SBCERS
Santa Barbara County Employees' Retirement System

Gregory E. Levin, CPA
Chief Executive Officer

Statement Regarding Board of Retirement Action Regarding Actuarial Assumptions On October 26, 2016

BACKGROUND STATEMENT

On October 26, 2016, the Board of Retirement of Santa Barbara County Employees' Retirement System ("SBCERS") took action to approve modification of actuarial assumptions regarding the assumed rate of future investment returns from 7.5% to 7.0%. The Board of Retirement ("the Board") also took steps necessary to adjust demographic assumptions in order to more closely reflect the historical experience of the plan. The Board took such action based on advice of its actuaries and investment consultants, after considerable study of changing economic and market conditions.

The Board's action on October 26 followed several years of discussion. Prior Board decisions reduced the assumed rate of return 41 bps from 8.16% to 7.75% in 2010 and 25bps from 7.75% to 7.5% in 2013. The Board considered reducing the assumption rate from 7.5% to 7.25% in 2015, but postponed this decision pending more thorough actuarial study, and in order to give plan sponsors more time to consider the impacts of such a change.

Setting the assumed rate of investment return is an important decision because it impacts the investment objectives of SBCERS, its anticipated future liabilities and the contributions required from employers and employees to meet those liabilities.

Although the most recent reduction of 50 bps from 7.5% to 7.0% is a greater incremental change than prior modifications, its impact on contribution rates will be more gradual than prior changes, which were effective immediately. This gradual impact is due to a modification of the Board's actuarial policy adopted in 2014. That change in policy provides for a phased implementation of changes in actuarial assumptions over a five year period. Accordingly, the full impact of the assumption rate change will not be reflected in contribution rates until fiscal year 2021-2022.

The Board will have gradually reduced the assumed rate of return 116 bps over a 10 year period once the most recent reduction is fully recognized. The resulting 7.0% assumed rate of return is comprised of a 4.25% real return assumption and a 2.75% inflation assumption. According to a recently conducted survey, these changes make SBCERS assumptions consistent with the median real return assumption of 4.3%, as compared to other California county pension plans.

The Board also recognized the demographic performance of the plan, including the fact that SBCERS female annuitants are living much longer than previously expected.

Employer rates are expected to increase 2.16% on average for the fiscal year 2017 – 2018. Changes to the assumptions, roughly a third of which were due to demographic experience, increased the total employer rate by 2.53% of pay. The current year shortfall against the assumed rate of return increased the employer rate by .87% of pay. This was partially offset by prior investment gains, the impact of new PEPRA members and other minor actuarial gains which reduced the employer rate by 1.24%.

The total fiscal year 2017 – 2018 employer composite rate of 38.71% is less than the rate paid in the 2014 – 2015 fiscal year, which was 38.94% of pay.

The Board's most recent action followed several months of discussion of issues affecting SBCERS' asset allocation and investment return expectations as well as discussions with its plan sponsors regarding the likely financial impact of changing investment conditions on contribution rates. The Board also recognizes that its decision will increase the percentage of pay contributed by participating employees.

In making decisions regarding actuarial assumptions, the Board acts as an independent body with fiduciary duties to the pension plan and its participants. Although charged with the duty to minimize employer contributions to the plan whenever possible, its primary obligation pursuant to the California Constitution is to ensure the integrity of the retirement plan and its ability to deliver pension benefits to its participants and beneficiaries.

The Board will consider the final Actuarial Valuation and Experience Study, which were developed using the assumptions adopted on October 26, 2016, at its public meeting on December 14, 2016.

SUMMARY FACTS AND QUOTATIONS

What and how this happened:

- The Santa Barbara County Board of Supervisors and other plan sponsors are solely and exclusively responsible for determining the retirement benefits awarded to their employees.

- The Santa Barbara County Board of Retirement, relying on the advice of its professional actuary and investment consultants, is responsible for determining the contributions necessary to fund the benefits awarded by plan sponsors and to act as a fiduciary over the funds collected.

- On October 26, 2016, the Board of Retirement reduced the assumed rate of return for the Santa Barbara County Employees Retirement System Investment Portfolio from 7.5% to 7.0%.

- On October 26, 2016, the Board of Retirement revised demographic assumptions to recognize the fact that SBCERS members are living longer than expected along with other changes.

- The impacts of the changes on employer contributions will be phased in gradually over five years from the fiscal year ending June 30, 2018 to the fiscal year ending June 30, 2022.

SBCERS CEO Gregory Levin stated:

"The Board of Retirement's action is a continuation of an effort over several years to gradually lower the System's assumed rate of return to reflect more conservative expectations of inflation and future investment earnings."

"The discussions leading to this change took place during several open public meetings that the Board of Retirement has held since 2014."

"The most recent action was data driven and brings SBCERS in line with its peer systems' estimates of real return."

"Estimates of the impacts of discount rate changes were presented to Santa Barbara County, the System's largest employer, in March of 2016. This presentation was designed to provide the County an opportunity to prepare for the budgetary impacts."

"The move to a lower assumed rate of return is a nationwide trend for pension systems and the result of a changing investment climate."

"The trend towards lower assumed rates has the effect of reducing the risk that today's employee service costs will be a burden on future generations of taxpayers."

The impacts of the decision:

- Overall, the net employer contribution rate for fiscal year beginning July 1, 2017 increased by 2.16% to 38.71% of covered payroll.

  SBCERS CEO Gregory Levin stated:

“Based on covered payroll estimates of approximately $346 million for FYE 2017, SBCERS expects that this will increase employer contributions from all sponsors by approximately $7.5 million for FYE 2018.”

“The increases mean that Plan Sponsors will pay a rate in 2017-2018 fiscal year that is slightly lower than the rates they paid in the 2014-2015 fiscal year.”

“Plan Sponsors may experience greater increases next year, however, increases above $7.5 million are most likely going to be due to the overall growth of payroll cost and not directly attributable to increases in the pension contribution rate”

"System employers will see gradually increasing rates related to past service costs over the next five years but future increases are expected to be smaller than the first year increase; however, it is important to note that future rates will also be affected by future investment earnings.”