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VIA E-MAIL AND USPS

June 16, 2016

Mr. Ray Ciranna  
General Manager  
Los Angeles Fire and Police Pensions  
701 E. 3<sup>rd</sup> Street, Suite 200  
Los Angeles, CA 90013

**Re: LAFPP – Increases in Normal Cost Rates for Airport Police Officers to Enter Tier 6**

Dear Ray:

As requested by LAFPP, we have estimated the increases in the normal cost rates for the City if existing and new Airport Police Officers who are currently (or would otherwise be) enrolled in the LACERS’ plans are permitted to enter LAFPP Tier 6. As discussed in the attached letter dated June 13, 2016, this initial analysis has been prepared using the Simplified Method outlined in that letter in order to meet the City’s deadline required for this analysis. As further discussed in that letter, we will be following up with a final analysis before the end of June using the actual census data based calculation under the Detailed Method also outlined in our June 13 letter. The results provided herein reflect a June 30, 2015 valuation date.

**SUMMARY OF RESULTS**

The estimated increases in the normal cost rates for the City, expressed as a percent of payroll, to allow existing and new Airport Police Officers to enter LAFPP Tier 6 are as follows:

<b>Summary of Results:</b>			
<b>Estimated <u>Increases</u> in the City’s Normal Cost Rates<sup>(1)</sup></b>			
	Retirement Plan	Health Plan	Both Plans Combined
Existing Airport Police Officers <sup>(2)</sup>	10.17%	3.79%	13.96%
New Airport Police Officers	13.68%	4.07%	17.75%

<sup>(1)</sup> All City contribution rates provided in this letter are assumed to be payable at the beginning of the year.

<sup>(2)</sup> The projected annual payroll for the 516 existing Airport Police Officers included in this study is \$49.0 million as of June 30, 2015.

Although employer normal cost rates would increase due to the inclusion of Airport Police Officers in LAFPP Tier 6<sup>1</sup>, there would be no adverse impact on the LAFPP plans' funded ratios. The reason for this is that the City would be obligated to make these employer normal cost contributions, and members would be responsible for paying the entire cost of converting any of their past LACERS service to LAFPP Tier 6 service (in addition to their obligation to pay the ongoing employee normal cost rate), as discussed below.

It should be noted that the normal cost increases provided in the table above are with respect to the funding required by the City. We have assumed that the Airport Police Officers would continue to pay an employee normal cost rate of 11% of pay per pay period (which is unchanged from the rate they are currently paying into LACERS).<sup>2</sup>

The assumed 11% employee normal cost rate is before the cost for the employees to purchase any prior LACERS service as LAFPP Tier 6 service. We have not included the amount required to purchase prior service, as the purchase cost is dependent on the specific procedures that would be used to determine the purchase. Those procedures would not be developed until after the ballot measure to approve Tier 6 membership is approved by the voters. The absence of such purchase cost should not affect the results provided herein for the City because it is anticipated that any such cost to purchase prior service would be borne entirely by the individual Airport Police Officers and not by the City.

## **BACKGROUND**

The City is preparing a ballot measure that would allow existing Airport Police Officers appointed to the Airport prior to January 7, 2018 to elect a change in their membership from LACERS to LAFPP. This ballot measure would also mandate LAFPP membership for all new Airport Police Officers appointed on or after January 7, 2018 (with some exceptions as outlined in the measure). All of the existing Officers who elect to join LAFPP and the new Officers who are mandated to join LAFPP would join the Tier 6 plan. Airport Police Officers who have accrued service at LACERS prior to January 7, 2018, and who elect LAFPP membership, would be required to convert all of their prior LACERS service to LAFPP service.

There would be increases in the City's ongoing normal cost rates associated with enrolling existing and new Officers in LAFPP instead of LACERS, and those increases in normal cost rates are provided in this letter. However, we reiterate that it is beyond the scope of this study to

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<sup>1</sup> These increases represent the changes in the employer normal cost rates payable during fiscal year 2016/2017 for the Airport Police Officers as members in LACERS.

<sup>2</sup> Under the LAFPP Tier 6 plan, the member normal contribution rate for current members is 9%, plus 2% additional contributions to support funding of retiree health benefits. The additional 2% contributions are not required for members with more than 25 years of service, and the 9% contributions are not required for members with more than 33 years of service. Based on our review of the documents related to the transfer, we understand that for tax qualification purposes all members who transfer from LACERS to LAFPP Tier 6 would have to pay a level contribution throughout their entire membership at LAFPP, similar to what they would be required to pay had they not transferred their membership from LACERS. As details are still being developed on what would comply with the relevant tax laws, we assume that the full 11% of employee contributions would continue to be paid even after members attain 25 or 33 years of service.

determine the cost for the individual members to purchase their prior LACERS service as LAFPP service.

## METHODOLOGY

The increases in the City's normal cost rates have been calculated in the following steps:

### *Step One: Normal Cost Rates under LACERS*

Previously, as part of completing the LACERS public safety tier feasibility study for the Airport Police Officers, we calculated the normal costs associated with (a) providing the 516 existing Airport Police Officers reported as of June 30, 2015 (who were represented by Bargaining Units 30, 39 and 40) a benefit under the LACERS Tier 1 plan, and (b) providing any new Airport Police Officers who would join in the future a benefit under the LACERS Tier 3 plan. Since no Airport Police Officers had yet entered Tier 3 as of June 30, 2015<sup>3</sup>, the demographic profile of new Airport Police Officers was estimated by using the demographics of the then active LACERS Tier 2 Airport Police Officers who were hired during the two-year period July 1, 2013 through June 30, 2015.

Under the ballot measure, certain existing non-represented Airport Police Officers will also be allowed to elect LAFPP membership. Note that when we previously calculated the normal cost rates in our aforementioned public safety tier study, we were not requested by the City to include three (3) non-represented Assistant Airport Police Chiefs in our calculations. Accordingly, our calculations were based only on the 516 Airport Police Officers, rather than all 519 existing Officers and Assistant Police Chiefs. Under the Simplified Method used herein, we have not refined the normal costs described in item (a) above to include the 3 non-represented Assistant Airport Police Chiefs. Even though the 3 Assistant Police Chiefs have a higher age at entry into LACERS which would normally lead to a higher normal cost rate under the funding method used by LACERS and LAFPP, that difference should not be material as they are a relatively small group compared to the other 516 Officers we included in our earlier study.

The normal cost rates for the City, expressed as a percent of payroll, for the 516 existing Officers assuming all of them are enrolled in the LACERS Tier 1 retirement and health plans, determined using their demographic and the actuarial assumptions used in the June 30, 2015 valuations, are as follows:

<b>Employer Normal Cost Rates as if All 516 Existing Airport Police Officers are Enrolled in LACERS Tier 1</b>			
	Retirement Plan	Health Plan	Both Plans Combined
Existing Airport Police Officers	5.45%	2.88%	8.33%

<sup>3</sup> Tier 3 became effective on February 21, 2016.

In determining the normal cost rates above, we took the 42 members reported by LACERS as Tier 2 members in the 2015 valuations and treated them as Tier 1 members to reflect the rescinding of the Tier 2 plan after the 2015 valuations. We combined those 42 members with the 474 members reported by LACERS as Tier 1 members in the 2015 valuations and we re-calculated the employer normal cost rates for all 516 existing Officers under LACERS Tier 1 plan provisions and using Tier 1 actuarial assumptions.

It should be noted that the normal cost rates for the City provided in the table above are less than the Tier 1 normal cost rates of 6.75% and 3.31%<sup>4</sup> for the City determined in the June 30, 2015 retirement and health valuations, respectively, based on the demographic profile of all LACERS Tier 1 members covered in all City Departments. (The employer normal cost rate for both plans combined is therefore 10.06% for all LACERS Tier 1 members.) This is because the average entry age of about 28.8 for the 516 Officers is lower than the average entry age of about 33.7 for all of the 21,915 Tier 1 active members included in the 2015 valuations.

Even though 10.06% is the combined employer normal cost rate calculated for all Tier 1 members (including most of the 516 Officers who were reported as Tier 1 members in the 2015 valuations), we believe it would be more appropriate when determining the increase in the cost to provide benefits under LAFPP to start with the 8.33% normal cost rate shown in the table above, which was calculated using only the 516 Officers included in study.

In the absence of the ballot measure, any new Airport Police Officers who join on or after January 7, 2018 would enter the new LACERS Tier 3. The Tier 3 normal cost rates for the City, expressed as a percent of payroll, for the new Airport Police Officers (again, estimated by using the demographics of the then active LACERS Tier 2 Airport Police Officers who were hired during the two-year period July 1, 2013 through June 30, 2015) are as follows:

<b>Employer Normal Cost Rates if New Airport Police Officers are Enrolled in LACERS Tier 3</b>			
	Retirement Plan	Health Plan	Both Plans Combined
New Airport Police Officers	1.94%	2.60%	4.54%

***Step Two: Normal Cost Rates under LAFPP***

In this step, we estimate the normal cost rates associated with enrolling the 516 existing and the new Airport Police Officers as described in Step One in LAFPP. Under the Simplified Method, we have not actually calculated the normal costs associated with enrolling the existing and the

<sup>4</sup> The 3.31% Tier 1 employer normal cost rate was developed for our June 30, 2015 health plan valuation report dated October 30, 2015 and was cited in our LACERS public safety tier feasibility study for the Airport Police Officers. Subsequently, we are asked by LACERS to recalculate this rate for our Tier 3 study report (dated March 14, 2016) to reflect a change in eligibility requirements for a retiree health benefit for certain part-time employees, and that recalculated rate was 3.40%. We note, however, that the change in the Tier 1 employer normal cost rate (i.e., from 3.31% to 3.40%) to reflect the change in eligibility requirements would not affect the employer normal cost rate increases shown in this letter.

new Airport Police Officers in the LAFPP. Instead, we have estimated the normal costs for these Officers based on the following observations and analysis.

As part of this analysis, we need to first estimate normal cost rates if all the existing 516 Officers would elect LAFPP membership. When we compared the demographic profile of the existing Airport Police Officers at LACERS against the demographic profile of the Tier 6 members included in our June 30, 2015 valuation for LAFPP (excluding Harbor Port Police members), we observed that the average entry age of the LAFPP Tier 6 members included in the valuation was about 27.1, whereas the average entry age of the existing Airport Police Officers was about 28.8, as we noted earlier. Entry age is an important factor in the calculation of costs under the actuarial cost method used by LACERS and LAFPP, and this difference in average entry ages of less than two years could result in some changes to the normal cost rates presented herein. However, as discussed in our June 13 letter, this relatively small difference in entry ages is not reflected under the Simplified Method used for this letter. However, the entry age difference will be reflected in our final analysis using the actual census data based calculation under the Detailed Method that will be performed before the end of June.

One major difference in demographics that we observed is that the average salary of the existing Airport Police Officers in LACERS (i.e., about \$95,000) is much higher than the average salary of the Tier 6 members in LAFPP (i.e., about \$72,000). For a pay related retirement benefit, the normal cost rate for the retirement plan is somewhat self-adjusting. Therefore, despite the difference in the current level of salary, we believe it is still reasonable to approximate the retirement plan normal cost rate for enrolling the existing Airport Police Officers in LAFPP Tier 6 by using the normal cost rate for the Tier 6 members in LAFPP. However, for a retiree health benefit that is not pay related, the above relationship for the normal cost for the retiree health plan would not hold true and we would need to consider making an adjustment to account for that difference in pay.

In consideration of making such an adjustment, we note that while the average salary as of June 30, 2015 for Tier 6 members is lower than for Airport Police Officers, the difference is accounted for by the earlier career point of the Tier 6 group. That is, the average attained age of the Tier 6 group is 28.2 compared to 42.9 for the Airport Police Officers. If Tier 6 member salaries increase according to the salary scale assumption adopted for the June 30, 2015 LAFPP valuation, their projected salary would be greater than for Airport Police Officers at the equivalent points in their careers (i.e., in about 13 years, based on average service for the two groups). The lower salary for Airport Police at an equivalent career point (i.e., after about 14 years of service) would *increase* any normal cost rate adjustment we would consider.

In addition, we observed that the average attained age of the Airport Police Officers was much higher than the average age of the current LAFPP Tier 6 members. Accordingly, Airport Police Officers would commence retiree health benefits sooner on average than current Tier 6 members. Since health care costs are assumed to increase with medical trend, the *dollar* amount of normal cost for Officers who would be retiring sooner (and thus subject to lower medical cost increases on average) would be *lower* than for current Tier 6 members. On average, Airport Police Officers would receive retiree health benefits about 15 years earlier and the dollar cost difference

would reflect the 15 fewer years of projected health cost increases, which would *decrease* any normal cost rate adjustment we would consider.

As the adjustments for the salary and the attained age differences described above would offset each other, we believe it is appropriate not to make an adjustment to the Tier 6 health plan employer normal cost rate of 6.67% from the June 30, 2015 valuation to be used for the Airport Police Officers, as discussed next.

The normal cost rates for the City, expressed as a percent of payroll, based on the demographics for the current 1,203 active LAFPP Tier 6 members, and on the actuarial assumptions used in the June 30, 2015 valuations, are as follows:

<b>Employer Normal Cost Rates for Current LAFPP Tier 6 Members</b>			
	Retirement Plan	Health Plan	Both Plans Combined
Current LAFPP Tier 6 Members	15.62%	6.67%	22.29%

Based on the earlier discussion regarding a possible adjustment to account for the difference in pay between the Officers and the Tier 6 members, we have determined that the same employer normal cost rates shown above for current LAFPP Tier 6 members can be used for the existing and new Airport Police Officers.

Now that we have estimated the normal cost rates for the 516 existing and the new Officers under Tier 6, we need to estimate the normal cost rates for only the existing Officers who may actually elect Tier 6 membership. We agree with the City's expectation that not all of the 516 existing Airport Police Officers would join LAFPP Tier 6 because of the cost to upgrade their past service, and that the shorter service employees (such as those with less than 5 years of service) might be most likely to join LAFPP. However, under the Simplified Method, we have made a simplifying assumption that the changes in the normal cost associated with enrolling only those with less than 5 years of past LACERS service would be the same as those for the 516 members.

Based on all of the information presented above, the normal cost rates for the 516 existing and the new Officers under LAFPP Tier 6 are as follows:

<b>Employer Normal Cost Rates for Existing and New LACERS Officers to Join LAFPP Tier 6 Members</b>			
	Retirement Plan	Health Plan	Both Plans Combined
Existing Officers to Join LAFPP Tier 6	15.62%	6.67%	22.29%
New Officers to Join LAFPP Tier 6	15.62%	6.67%	22.29%



**Step Three: Increase in Normal Cost Rates**

The increases in the normal cost rates for the City for the existing and the new Airport Police Officers to join LAFPP can be calculated by taking the difference between the normal cost rates for LAFPP estimated in Step Two and the normal cost rates for LACERS estimated in Step One. These increases, expressed as a percent of payroll, are as follows:

<b>Estimated Increases in Employer Normal Cost Rates</b>			
	Retirement Plan	Health Plan	Both Plans Combined
Existing Airport Police Officers <sup>(1)</sup>	10.17%	3.79%	13.96%
New Airport Police Officers	13.68%	4.07%	17.75%

<sup>(1)</sup> The projected annual payroll for the 516 existing Airport Police Officers included in this study is \$49.0 million as of June 30, 2015.

Although employer normal cost rates would increase due to the inclusion of Airport Police Officers in LAFPP Tier 6<sup>5</sup>, there would be no adverse impact on the LAFPP plans' funded ratios. The reason for this is that the City would be obligated to make these employer normal cost contributions, and members would be responsible for paying the entire cost of converting any of their past LACERS service to LAFPP Tier 6 service (in addition to their obligation to pay the ongoing employee normal cost rate), as discussed below.

It should be noted that the normal cost increases provided in the table above are with respect to the funding required by the City. We have assumed that the Airport Police Officers would continue to pay an employee normal cost rate of 11% of pay per pay period (which is unchanged the rate they are currently paying into LACERS).<sup>6</sup>

The 11% assumed employee normal cost rate is before the cost for the employees to purchase any prior LACERS service at LAFPP Tier 6 service. We have not included the amount required to purchase prior service, as the purchase cost is dependent on the specific procedures that would be used to determine the purchase. Those procedures would not be developed until after the ballot measure to approve Tier 6 membership is approved by the voters. The absence of such

<sup>5</sup> These increases represent the changes in the employer normal cost rates payable during fiscal year 2016/2017 for the Airport Police Officers as members in LACERS.

<sup>6</sup> As noted earlier, under the LAFPP Tier 6 plan, the member normal contribution rate for current members is 9%, plus 2% additional contributions to support funding of retiree health benefits. The additional 2% contributions are not required for members with more than 25 years of service, and the 9% contributions are not required for members with more than 33 years of service. Based on our review of the documents related to the transfer, we understand that for tax qualification purposes all members who transfer from LACERS to LAFPP Tier 6 would have to pay a level contribution throughout their entire membership at LAFPP, similar to what they would be required to pay had they not transferred their membership from LACERS. As details are still being developed on what would comply with the relevant tax laws, we assume that the full 11% of employee contributions would continue to be paid even after members attain 25 or 33 years of service.

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purchase cost should not affect the results provided herein for the City because it is anticipated that any such cost to purchase prior service would be borne entirely by the individual Airport Police Officers and not by the City.

Even though we have utilized the assumptions discussed throughout this report under the Simplified Method in lieu of the actual census data based calculations under the Detailed Method, we believe these assumptions are reasonable for this type of study.

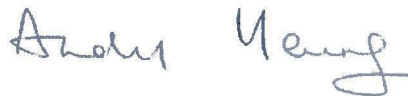
The following are members of the American Academy of Actuaries. We are qualified to render the actuarial opinion contained herein.

Please let us know if you have any questions.

Sincerely,



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



Andy Yeung, ASA, EA, MAAA, FCA  
Vice President and Actuary



Thomas Bergman, ASA, EA, MAAA  
Associate Actuary

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cc: Joe Salazar  
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VIA EMAIL AND USPS

June 13, 2016

Mr. Ray Ciranna  
General Manager  
Los Angeles Fire and Police Pensions  
701 E. 3<sup>rd</sup> Street, Suite 200  
Los Angeles, CA 90013

**Re: LAFPP – Methodologies to Calculate Increase in Normal Costs for Airport Police Officers to Enter Tier 6**

Dear Ray,

When we proposed to provide the results of our cost analysis for Airport police officers to enter Tier 6 before the end of June 2016, we were planning on performing our study using the same detailed method we would usually use for such a study, as outlined in Section A below.

Since the City is in need of the results on or before June 17, we would suggest the completion of our study using a Simplified Method as outlined in Section B below. While the use of the Simplified Method would allow us to meet the City's deadline, we would need to include some disclaimers in our written report to disclose the assumptions associated with using that Simplified Method. However, we would also state that we believe the assumptions used are reasonable for the purposes of this study. The major assumptions that we would disclose are described in Section B so that the City is aware of those limitations as we complete our analysis using that method.

As we further discussed, even though we would use the Simplified Method when we deliver our initial report, we would follow up with a final report before the end of June 2016 prepared using the Detailed Method.

## **Section A – Detailed Method**

Under this Method, our analysis would be prepared in the following steps:

- 1) Previously, as part of completing the LACERS public safety tier study, we calculated the normal costs associated with (a) providing the 516 existing Airport police officers (reported as of June 30, 2015) a benefit under the LACERS Tier 1 plan and (b) providing any new Airport police officers who would join in the future a benefit under the LACERS Tier 3 plan. Since no Airport police officers have entered Tier 3 as of June 30, 2015, the demographic profile of the new Airport police officers was estimated by looking at those Airport police officers who joined the LACERS Tier 2 plan during the period July 1, 2013 through June 30, 2015.

Since we were not requested by the City to include the 3 non-represented assistant Airport police chiefs in our earlier study, under the Detailed Method we would refine those normal costs calculation to include those 3 members, which would bring the number of Airport police officers to 519 as of June 30, 2015.

- 2) We would then calculate for the first time the normal costs associated with enrolling the Airport police officers in the LAFPP Tier 6 plan.

We agree with the City's expectation that not all of the 519 existing Airport police officers would join LAFPP Tier 6 (because of the cost to upgrade their past service) and that the shorter service employees (such as those with less than 5 years of service) might be most likely to join LAFPP. For that reason, we would value the changes in the normal cost associated with enrolling only those with less than 5 years of past LACERS service as well as the normal cost associated with enrolling the full 519 members in the LAFPP Tier 6 plan.

- 3) We would calculate for each of the retirement and the retiree health plans the changes in the normal cost rate for the existing Airport police officers as described in 2) as well as for any new Airport police officers who would join LAFPP Tier 6 instead of LACERS Tier 3. Again, the demographic profile of the new Airport police officers would be estimated by looking at those Airport police officers who joined the LACERS Tier 2 plan during the period July 1, 2013 through June 30, 2015.

## **Section B – Simplified Method**

We would not be able to complete the actual census data based calculation under the Detailed Method in time for the City's June 17 deadline. Under the Simplified Method, in order to meet the City's deadline, we would estimate the changes in the normal cost rate in the following steps:

- 1) We would not refine the normal costs described in A(1) to include the 3 non-represented assistant Airport police chiefs. Even though the 3 assistant police chiefs have a higher age at entry into LACERS which would normally lead to a higher normal cost rate under the funding method used by LACERS and LAFPP, that difference should not be material as they

are a relatively small group compared to the other 516 officers we have included in our earlier study.

- 2) We would not calculate the normal costs associated with enrolling the Airport police officers in the LAFPP Tier 6 plan. Instead, we would estimate the normal costs for the 516 existing officers based on the following observations.

When we compare the demographic profile of the existing Airport police officers against the demographic profile of the other Tier 6 members included in our June 30, 2015 valuation for LAFPP (again, the age at entry into City service is one of the important factors), the major difference we observe is that the average salary of the existing Airport police officers (of about \$95,000) is much higher than the average salary of the other Tier 6 members in LAFPP (of about \$72,000). For a pay related retirement benefit, the normal cost rate for the retirement plan is somewhat self-adjusting so in spite of the difference in the current level of salary we believe it is still reasonable to approximate the normal cost rate for enrolling the existing Airport police officers in LAFPP Tier 6 by using the normal cost rate for the other Tier 6 members in LAFPP. However, for a retiree health benefit that is not pay related, the above relationship for the normal cost for the retiree health plan would not hold true so we would need to make a relatively straightforward adjustment to account for that difference in pay.

Once the normal cost rates to enroll the existing 516 members in LAFPP Tier 6 have been estimated, we would make another simplifying assumption that there would not be a material difference between the normal cost rates of the 516 members and the normal cost rates for members with less than 5 years of past service (who might most likely join LAFPP).

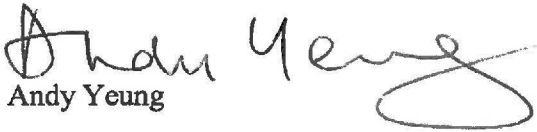
- 3) We would calculate for each of the retirement and the retiree health plan plans the changes in the normal cost rate for the existing officers as described in 2). However, for the new Airport police officers we would have to further assume that their normal cost rates in LAFPP Tier 6 would be the same as those 516 members calculated in 2).

As noted above, we believe these are reasonable assumptions for this type of study and would state that in our report. We would also note that for the study under either the Simplified Method (to be used in our initial report) or the Detailed Method (to be used in our final report), we would not be including the cost to purchase prior LACERS service for the individual members. This is because the analysis to determine such purchase cost is dependent on the specific procedures used to determine the purchase cost which would not be drawn up until after the ballot measure to approve Tier 6 membership is approved by the voters. This would not affect the results in our reports because it is anticipated that any such cost to purchase prior service would be borne entirely by the individual Airport police officers.

Ray Ciranna  
June 13, 2016  
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Please let us know if you have any questions.

Sincerely,

  
Andy Yeung

AYY/jl

cc: Joe Salazar  
Li Hsi  
Lita Payne  
Maritta Aspen  
Anya Freedman

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