



100 Montgomery Street Suite 500 San Francisco, CA 94104-4308  
T 415.263.8200 www.segalco.com

VIA E-MAIL and USPS

July 7, 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 to Enter Tier 6  
Supplement to Letter Dated June 16, 2016, which had Results Prepared under  
Simplified Method**

Dear Ray:

As requested by LAFPP, we have calculated the increases in the normal cost rates for the City if existing and new Airport Police who are currently (or would otherwise be) enrolled in the LACERS' plans are permitted to enter LAFPP Tier 6.

As discussed in the attached methodologies letter dated June 13, 2016, this analysis has been prepared using the actual data-driven Detailed Method outlined in that letter. As the results prepared using the Detailed Method are comparable to the estimates prepared using the Simplified Method, this letter may be viewed as a supplement to our letter dated June 16, 2016 which provided the results under the Simplified Method (note that the Simplified Method was also outlined in our June 13 methodologies letter). The results provided herein reflect a June 30, 2015 valuation date.

#### **SUMMARY OF RESULTS**

The increases in the normal cost rates for the City, expressed as a percent of payroll, to allow existing and new Airport Police to enter LAFPP Tier 6 are shown on the following page.

<b>Increases in the City's Normal Cost Rates<sup>(1)</sup></b>			
	<b>Retirement Plan</b>	<b>Health Plan</b>	<b>Both Plans Combined</b>
If all Airport Police elect Tier 6 <sup>(2)</sup>	10.21%	3.37%	13.58%
If only Airport Police with 5 or less years of service elect Tier 6 <sup>(3)</sup>	9.44%	3.90%	13.34%
New Airport Police mandated to join Tier 6 (if hired on or after January 7, 2018)	13.73%	4.78%	18.51%

<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 519 existing Airport Police Officers and Airport Police Chiefs ("Airport Police") included in this study is \$49.5 million as of June 30, 2015.

<sup>(3)</sup> The projected annual payroll for the 60 existing Airport Police with five (5) or less years of service included in this study is \$3.8 million as of June 30, 2015.

Although the City's normal cost rates would increase due to the inclusion of Airport Police in LAFPP Tier 6<sup>1</sup>, there would be no adverse impact on the LAFPP plan funded ratios. The reason for this is that the City would be obligated to make these 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 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

<sup>1</sup> These increases represent the changes in the City's normal cost rates payable during fiscal year 2016/2017 for the Airport Police 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.

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 and not by the City.

## **BACKGROUND**

The City is preparing a ballot measure that would allow existing Airport Police 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 appointed on or after January 7, 2018 (with some exceptions as outlined in the measure). All of the existing Airport Police who elect to join LAFPP and the new Airport Police who are mandated to join LAFPP would join the Tier 6 plan. Airport Police 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 Airport Police 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 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 41<sup>4</sup> then active LACERS Tier 2 Airport Police Officers who were hired during the two-year period July 1, 2013 through June 30, 2015.

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

<sup>4</sup> One (1) of the 42 LACERS Tier 2 Airport Police Officers included in the feasibility study was hired before July 1, 2013.

Under the ballot measure, certain existing non-represented Airport Police Chiefs 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 Airport Police Chiefs in our calculations. Our calculations were based only on the 516 Airport Police Officers, rather than all 519 existing Officers and Chiefs. In this study, we have refined the normal costs described in item (a) above to include the 3 non-represented Airport Police Chiefs.

*All Existing Airport Police*

The normal cost rates for the City, expressed as a percent of payroll, for the 519 existing Officers and Chiefs assuming all of them are enrolled in the LACERS Tier 1 retirement and health plans, determined using their demographics and the actuarial assumptions used in the June 30, 2015 valuations, are as follows:

<b>The City's Normal Cost Rates as if All 519 Existing Airport Police are Enrolled in LACERS Tier 1</b>			
	<b>Retirement Plan</b>	<b>Health Plan</b>	<b>Both Plans Combined</b>
All 519 Existing Airport Police	5.47%	2.86%	8.33%

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 477 members reported by LACERS as Tier 1 members in the 2015 valuations and we re-calculated the City's normal cost rates for all 519 existing Officers and Chiefs under LACERS Tier 1 plan provisions and using Tier 1 actuarial assumptions.

Even though 10.06% is the City's combined (i.e., Retirement and Health Plans) normal cost rate calculated for all Tier 1 members (including most of the 519 Airport Police 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 519 Airport Police included in study.

*Existing Airport Police with 5 or Less Years of Service*

We agree with the City’s expectation that not all of the 519 existing Airport Police would join LAFPP Tier 6 because of the cost to upgrade their past service, and that the shorter service employees (such as those with 5 or less years of service) might be most likely to join LAFPP. Accordingly, we have also calculated the normal cost rates for the City, expressed as a percent of payroll, for only the 60 (out of the 519) existing Airport Police with five (5) or less years of service to be as follows:

<b>The City’s Normal Cost Rates for Only Existing Airport Police with 5 or Less Years of Service</b>			
	<b>Retirement Plan</b>	<b>Health Plan</b>	<b>Both Plans Combined</b>
Airport Police with 5 or less years of service	6.02%	4.02%	10.04%

*New Airport Police*

In the absence of the ballot measure, any new Airport Police 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 (again, estimated by using the demographics of the 41 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>The City’s Normal Cost Rates if New Airport Police are Enrolled in LACERS Tier 3</b>			
	<b>Retirement Plan</b>	<b>Health Plan</b>	<b>Both Plans Combined</b>
New Airport Police mandated to join Tier 6 (if hired on or after January 7, 2018)	1.92%	4.00% <sup>(1)</sup>	5.92%

<sup>(1)</sup> We have refined the cost associated with providing Tier 3 health benefits for new Airport Police. Previously that cost was estimated at 2.60% determined using the Tier 2 health benefit provisions. Our Detailed Method has updated the calculation to apply Tier 3 health provisions.

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

In this step, we calculate the normal cost rates associated with enrolling the 519 existing and the new Airport Police as described in Step One in LAFPP Tier 6. We have updated the normal costs estimated in our June 16 letter by calculating the normal costs using the demographic profile associated with the existing and the new Airport Police. We have also calculated the normal cost rates for only the existing Airport Police who are most likely to actually elect Tier 6 membership (i.e., those with 5 or less years of service, for purposes of this study).

Based on all of the information presented above, the normal cost rates under LAFPP Tier 6 for the 519 existing Airport Police, for the 60 existing Airport Police with 5 or less years of service, and for the 41 members included as new Airport Police, are as follows:

<b>The City's Normal Cost Rates for Existing and New LACERS Airport Police to Join LAFPP Tier 6</b>			
	<b>Retirement Plan</b>	<b>Health Plan</b>	<b>Both Plans Combined</b>
If all Airport Police elect Tier 6	15.68%	6.23%	21.91%
If only Airport Police with 5 or less years of service elect Tier 6	15.46%	7.92% <sup>(1)</sup>	23.38%
New Airport Police mandated to join Tier 6 (if hired on or after January 7, 2018)	15.65%	8.78% <sup>(1)</sup>	24.43%

<sup>(1)</sup> The normal cost rates for these Airport Police are higher than the Tier 6 retiree health rate of 6.67%. The difference is because, while on a dollar basis the retiree health normal costs are similar, the lower compensation for Airport Police (for example, \$72,000 annual average for Tier 6 LAFPP members vs. \$64,000 for Airport Police with 5 or less years of service) *increases* the cost as a percentage of pay.

***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 to join LAFPP can be calculated by taking the difference between the normal cost rates for LAFPP calculated in Step Two and the normal cost rates for LACERS calculated in Step One. These increases, expressed as a percent of payroll, are as follows:

<b><u>Increases in the City's Normal Cost Rates</u></b>			
	<b>Retirement Plan</b>	<b>Health Plan</b>	<b>Both Plans Combined</b>
If all Airport Police elect Tier 6	10.21%	3.37%	13.58%
If only Airport Police with 5 or less years of service elect Tier 6	9.44%	3.90%	13.34%
New Airport Police mandated to join Tier 6 (if hired on or after January 7, 2018)	13.73%	4.78%	18.51%

#### **NOTE ON EFFECT ON FUNDED RATIOS**

Although the City's normal cost rates would increase due to the inclusion of Airport Police 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 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 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>6</sup>

The assumed 11% 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 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 and not by the City.

#### **NOTE ON ASSUMED MEDICAL PLAN SELECTION**

We understand that Airport Police who elect to join LAFPP Tier 6 will, upon reaching eligibility to retire, have a choice of LACERS retiree medical plans, but will be subject to the LAFPP maximum medical subsidy limit. Due to limited, readily available data on Airport Police enrollment in LACERS medical plans<sup>7</sup>, we will need to make new assumptions (potentially different from those in the LACERS or LAFPP valuations) for medical plan

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<sup>5</sup> These increases represent the changes in the City's normal cost rates payable during fiscal year 2016/2017 for the Airport Police 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.

<sup>7</sup> As part of the LACERS valuation, we do not analyze retiree health elections by department (e.g. Airport Police) as the Bargaining Unit information is not provided for current retirees.

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election among Airport Police at retirement. As experience emerges over time, we can refine our medical plan election assumptions for this group.

For this study, we have assumed that Airport Police will select similar plans roughly in proportion as assumed for future LAFPP Police retirees, shown on pages 43 and 44 in our June 30, 2015 OPEB valuation report. For pre-65 retirees, we have assumed that 65% will enroll in the Anthem Blue Cross PPO and 35% will enroll in the Kaiser Permanente HMO. For retirees over age 65, we have assumed that 85% will enroll in the Anthem Blue Cross PPO and 15% will enroll in the Kaiser Permanente Senior Advantage HMO.

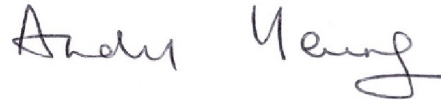
The following are members of the American Academy of Actuaries. We are qualified to render the actuarial opinion contained herein.

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

/bqb  
Enclosure (5437036)

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





100 Montgomery Street Suite 500 San Francisco, CA 94104-4308  
T 415.263.8200 www.segalco.com

**Andy Yeung, ASA, MAAA, FCA, EA**  
Vice President & Actuary  
ayeung@segalco.com

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.

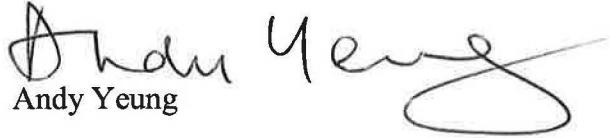
Once the normal cost rates to enroll the existing 516 members in LAFPP Tier 6 have been estimated, we would make another simplifying assumption that there would not be a material difference between the normal cost rates of the 516 members and the normal cost rates for members with less than 5 years of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

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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