

To FCERA's Members,

This Memorandum summarizes the Board's recent review and correction of employee contribution rates from July 2003 through February 2007. For more detail about the Board's decisions, and its open session deliberations that led to them, members may consult the relevant Board minutes and/or the audio recordings of the Board meetings, which are all available on request at FCERA's office.

COLA UAAL

The review process began when the Board determined, in December 2006, that members had been improperly charged for a portion of the unfunded actuarial accrued liability (UAAL) associated with the Cost of Living Adjustment (COLA) benefit, beginning in July 2003. This has been referred to as the COLA UAAL issue. The inclusion of COLA UAAL in employee rates was stopped in March of this year and, as a result, all FCERA active employee members saw their employee contributions decrease in their March pay checks.

The "Phase In"

In fiscal year 2004-2005, General member contribution rates were set to increase dramatically. In order to lessen the immediate impact this dramatic increase had on members, the Board implemented a "phase in" of member contribution rates. Under the "phase in," members initially paid only a portion of the increases in rates that would have otherwise occurred, with the understanding that the amounts not paid by members in those initial years would be recovered through corresponding increases to member rates in future years. The "phase in" impacted General rates from July 2004 through February 2007, and impacted Safety rates from July 2005 through February 2007.

In retrospect, we now know that, after weighing the "phase in" against the COLA UAAL issue: (1) General members underpaid contributions from July 2004 through June 2005, but overpaid contributions from July 2005 through February 2007; and (2) safety members overpaid contributions from July 2004 through February 2007.

The Correction Process

In December 2006, the Board voted to stop charging members for any portion of the COLA UAAL going forward. That decision was implemented in March 2007 and all FCERA active employee members saw their employee contributions decrease in their March pay checks. In January 2007, the Board voted to make

appropriate adjustments to correct for COLA UAAL payments by members between July 2003 and February 2007. The Board also decided to offset any underpayments that resulted from the "phase in" against any payments made towards COLA UAAL.

Other Errors Discovered by New Actuary During Correction Process

In the process of correcting for the COLA UAAL issue, the Board's new actuary identified two additional errors that the Board's prior actuary made, which impacted employee contribution rates between July 2003 and February 2007.

Salary Assumption Error (Safety Only): An error by the prior actuary relating to the salary increase assumption for Safety members resulted in *additional overpayments* by Safety members from July 2004 through February 2007. Like the COLA UAAL error, this error was corrected in March, resulting in a further decrease in Safety members' contribution rates at that time.

Basic Rate Error (General Members Only): An error by the prior actuary in developing the "basic" contribution rate for General Members in fiscal year 2003-2004 resulted in *underpayments* by General Tier 1 members from July 2003 through June 2004.

The Correction Process Continued

From January through August of this year, the Board worked with staff, legal counsel and its new actuary to determine how to deal with all of these issues. Through a series of meetings, the Board ultimately decided to correct for all of the issues identified above. The Board decided to offset all underpayments against all overpayments on a member-by-member basis. In the event that a member made a net overpayment, FCERA would refund net amounts overpaid by the member, with interest. The Board decided not to recover any net underpayments on an individual basis, but instead to recover the total amount of all net underpayments, with interest, through appropriate increases to member contribution rates in fiscal year 2008-2009. The results of these Board decisions, in general terms, are as follows:

Safety and General Tier 2 Members - It was determined that all Safety (Tier 1 and Tier 2) and all General Tier 2 members were due refunds of payments they made towards COLA UAAL. Safety members were entitled to additional refund amounts as a result of the Safety Salary Assumption Error. Individual refund amounts vary based on a variety of factors, including salary, age at entry and whether the member was making contributions for the entire time period of July 2003 through February 2007, or made contributions for only a portion of that time period.

General Tier 1 Members – It was determined that some General Tier 1 members were due refunds of payments they made towards COLA UAAL. After all appropriate adjustments were made, however, most General Tier 1 members were not due a refund, because most of them actually paid less than the total amount than otherwise would have been properly charged to them if the COLA UAAL error, the "phase in" and the Basic Rate Error in fiscal year 2003-2004 had not occurred. For those General Tier 1 members due a refund, the amounts vary based on a variety of factors, including salary, age at entry and whether the member was making contributions for the entire time period of July 2003 through February 2007, or made contributions for only a portion of that time period. This last factor (whether contributions were made during the whole relevant time period or only part of it) was particularly significant for General Tier 1 members, because General Tier 1 members *underpaid* contributions from July 2003 through June 2005, but *overpaid* contributions from July 2005 through February 2007.

As mentioned above, for those General Tier 1 members whose individual calculations resulted in a net underpayment, the Board decided *not* to recover those underpayments on an individual basis. Instead, the Board will recover the total amount of those underpayments through appropriate increases to the contribution rates paid by all General Tier 1 members in the next fiscal year (July 1, 2008 to June 30, 2009). Those increases are currently estimated to be between 0.5% and 0.6% of pay, on average.

Roberto L. Peña

Retirement Administrator