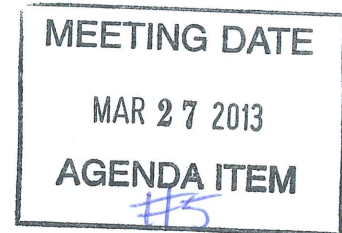


MEMO

Date: March 27, 2013
To: CCCERA Board of Retirement
From: Kurt Schneider, Deputy Chief Executive Officer
Subject: First 5 Contra Costa - \$2 Million UAAL Prepayment



Recommendation: Consider First 5's Request Regarding the Amortization of the Prepayment

Over the past year CCCERA staff has had discussions with First 5 Contra Costa Children and Families Commission (First 5) regarding the Unfunded Actuarial Accrued Liability (UAAL), and First 5's required contribution to fund it. First 5 is currently pooled with Cost Groups #1 and #2 for the purpose of calculating their UAAL contribution rate, so any such prepayment would require some type of special treatment to reduce First 5's UAAL contribution rate in the future in such a way that the prepayment has minimal impact on the UAAL contribution rate of the other employers in the cost group.

While this is not the first time a CCCERA participating employer has made an additional contribution towards their UAAL, this is the first time since CCCERA adopted multiple amortization "layers" in 2008. In addition, there are other circumstances unique to First 5 that the Board should bear in mind when deciding whether to treat this prepayment differently than those in the past. The following correspondence is attached:

- March 29, 2012 correspondence from CCCERA to First 5 explaining how First 5's UAAL contribution rate is determined
- December 17, 2012 request from First 5 regarding the treatment of their proposed \$2 million UAAL prepayment
- February 6, 2013 response from the System's actuary, the Segal Company, which recommended we granted First 5's request with the exception that the amortization of the prepayment be done as a level percent of payroll
- March 1, 2013 response from First 5 giving further support for their request regarding the level dollar amortization
- March 19, 2013 response from Segal acknowledging that First 5's request for level dollar amortization is reasonable from an actuarial perspective, and would not unnecessarily complicate the actuarial valuation process

Recommendation: Consider whether it is appropriate to amortize First 5's UAAL prepayment as a level dollar amount, and make any Board action subject to legal review.



March 29, 2012

Shawn Garcia
Administrative Manager
First 5 Contra Costa
1485 Enea Ct., Suite 1200
Concord, CA 94520

Re: Followup to meeting of February 28, 2012

Dear Shawn,

Thank you for meeting with us on February 28, 2012 to discuss your questions on the depooling methodology in respect to First 5 and the possibility of making payments towards your Unfunded Actuarial Accrued Liability (UAAL).

As we discussed, for the purpose of calculating the employer's contribution rate towards the Unfunded Actuarial Accrued Liability (UAAL), small employers are pooled with the County. The Board took action to group those employers with less than 50 employees with the most appropriate group. In this case, First 5 is pooled with Cost Group #1. A review with our counsel indicates that the Board has appropriately and lawfully established uniform rates based on a pooling of the actuarial liabilities generated by the employees of different participating employers.

The current practice of CCCERA is to amortize gains and losses (UAAL) by year, over an 18 year period. As of the December 31, 2010 valuation, the UAAL rate for Cost Group #1 was 21.25% of payroll. An employer could, in theory, make a contribution exactly equal to their UAAL and receive an adjustment to their contribution rate that offsets their UAAL contribution rate.

Based on the UAAL as of December 31, 2010, in order to receive a UAAL credit of 21.25%, First 5 would have had to contribute \$3,456,000 as of that date. This amount is based on current payroll, increased by 4.25% per year. When those amounts are discounted back to the valuation date at 7.75% per year they total \$3,456,000.

After the additional contribution is made, the UAAL contribution rate for the entire Rate Group would be calculated as if the additional contribution had not been made. Then First 5 would receive a reduction to their contribution rate as the additional contribution is amortized. Since all assumptions will not exactly be met, the credit in future years will not exactly offset the UAAL contribution rate, however, First 5 will eventually receive credit for the entire additional contribution as long as they have payroll and a required contribution. Note that if the payroll for First 5 does not increase as fast as the entire Rate Group, the credit from the additional payment could far exceed the UAAL contribution rate and serve to offset the employer Normal Cost.

Because of the complicated subject matter, and the changes ensuing because of variances, we recommend that you consult with your actuary before making any additional contributions towards the First 5 UAAL.

Please let me know if you have further questions on this matter.

Sincerely,

Marilyn Leedom
Retirement Chief Executive Officer

Creating a
Brighter
Future for
Contra Costa's
Children and
Families

December 17, 2012

Marilyn Leedom
Chief Executive Officer
CCC Employees' Retirement Association
1355 Willow Way, Suite 221
Concord, CA 94520

Dear Marilyn,

We are responding to your letter of March 29, 2012, which offered the possibility of making a contribution toward First 5's pension unfunded actuarial liability (UAAL).

In consultation with the Commission's actuary, John Bartel, staff and Commissioners have discussed your proposal and reviewed several prepayment scenarios. At its November 5, 2012 meeting, the Commission approved a motion to partially pre-fund the Commission's pension unfunded accrued actuarial liability (UAAL) payment; and authorized the Executive Director to present to CCCERA the Commission's desire to pre-fund its UAAL with a payment of \$2 million to be amortized over 11 years at 7.75%.

Mr. Bartel offers this explanation for the CCCERA Board considering accepting a \$2 million prepayment in exchange for an 11 year level dollar reduction of First 5's contribution payments:

The UAAL for First 5 is pooled with the County and ten other Districts in Cost Groups #1 and #2. We understand that in order to determine the adjustment to First 5's contribution rate due to the prepayment, an amortization of the prepayment will have to be created and tracked as has been done by CCCERA for other pooled Districts to account for POBs or any other special contributions. Historically, when an agency has paid a portion of the UAAL CCCERA has used the same amortization method (and period) for the special contribution as used by CCCERA to amortize the UAAL. The last such payment, however, was in 2007 when CCCERA used a single amortization layer. Subsequently CCCERA has moved to a layered amortization policy.

The December 31, 2011 Actuarial Valuation shows five different amortization periods ranging from 11 to 18 years, with a sixth period expected to be added in the 2012 Valuation. In the December 31, 2011 Actuarial Valuation, the outstanding balance of the first layer (the entire December 31, 2007 outstanding UAAL) represented approximately 61% of the UAAL, and had 11 years remaining. We believe a reasonable approach is to amortize First 5's UAAL prepayment using the same period as that layer. The proposed prepayment is less than this outstanding layer. There are two main reasons why this approach is beneficial for both First 5 and CCCERA.

The first benefit is to allow First 5 to manage contribution rate volatility. CCCERA abandoned the single closed amortization layer approach in favor of multiple layers precisely to avoid excessive contribution rate volatility. By using a longer period for new gains and losses than is used for the outstanding UAAL, contribution rate adjustments are minimized. However, closed layers unavoidably lead to tail volatility when the layers are fully amortized. Using the special contribution credit layer to offset what is by far the largest outstanding UAAL layer, First 5 can mitigate this tail volatility. The second benefit is to minimize investment risk to the County and the ten other Districts in the UAAL pool. Since First 5 is essentially credited with the long-term expected rate of return on the outstanding balance of the prepayment credit throughout the amortization period, by amortizing the credit as a level dollar along with the shortest outstanding UAAL layer, the risk to the other employers is minimized.

We look forward to working with you toward an arrangement that is acceptable to all parties. Thank you for considering our request.

Sincerely,



Sean Casey
Executive Director

cc: John Bartel



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February 6, 2013

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
First 5 Children and Families Commission ("First 5") Potential Prepayment
Towards Unfunded Actuarial Accrued Liability (UAAL)**

Dear Marilyn:

As requested, we are providing information regarding First 5's potential \$2 million UAAL prepayment. First 5's December 17, 2012 letter contains their specific request which consists of making a \$2 million prepayment towards their December 31, 2011 UAAL in exchange for an 11-year level dollar amortization of the prepayment that will be used to reduce First 5's UAAL contribution rate.

Background

Historically, certain participating employers have contributed additional contributions towards their UAAL (sometimes via proceeds from a Pension Obligation Bond (POB)). The additional contributions were then separately tracked and amortized as a level percent of payroll over the remaining period of CCCERA's single amortization layer, and used to reduce that employer's UAAL contribution rate over that same period.

Beginning with the December 31, 2008 Actuarial Valuation, CCCERA began using multiple amortization "layers". No employers have made additional contributions since CCCERA adopted this approach. With the December 31, 2009 Actuarial Valuation, the Board depooled CCCERA's UAAL. This eliminated the need for separately tracking and amortizing any additional contribution for employers that are in their own cost group, however, small Districts remained pooled with the County.



In CCCERA's annual actuarial valuation, First 5's UAAL is pooled with the County and ten other employers as part of Cost Group 1 and 2. This UAAL is amortized as layers over various periods that range from 11 years to 18 years as of December 31, 2011. Our August 8, 2012 letter contains the UAAL for each employer and the methodology used to determine the UAAL. Based on that letter, First 5's UAAL is \$3,995,000 as of December 31, 2011. First 5's UAAL amortization layers and the periods remaining for each layer as of December 31, 2011 are as follows:

Date Established	Source	Outstanding Balance	Years Remaining
December 31, 2007	Restart of Amortization	\$2,450,000	11
December 31, 2008	Actuarial (Gain)/Loss	\$268,000	15
December 31, 2009	Actuarial (Gain)/Loss	\$557,000	16
December 31, 2009	Assumption Change	\$133,000	16
December 31, 2009	Depooling Implementation	\$(252,000)	16
December 31, 2010	Actuarial (Gain)/Loss	\$518,000	17
December 31, 2011	Actuarial (Gain)/Loss	\$321,000	18
	Total UAAL:	\$3,995,000	

Discussion

From an actuarial perspective, we believe it would be reasonable for CCCERA to accept the \$2 million prepayment towards First 5's December 31, 2011 UAAL in exchange for a corresponding reduction in First 5's UAAL contribution rate over an 11-year period. This is because the UAAL prepayment amount is less than the outstanding UAAL balance on First 5's first and largest UAAL amortization layer (see above) that has 11 years remaining as of December 31, 2011.¹ Assuming that the prepayment is received before July 1, 2013, the rate reduction would be effective on July 1, 2013, which is the date that the contribution rates from the December 31, 2011 valuation become effective. Note that to determine the reduction in the UAAL it would be necessary for us to discount the \$2 million prepayment for approximately 1.5 years back to the December 31, 2011 valuation date using the current 7.75% investment return assumption.

We recommend that the reduction in First 5's UAAL contribution rate be based on amortizing the \$2 million as a level percent of payroll instead of as a level dollar amount. This is to be

¹ If the UAAL prepayment amount was larger than the outstanding balance on the first amortization layer, then we would recommend that the excess portion be amortized over the period remaining for the next layer, etc.

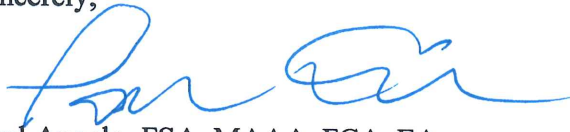
consistent with the methodology used in the annual actuarial valuation where the UAAL is amortized as a level percent of payroll assuming payroll will grow at 4.25% per year.

The outstanding balance of the prepayment amount will be tracked separately over the 11-year period in a manner that is consistent with the procedure used to track the UAAL layers shown above. The dollar amount of the annual reduction due to the prepayment will be based on amortizing the outstanding balance of the prepayment amount using CCCERA's investment return and payroll growth assumptions in effect at each valuation date. The reduction in the UAAL contribution rate will then equal the dollar amount of reduction divided by First 5's payroll. This means that the reduction in First 5's UAAL contribution rate will vary over time based on the level of First 5's payroll.

Since the outstanding balance of the prepayment amount is tracked separately over the 11-year period based on CCCERA's investment return assumption in effect at each valuation date (currently, 7.75% per year), any gain or loss from investments that occurs during the 11-year period over which the prepayment is recognized will be pooled across all of the employers in Cost Group 1 and 2. Since the prepayment amount is relatively small compared to the overall assets of all employers in Cost Group 1 and 2 (roughly \$3 billion), the prepayment amount should not significantly increase the volatility of the UAAL contribution rates for those two cost groups.

We look forward to discussing this information with you.

Sincerely,



Paul Angelo, FSA, MAAA, FCA, EA
Senior Vice President & Actuary



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

JZM/gxk

March 1, 2013

Marilyn Leedom
Retirement Chief Executive Officer
CCC Employees' Retirement Association
1355 Willow Way, Suite 221
Concord, CA 94520

Dear Ms. Leedom,

In response to your letter of March 29, 2012, which offered the possibility of First 5 making a contribution toward its pension unfunded actuarial liability (UAAL), I would like to submit the following proposal for consideration by the CCCERA Board: *We request a \$2 million payment towards our unfunded liability in exchange for a reduction in the amortization payment based on an 11 year level dollar amount.*

As you know, the Contra Costa Children and Families Commission – which now is also known as First 5 Contra Costa – was created subsequent to the passage of Proposition 10 in November, 1998. Proposition 10 instituted a 50-cents-per-pack cigarette tax to support services for children 0-5 and their families in every California county. The Board of Supervisors created the Contra Costa Children and Families Commission as an independent public agency in 2000, allowing it to establish its own staff and agency policies and procedures.

Also in 2000, First 5 joined CCCERA for the purpose of providing its employees with pension benefits. At the time that First 5 joined CCCERA, only one of its employees had any prior service credit with CCCERA; all other employees were new to CCCERA.

First 5's situation is unique compared to other CCCERA participating agencies. First 5 brought little to no unfunded liability to the CCCERA system when it joined and still has no active retirees. Even so, First 5, like all other CCCERA members, continues to pay its normal contribution as well as the full contribution toward the UAAL, mostly incurred by other member agencies with significantly longer histories.

First 5 is also unique in that it depends, by design, on a declining revenue source. The framers of Proposition 10 anticipated that a secondary benefit of the cigarette tax would be to reduce cigarette consumption and the harmful effects of smoking. As a result of this and other state and federal taxes, cigarette consumption in California drops on average 2-3% each year. First 5's initial full year of tax revenue was \$14,764,000; in the 2012-13 fiscal year it is projected to be \$8,492,000.

As a result, First 5's current 25 employees are likely to be the most it ever has. The Commission's next strategic plan – which will address the fiscal years starting July, 2015, will have to call for reducing staff as Prop 10 revenue continues to drop.

Because of our unique situation, we have explored with you over the last several years a number of methods to mitigate the cost of the Commission's UAAL contribution. At this juncture the best remedy appears to be a prepayment of our future payments to take advantage of CCCERA's existing interest rate, as you proposed in your letter of last March.

In consultation with the Commission's actuary, John Bartel, and our Commissioners, we have discussed your proposal and reviewed several prepayment scenarios. At its November 5, 2012 meeting, the Commission authorized me to present to CCCERA the Commission's desire to pre-fund its UAAL with a payment of \$2 million to be amortized over 11 years at 7.75%. Our actuary also recommends that this pre-payment be amortized on a level-dollar basis as it is much more compatible with a declining revenue base than an increasing dollar amortization.

I understand the burdens that you and the Retirement Board must carry at this time. I very much appreciate the time and attention that you and your staff have provided us over the years as we, too, have grappled with the long-term implications of funding pension benefits for our employees. I hope that you and the Board will appreciate the unique and special nature of First 5's situation and look favorably on our request.

Thank you for considering our request. Please do not hesitate to contact me for any reason.

Sincerely,



Sean Casey
Executive Director

cc: Ms. PJ Shelton, Commission Chair
Mr. John Bartel



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March 19, 2013

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
First 5 Children and Families Commission ("First 5") Proposal Regarding a
\$2 Million Prepayment Towards Unfunded Actuarial Accrued Liability (UAAL)**

Dear Marilyn:

As requested, we are providing additional information regarding First 5's proposed \$2 million UAAL prepayment. Our February 6, 2013 letter contained details on how the prepayment would be handled in the annual actuarial valuation. The information found in our letter confirmed that First 5's request was reasonable, except that we believed that the prepayment should be amortized as a level percent of payroll instead of as a level dollar amount as was originally requested by First 5.

First 5's March 1, 2013 letter to CCCERA formally submitted the following for consideration by the CCCERA Board:

"We request a \$2 million payment towards our unfunded liability in exchange for a reduction in the amortization payment based on an 11-year level dollar amount."

Their letter also provides further background on the potential issues associated with their ongoing level of employees and permanence as an employer as rationales behind their specific request.

Based on this new information, we believe that amortizing the prepayment amount as a level dollar amount is reasonable from an actuarial perspective.

Benefits, Compensation and HR Consulting Offices throughout the United States and Canada

Note that the California Actuarial Advisory Panel (CAAP) has recently issued guidelines regarding actuarial funding policies. In particular, Item 8. of the "Discussion" section under the "Amortization Policy" section in the CAAP document is shown below.

8. *Level dollar amortization: fundamentally different from level percent of pay amortization.*
- a. *No level dollar amortization period is exactly equivalent to a level percent period.*
 - b. *Plan and/or sponsor circumstances could determine appropriateness of level dollar method.*
 - i. *Level dollar could be appropriate for plans where benefits are not pay related.*
 - ii. *Could be appropriate for sponsors and plans that are particularly averse to future cost increases, e.g., utilities setting rates for current rate payers.*
 - iii. *Could be appropriate for sponsors and plans that want an extra measure of conservatism or protection against low or no future payroll growth.*
 - iv. *Could be useful as a step in developing amortization payments in proportion to some basis other than payroll.*

In First 5's case, it appears that item iii. may apply here.

We do not anticipate that amortizing this amount as a level dollar amount will cause any unnecessary complication or disruption to the actuarial valuation process as compared to amortizing as a level percent of payroll. However, the Board should consider whether it is appropriate to grant this exception for this employer as compared to the other employers who have previously made UAAL prepayments or those that will make future UAAL prepayments.

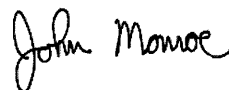
Finally, First 5's letter mentions that the prepayment would be "...amortized over 11 years at 7.75%". Consistent with our February 6, 2013 letter, we will again note that these amounts are amortized using CCCERA's investment return assumption in effect at each valuation date. CCCERA's recently adopted investment return assumption of 7.25% is scheduled to be used in the December 31, 2012 actuarial valuation, and future valuations unless changed by the Board.

We are members of the American Academy of Actuaries and we meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion herein. We look forward to discussing this information with you.

Sincerely,



Paul Angelo, FSA, MAAA, FCA, EA
Senior Vice President & Actuary



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

/bqb