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VIA E-MAIL AND USPS

November 24, 2010

Mr. Russell Crosby  
Director/Retirement Services  
City of San Jose Police and Fire Department Retirement Plan  
1737 N First Street, Suite 580  
San Jose, CA 95112-4505

**Re: Estimated Employer and Employee Contribution Rates for the Pension Plan for June 30, 2010 Under Different Investment Return Assumptions; Overview of 2009/2010 Actuarial Experience**

Dear Russell:

We have been requested by your office to estimate the employer and employee contribution rates for the Pension Plan for the June 30, 2010 actuarial valuation under the following three alternative investment return assumptions: 8.00%, 7.75% and 7.50%.

We have also reconciled the change in the Pension Plan's Unfunded Actuarial Accrued Liability (UAAL) so that the Board can determine the areas where the actual experience of the Pension Plan differed from the actuarial assumptions during 2009/2010. A reconciliation of the change in the employer contribution rates from the June 30, 2009 actuarial valuation to the June 30, 2010 actuarial valuation is also provided in this letter.

As requested by your office, we have also included a discussion of the current actuarial procedure that determines the City's Annual Required Contribution (ARC) as a percent of payroll.

**Background and Discussions**

*Employer and Employee Contribution Rates for the Pension Plan as of June 30, 2010*

In the following table, we compare the employer and employee contribution rates for the Pension Plan determined as of June 30, 2010 using all the membership and financial data as of the same date. A more detailed breakdown of the rate can be found in Attachments A, B and C.

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With the exception of utilizing alternative investment assumptions of 7.75% and 7.50% in addition to the current assumption of 8.00%, these contribution rates have been calculated using the same actuarial assumptions adopted by the Board for the June 30, 2009 valuation.

**Summary of Recommended Employer and Employee Contribution Rates as of June 30, 2009 and 2010**

	June 30, 2009 Valuation (8%)		June 30, 2010 Valuation (8%)		June 30, 2010 Valuation (7.75%)		June 30, 2010 Valuation (7.5%)	
	% Payroll	Amount <sup>(1)</sup> (\$000)	% Payroll	Amount <sup>(1)</sup> (\$000)	% Payroll	Amount <sup>(1)</sup> (\$000)	% Payroll	Amount <sup>(1)</sup> (\$000)
<b>City Contribution Rate<sup>(2)</sup></b>								
Police	38.77%	\$61,104	45.00%	\$70,922	49.78%	\$78,456	54.75%	\$86,289
Fire	40.69%	\$38,026	46.78%	\$43,717	51.54%	\$48,166	56.48%	\$52,782
Combined	39.48%	\$99,130	45.66%	\$114,639	50.44%	\$126,622	55.40%	\$139,071
<b>Employee Contribution Rate<sup>(2)</sup></b>								
Police	9.81%	\$15,461	9.84%	\$15,508	10.46%	\$16,486	11.13%	\$17,541
Fire	10.09%	\$9,429	10.13%	\$9,467	10.76%	\$10,055	11.43%	\$10,682
Combined	9.91%	\$24,890	9.95%	\$24,975	10.57%	\$26,541	11.24%	\$28,223

(1) Based on June 30, 2010 projected annual payroll (\$000) for:

Police: \$157,605

Fire: \$93,453

Total: \$251,058

(2) Contribution rates have not been adjusted to reflect any UAAL rates that employee may have agreed to pay.

*Comparison of Actual Experience to that Expected by the Actuarial Assumptions*

As part of the June 30, 2009 experience analysis process, we reviewed all the non-economic and economic actuarial assumptions used in valuation for the Pension Plan. As requested by the Board in its November 2010 meeting, we are preparing a report with our review and recommendations for the economic assumptions, including the investment return assumption, for the June 30, 2010 valuation.

As we are not scheduled to perform a detailed experience analysis of the non-economic actuarial assumptions, we have performed only a high level review of the actuarial experience during 2009/2010 by measuring the impact of actual experience deviations from the key actuarial assumptions on both the UAAL and the employer's contribution rate for the Pension Plan.

A reconciliation of the UAAL from June 30, 2009 to June 30, 2010 for the Pension Plan calculated using all the actuarial assumptions adopted by the Board for the June 30, 2009 valuation (including the 8% investment return assumption) is provided in the following table.

**Preliminary Reconciliation of the Unfunded Actuarial Accrued Liability (UAAL)  
from June 30, 2009 to June 30, 2010 (\$000)**

UAAL as of June 30, 2009	\$393,913
Normal cost from July 1, 2009 to June 30, 2010	88,618
Total employer and employee contributions from July 1, 2009 to June 30, 2010 <sup>(1)</sup>	(72,412)
Interest (includes weighted averages on 2009/2010 contributions)	<u>33,651</u>
Expected UAAL as of June 30, 2010	\$443,770
Changes during 2009/2010 due to:	
- Loss from investment (after smoothing)	\$149,622
- Gain due to lower than expected salary increases	(35,814)
- Gain due to more deaths than expected among retirees/beneficiaries	(4,574)
- Loss from more service retirements offset by fewer disability retirements <sup>(2)</sup>	5,665
- Other experience gains	<u>(9,157)</u>
Subtotal	\$105,742
Actual UAAL as of June 30, 2010	\$549,512

- (1) Due to the one year delay between the calculation of the rate in the June 30, 2009 valuation and the implementation of rate one year later in the 2010/2011 fiscal year, the actual contributions during the 2009/2010 year of \$72.4 million were less than those expected of \$126.0 million. The difference (\$53.6 million) represents a shortfall that gives rise to an increase in the contribution rate in the June 30, 2010 valuation.
- (2) This calculation should be considered preliminary because the data required to analyze the number of service retirements that may subsequently be reclassified as disability retirements is not available.

A reconciliation of the change in the employer's rate from June 30, 2009 to June 30, 2010 for the Pension Plan calculated using all the actuarial assumptions adopted by the Board for the June 30, 2009 valuation (including the 8% investment return assumption) is provided in the table below.

**Preliminary Reconciliation of Recommended Employer Contribution from June 30, 2009 to June 30, 2010**

	Contribution Rate	Estimated Amount <sup>(1)</sup> (\$000)
Average employer contribution as of June 30, 2009	39.48%	\$99,130
Changes during 2009/2010 due to:		
- Loss from investment (after smoothing)	5.00%	\$12,541
- Loss from contributions less than expected due to one year delay between rate calculation and rate implementation	1.78%	\$4,481
- Gain due to lower than expected salary increases	-1.20%	-\$3,021
- Increase in UAAL rate from aggregate payroll increase less than 4.25%	0.78%	\$1,958
- Gain due to more deaths than expected among retirees/beneficiaries	-0.15%	-\$386
- Loss from more service retirements offset by lower disability retirements <sup>(2)</sup>	0.19%	\$478
- Other experience gains	<u>-0.22%</u>	<u>-\$542</u>
Subtotal	6.18%	\$15,509
Average employer contribution as of June 30, 2010.	45.66%	\$114,639

(1) Based on June 30, 2010 projected annual payroll (\$000) of \$251,058.

(2) Preliminary.

The main actuarial assumption changes from the June 30, 2009 experience study that gave rise to the significant combined employer and employee rate increase of almost 10% of payroll were as follows:

- Increase in total wage inflation and individual merit and promotional increases.
- Increase in life expectancy for both service and disabled retirees and beneficiaries
- Increase in both service and disability retirements.

In the above reconciliations of UAAL and employer contributions, note that during the 2009/2010 year there were actuarial gains from salary and mortality experience. The combined actual experience from salary, mortality and retirements was more financially favorable than that predicted by the new assumptions.

*Current Actuarial Procedure for Determining the City's Annual Required Contribution (ARC)*

As we have indicated in the above schedules of reconciliation of the UAAL and the City contribution rate, when the Plan's contribution rates go up (as they are expected to do in each of the next several valuations to recognize prior deferred investment losses under the asset smoothing method) the Plan incurs additional contribution losses due to the one year delay between the rate calculation and the rate implementation. Another factor that may give rise to additional contribution losses is when the City's actual payroll during the fiscal year of rate implementation is less than that anticipated by the valuation.

Under the current actuarial procedure used by the Plan, the City's ARC is developed by taking the total of the dollar Normal Cost and the dollar amount required to amortize the UAAL for the year immediately following the date of the valuation and expressing that contribution amount as a percent of projected payroll over that same period. If actual payroll is less than projected, then the actual dollar amount of UAAL amortization contributions will be less than the amount required in the valuation. This will cause a contribution loss and will result in an increase in the employer's rate for the next year.

There are several methodologies that may be considered by the Board in managing the above sources of contribution loss and we are available to discuss these if they are of interest to the Board.

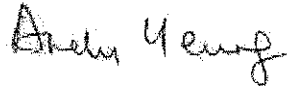
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Please let us know if you have any questions.

Sincerely,



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



Andy Yeung, ASA, EA, MAAA  
Vice President & Associate Actuary

CZI/hy  
Enclosures

**Attachment A - City and Member Contribution Rates under 8.00% Investment Return Assumption**

	June 30, 2010 Actuarial Valuation		June 30, 2009 Actuarial Valuation	
	Rate	Estimated Annual Amount*	Rate	Estimated Annual Amount*
<b>Police Members</b>				
Normal Cost - City	26.03%	41,024,649	25.96%	40,914,325
Normal Cost - Member	9.76%	15,382,273	9.74%	15,350,752
UAAL - City - Benefit Improvement	2.52%	3,971,653	2.31%	3,640,681
UAAL - City - Other	16.45%	25,926,065	10.50%	16,548,552
UAAL - Member	0.08%	126,084	0.07%	110,324
Police Rate - City	45.00%	70,922,366	38.77%	61,103,558
Police Rate - Member	9.84%	15,508,357	9.81%	15,461,076
<b>Fire Members</b>				
Normal Cost - City	26.87%	25,110,879	26.75%	24,998,735
Normal Cost - Member	10.07%	9,410,739	10.03%	9,373,357
UAAL - City - Benefit Improvement	3.46%	3,233,481	3.44%	3,214,791
UAAL - City - Other	16.45%	15,373,054	10.50%	9,812,588
UAAL - Member	0.06%	56,072	0.06%	56,072
Fire Rate - City	46.78%	43,717,414	40.69%	38,026,114
Fire Rate - Member	10.13%	9,466,811	10.09%	9,429,429
<b>Police and Fire Combined - City</b>	<b>45.66%</b>	<b>114,639,780</b>	<b>39.48%</b>	<b>99,129,672</b>
<b>Police and Fire Combined - Member</b>	<b>9.95%</b>	<b>24,975,168</b>	<b>9.91%</b>	<b>24,890,505</b>

\* Amounts are based on June 30, 2010 projected annual payroll \$251,058,473

**Attachment B - City and Member Contribution Rates under 7.75% Investment Return Assumption**

	June 30, 2010 Actuarial Valuation		June 30, 2009 Actuarial Valuation	
	Rate	Estimated Annual Amount*	Rate	Estimated Annual Amount*
<b>Police Members</b>				
Normal Cost - City	27.69%	43,640,896	25.96%	40,914,325
Normal Cost - Member	10.38%	16,359,426	9.74%	15,350,752
UAAL - City - Benefit Improvement	2.49%	3,924,371	2.31%	3,640,681
UAAL - City - Other	19.60%	30,890,631	10.50%	16,548,552
UAAL - Member	0.08%	126,084	0.07%	110,324
Police Rate - City	49.78%	78,455,897	38.77%	61,103,558
Police Rate - Member	10.46%	16,485,510	9.81%	15,461,076
<b>Fire Members</b>				
Normal Cost - City	28.53%	26,662,202	26.75%	24,998,735
Normal Cost - Member	10.70%	9,999,494	10.03%	9,373,357
UAAL - City - Benefit Improvement	3.41%	3,186,755	3.44%	3,214,791
UAAL - City - Other	19.60%	18,316,830	10.50%	9,812,588
UAAL - Member	0.06%	56,072	0.06%	56,072
Fire Rate - City	51.54%	48,165,787	40.69%	38,026,114
Fire Rate - Member	10.76%	10,055,566	10.09%	9,429,429
<b>Police and Fire Combined - City</b>	<b>50.44%</b>	<b>126,621,684</b>	<b>39.48%</b>	<b>99,129,672</b>
<b>Police and Fire Combined - Member</b>	<b>10.57%</b>	<b>26,541,076</b>	<b>9.91%</b>	<b>24,890,505</b>

\* Amounts are based on June 30, 2010 projected annual payroll \$251,058,473

**Attachment C - City and Member Contribution Rates under 7.50% Investment Return Assumption**

	June 30, 2010 Actuarial Valuation		June 30, 2009 Actuarial Valuation	
	Rate	Estimated Annual Amount*	Rate	Estimated Annual Amount*
<b>Police Members</b>				
Normal Cost - City	29.48%	46,462,030	25.96%	40,914,325
Normal Cost - Member	11.05%	17,415,381	9.74%	15,350,752
UAAL - City - Benefit Improvement	2.46%	3,877,089	2.31%	3,640,681
UAAL - City - Other	22.81%	35,949,759	10.50%	16,548,552
UAAL - Member	0.08%	126,084	0.07%	110,324
Police Rate - City	54.75%	86,288,878	38.77%	61,103,558
Police Rate - Member	11.13%	17,541,465	9.81%	15,461,076
<b>Fire Members</b>				
Normal Cost - City	30.31%	28,325,669	26.75%	24,998,735
Normal Cost - Member	11.37%	10,625,631	10.03%	9,373,357
UAAL - City - Benefit Improvement	3.36%	3,140,028	3.44%	3,214,791
UAAL - City - Other	22.81%	21,316,678	10.50%	9,812,588
UAAL - Member	0.06%	56,072	0.06%	56,072
Fire Rate - City	56.48%	52,782,375	40.69%	38,026,114
Fire Rate - Member	11.43%	10,681,703	10.09%	9,429,429
<b>Police and Fire Combined - City</b>	<b>55.40%</b>	<b>139,071,253</b>	<b>39.48%</b>	<b>99,129,672</b>
<b>Police and Fire Combined - Member</b>	<b>11.24%</b>	<b>28,223,168</b>	<b>9.91%</b>	<b>24,890,505</b>

\* Amounts are based on June 30, 2010 projected annual payroll \$251,058,473