as well. All this was to be done with the intention of being able to take advantage of the expected lower prices for both long-term bonds and equities when it appeared that interest rates had peaked.

This program was successfully executed. As of June 30, 1978, short-term investments (Treasury bills, certificates of deposit and commercial paper) had been increased to represent 14.08% of the portfolio, while a year earlier they constituted only 4.23% of the Fund's assets. Equities (stocks) were reduced from 21.85% of assets to 14.19%, while longer term fixed-income securities (mostly bonds) declined from 73.92% to 71.73% of assets during the fiscal year. Thus, the fund was able to move money from equities and long-term bonds into short-term investments, and commit most "new" money to short-term investments, as well. This maneuver benefitted the fund substantially since the yield on short-term investments soared to unusually high levels during this

To the Mayor and City Council
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As required by the City Charter, the System's earnings are distributed to members' accounts and City reserves twice a year, on December 31 and June 30, based on the actual account balances as they existed six months prior to each of those dates. The rates this year were 3.215% for the December 31, 1977 distribution and 3.430% for the June 30, 1978 distribution. This is equivalent to a compounded total rate of 6.755% annually. The System's distribution rates have been increasing over the years in line with the gradually rising interest rates and the improving overall rates of return on the investment portfolio.

The Board believes it is important to obtain an outside, objective measurement and evaluation of the System's investment performance. To accomplish this, we have for several years utilized the services of A.G. Becker, Inc. one of the recognized experts in the field. According to Becker's 1977-78 evaluation, the Retirement fund's performance for the year was at about the median level of all the funds in the Becker survey. For the 10-year period ending June 30, 1978, however, the System's total return of 5.5% compounded annually was clearly superior. According to Becker, this level of performance was surpassed by only 6% of all the funds in the survey. The Board hopes to maintain this excellent long-range ranking in the years ahead.

INCREASED RETIREMENT CONTRIBUTIONS

On March 15, the Board of Administration received the report of its consulting actuary, Towers, Perrin, Forster & Crosby, Inc. (TPF&C), on the actuarial investigation and valuation of the System as of June 30, 1977. In this report, the actuary, in accordance with the newly-adopted official position of the American Academy of Actuaries, for the first time took official note of and actuarially recognized the effect of continued inflation on the salary scale. According to the actuary, for example, the City's average salary has increased approximately 90% over the past 10 years, corresponding to an annual compounded rate of 6-5/8%. TPF&C therefore recommended that this phenomenon be recognized by assuming an annual inflationary increase in salaries of 2-1/2%, in addition to the 1% that has been used previously to take account of longevity and promotional increases. Actuarial recognition of this continuing rise in salaries will significantly increase the amount of City contributions required to fund the System, and will increase member contribution rates, on average, by 54%. Because of the severe impact of such a large increase in City and employee contributions, the Board discussed the actuarial report at a number of meetings attended by representatives of the various employee

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organizations. The Board also contracted with the Martin E. Segal Company, another consulting actuary, to comment on the TPF&C report. After a detailed review, the Segal Company took no major exception to the TPF&C report. As of June 30, 1978, the Board had not yet adopted the actuarial report which would trigger the substantial increase in employee contribution rates.

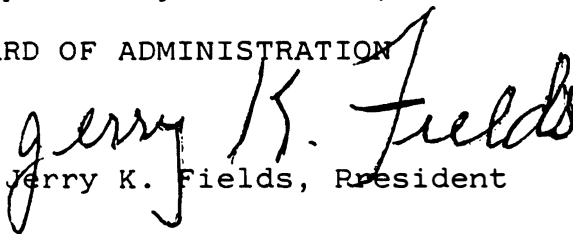
RECIPROCITY

Members of our staff continued to meet with representatives of the Department of Water and Power Retirement Plan and the City Administrative Officer in an effort to develop a workable arrangement for providing reciprocal retirement benefits to members of the City Employees' Retirement System and the Department of Water and Power Retirement Plan. As far back as 1975, the City Administrative Officer reported to the City Council on various inequities which arise when employees transfer membership between the two retirement systems. In May 1977, the electorate approved Proposition 7 which authorized certain alterations to the Water and Power Plan which were necessary to effect reciprocity, and these have since been accomplished. As of June 30, 1978, substantial accord had been reached on the provisions of a proposed reciprocity agreement, but the costs of such an arrangement and the proper apportionment thereof were still under discussion.

We appreciate your consideration of this report and would welcome any comments or suggestions regarding the Retirement System's operations.

Respectfully submitted,

BOARD OF ADMINISTRATION


By Jerry K. Fields, President

CITY EMPLOYEES' RETIREMENT SYSTEM

GENERAL STATISTICS

Active Membership

	<u>June 30, 1978</u>	<u>June 30, 1977</u>	<u>Increase or (Decrease)</u>
Males	16,912	16,201	711
Females	<u>6,649</u>	<u>5,401</u>	<u>1,248</u>
Total	23,561	21,602	1,959

Retirement Roll

	<u>June 30, 1978</u>		<u>June 30, 1977</u>	
	<u>Number</u>	<u>Average Monthly Allowance</u>	<u>Number</u>	<u>Average Monthly Allowance</u>
Service Retirements	5,191	\$523	4,789	\$487
Disability Retirements	498	303	465	289
Survivorships	306	383	284	362
Limited Pensions	11	657	13	514
Family Death Benefit Plan Beneficiaries	<u>218</u>	290	<u>177</u>	246
Total	6,224		5,728	

Applications Processed to Completion

	<u>1977-78</u>	<u>1976-77</u>	<u>Increase or (Decrease)</u>
Service Retirements	498	498	0
Disability Retirements	44	47	(3)
Family Death Benefit Plan	24	23	1
Death Benefits			
Active Employees			
Limited Pensions with Refund of Contributions	18	27	(9)
Survivorships	31	27	4
Refund of Contributions	35	35	0
Retired Employees			
Death Payments	191	220	(29)
Refund of Contributions to Former Members	1,825	1,552	273

Service Retirement Data

1977-78	<u>Average Age</u>	<u>Average Service</u>	<u>Average Allowance</u>	<u>Under Age 60</u>
	61.15	22.66 yrs.	\$723.21	35.98%

Touche Ross & Co.

December 15, 1978

Honorable Members of the City Council of
the City of Los Angeles, California

and

Board of Administration
City Employees' Retirement System

We have examined the balance sheets of the City of Los Angeles City Employees' Retirement System as of June 30, 1978 and 1977, and the related statements of changes in net assets available for plan benefits and city contributions (deficits) available for future retirees for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of the City of Los Angeles City Employees' Retirement System at June 30, 1978 and 1977, and the changes in net assets available for plan benefits and city contributions (deficits) available for future retirees for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Touche Ross & Co.

Certified Public Accountants

June 30

1978	1977
\$ 1,869,607	\$ 732,269
\$ 9,149,907	\$ 8,037,049
1,671,152	1,615,675
<u>58,701</u>	<u>21,191</u>
10,879,760	9,673,915
88,700,000	23,400,000
448,080,784	408,967,202
<u>88,736,170</u>	<u>120,889,457</u>
625,516,954	553,256,659
638,266,321	563,662,843
(2,182,487)	(354,077)
<u>\$636,083,834</u>	<u>\$563,308,766</u>
\$189,681,349	\$180,236,615
484,471,178	411,547,967
(38,068,693)	(28,475,816)
<u>\$636,083,834</u>	<u>\$563,308,766</u>

CITY OF LOS ANGELES
CITY EMPLOYEES' RETIREMENT SYSTEM

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 1978 AND 1977

Note 1 - Summary of Significant Accounting Policies:

Investments

Temporary investments, consisting primarily of commercial paper and certificates of deposit, are carried at cost, which approximated market at June 30, 1978 and 1977.

Investments in bonds are carried at amortized cost and had quoted values of approximately \$398,600,000 and \$382,000,000 at June 30, 1978 and 1977, respectively. Bonds that are held to maturity are redeemed at par. Exchanges of bonds are accounted for pursuant to the deferral and amortization method, whereby the amortized cost of the bonds disposed of is transferred as the cost of the bonds acquired, plus or minus any cash principal differentials. Resulting premiums and discounts are recorded as yield adjustments and amortized against investment income to be realized from the bonds acquired. During the years ended June 30, 1978 and 1977, bond investments with an aggregate amortized cost of approximately \$131,600,000 and \$97,600,000, respectively, were exchanged in this manner. The amortized cost of the bonds exchanged exceeded the quoted value of the bonds by \$12,057,000 and \$6,886,000 for 1978 and 1977, respectively.

Investments in stocks are carried at cost and had quoted market values of approximately \$88,700,000 and \$112,700,000 at June 30, 1978 and 1977, respectively. At June 30, 1978, stocks with a cost of approximately \$36,874,000 and a quoted market value of approximately \$33,965,000 had outstanding covered call option contracts written against them. If all of the options were exercised, the aggregate sales value of those optioned stocks would be approximately \$34,593,000. Included in deferred income at June 30, 1978, is the amount of \$1,321,888, which is the premium resulting from the sale of the outstanding covered call option contracts. Option premiums are accounted for on a completed transaction basis, with earned net premiums being credited to income accounts for all expired or repurchased contracts. Option premiums are accounted for as part of the stock sales price when the option is exercised. At June 30, 1977, the amount of stock that was optioned was insignificant.

Reserve for Retirement Allowances

As provided in the Los Angeles City Charter, the City Employees' Retirement System (the System) is maintained on a reserve basis, determined in accordance with accepted actuarial methods.

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 1978 AND 1977

(Continued)

- Salary increases and scales - The valuation as of June 30, 1977, gave effect to general salary increases that took effect July 1977. There have been no general salary increases since then. The salary scale used by the actuary in making the actuarial valuation consists of two elements; one element for service, merit and promotion (1%) and another element for anticipated increases arising from future inflation (2-1/2%).
- Cost of living annual increase - The year-end valuations were prepared utilizing an assumption of a 3% annual rate of increase for both retired members and for active members when they retire.
- Mortality after service and disability retirements - The valuation is based upon the use of the 1971 Group Annuity Mortality Table and the 1973 Disability Mortality Table.
- Employee turnover and retirement - Expected rates of employee turnover and retirement were developed during the last actuarial investigation based on actual experience of the System. These rates will be used until the next actuarial investigation.
- Funding method - The entry age normal cost funding method is used in the actuarial valuation. Under this method, normal costs are calculated as a level percent of salary necessary to fund the projected future benefits over the period from the date of participation to the date of retirement.
- Funding of prior and past service costs - These costs are generally being funded over a 30-year period ending June 30, 2004, as a level percentage of salary.

Actuarial valuations performed by the consulting actuary contained the following balances:

- The actuarially determined unfunded prior and past service costs of the System were \$661,767,087 and \$642,556,667 at June 30, 1978 and 1977, respectively.

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CITY EMPLOYEES' RETIREMENT SYSTEM

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 1978 AND 1977

(Continued)

Note 5 - Defrayal of Portion of Members' Contributions:

A City ordinance became effective in October 1975 that permits the City to subsidize and pay a portion of certain employee contributions. Payments made by the City in this manner are not refundable to members upon their withdrawal from the system prior to retirement. Therefore, the City does not have to contribute the total amount of employee contributions that it subsidizes. The amount payable by the City, based upon the actuarial valuations, is approximately 70% of subsidized employee contributions. For the years ended June 30, 1978 and 1977, the City contributed \$7,737,312 and \$7,473,826, respectively, in this manner.

DISTRIBUTION OF SECURITIES BY TYPE AND CLASS (continued)

	<u>June 30, 1978</u>	<u>June 30, 1977</u>
Stocks:		
Common Stocks		
Automotive	2.72%	2.69%
Banks and Finance	5.13	2.05
Chemical	--	7.05
Drugs and Medical Supply	10.34	9.36
Electrical Equipment	3.99	6.78
Electronics	2.29	2.56
Food and Beverage	7.11	5.96
Household-Personal Products	5.04	4.72
Insurance	1.09	1.60
Lodging and Food Service	2.52	1.85
Machinery	1.01	2.86
Metals and Mining	3.20	5.05
Office Equipment	16.45	14.56
Oil and Oil Service	13.17	10.18
Photographic	3.72	2.61
Public Utilities	9.03	4.99
Publishing and Broadcasting	1.63	--
Retail Trade	4.11	8.27
Telephone	3.95	3.71
Miscellaneous	<u>3.50</u>	<u>3.15</u>
	<u>100.00%</u>	<u>100.00%</u>

YIELD ON INVESTMENTS

	<u>Year Ended June 30, 1978</u>	<u>Year Ended June 30, 1977</u>
Fixed Income	7.10%	6.94%
Stocks	4.24	3.72
Fixed Income and Stocks	6.51	6.27
Short-term Securities	6.74	5.07
Total Portfolio	6.52	6.24