GRS
Gabriel Roeder Smith & Company
Consultants & Actuaries
5605 N. MacArthur Blvd.
Suite 870
Irving, TX 75038-2631
469.524.0000 phone
469.524.0003 fax
www.gabrielroeder.com

June 15, 2011

Mr. Oscar K. Shelton
Director of Personnel
City of Warwick - City Hall
3275 Post Road
Warwick, RI 02886

Re: Warkwick MERP - Information Regarding Recommended Assumption and Method Changes

Dear Oscar:

As requested, below is additional information regarding the actuarial assumption and method changes that were incorporated into the actuarial valuation performed as of July 1, 2010.

In determining liabilities and contribution rates for retirement plans, actuaries must make assumptions about the future. These assumptions are continuously reviewed and periodically updated to better estimate the plan's liability and on-going cost. Earlier this year, GRS performed an assumption review for the Employees' Retirement System of Rhode Island (ERSRI), which included a review of the economic and demographic experience of the Rhode Island Municipal Employees' Retirement System (MERS). The study examined the assumptions used for expected investment rate, inflation rate, retirement, mortality, termination, disability, salary increases, payroll growth, and other miscellaneous assumptions. ERSRI has adopted updated assumptions as a result of this analysis. While the City of Warwick Municipal Retirement Plan (Warwick MERP) was not included in this analysis, we believe that the future experience of Warwick MERP, with regard termination, disability, mortality, and compensation increases will be similar to those expected in other municipal retirement systems in Rhode Island. Therefore, we believe these updated assumptions are consistent, reasonable, and more accurately portray the retirement system's liability and cost.

The updated assumptions discussed below are the same as those used to determine the liability and annual pension cost disclosed in our actuarial valuation report dated June 2011. The Board will need to approve and adopt these recommended assumptions as part of process of approving the July 1, 2010 actuarial valuation.

Summary of Assumption Changes

GRS's recommended assumption changes for Warwick MERP include:

1. Decrease the annual investment rate of return (net of expenses) from 8.00% to 7.50%.
2. Change the salary increase assumption from a 5.25% annual increase assumption to a service related assumption that ranges from an 8.0% increase for newly hired members to 4.0% annual increases for members with 15 or more years of service.
3. Decrease the payroll growth assumption from 4.00% to 3.75%. This assumption does not assume any growth in the number of active members.
4. Modify the rates of withdrawal. Rates were increased for members with less than 5 years of service and reduced for members with more than 5 years of service.
5. Increase the rate of retirement for members who attain 80 points before their normal retirement age.
6. Modify the post-termination mortality assumption for retirees to more closely reflect anticipated plan experience and to reflect an assumption of continual future improvement in life expectancy.

The recommended decrease to the annual investment rate of return from 8.00% to 7.50% and the improvement to the mortality assumption had the most significant impact on increasing the plan's liability and cost. Less significant changes were made to termination rates, disability rates, and the rate of salary increases.

The recommendation to decrease the investment return assumption was not based on the recent historical experience of the plan. Rather, it was based by comparing the plan's asset allocation with forward-looking investment return assumptions developed by several recognized investment consulting firms. Decreasing the investment return assumption will increase the likelihood that the plan's future investment experience will meet this assumption and decrease the size of the investment losses during years that actual experience is less than assumed.

The mortality assumption is used to calculate the estimate length of time a retiree's benefit will paid in the future. The longer retirees live and receive their benefits, the larger the liability of the plan, thus increasing the contributions necessary to appropriately fund the plan. The experience study we performed for ERSRI indicated that retirees we living longer than currently assumed. Therefore, we needed to select a new mortality table that better match current life expectancy. Second, we needed to establish a new approach to projecting future increases in life expectancy, since setting a static margin to reflect future anticipated increases in life expectancy has been insufficient to keep up with actual improvements in life expectancy. Therefore, we recommend using an updated mortality table with a generational projection feature that will explicitly project continual increases in life expectancy each year in the future. The following table provides the life expectancy for individuals retiring in future years based on the recommended assumption with a generational projection.

Proposed Life Expectancy for an Age 65 Retiree in Years					
Gender	Year of Retirement				
	2010	2015	2020	2025	2030
Male	18.8	19.2	19.6	19.9	20.3
Female	22.1	22.3	22.5	22.7	23.0

Because this assumption has continuous improvement, life expectancies for today's younger active members are expected to be materially longer than those of today's retirees. Therefore, we expect the mortality assumption to remain appropriate for many years into the future and future periodic updates are expected to result in minor changes in the plan's liability and cost.

Summary of Method Change

In conjunction with this valuation, GRS recommends changing the method for determining the actuarial value of assets (AVA) which is used to determine the contribution rates and funded status of the retirement system. We recommend that the plan use a 5-year smoothed asset value rather than the market value of assets. This smoothed method used to compute the AVA takes the difference between actual earnings and expected earnings (based on the assumed investment return rate) each year, and recognizes the difference over five years, at 20% per year.

A 5-year smoothed value is the most predominate asset valuation method utilized by public sector retirement programs, is used by all the retirement systems that are part of the Employees' Retirement System of Rhode Island (ERSRI), and is used in the City's actuarial valuations of the police and fire plans. The most significant advantage to using this asset valuation method is it reduces the volatility in the contribution rates due to short-term volatility in the plan's investment experience.

Please note that this is a recommended change in the method used to derive the valuation assets, which has historically been based on the market value adjusted for the COLA bank. This change is consistent with the City's other plans is consistent with the ERSRI methodologies. Although this means that recognition of part of the FY 2008-FY2009 investment losses are being deferred, the additional contributions required in future years because of this will in part be offset by the fact that net actuarial losses from 1992 and 1994 will be completely amortized over the next four years, and the charges for these items will disappear from the calculations.

The actuarial value of assets determined above is then further adjusted to reflect the COLA bank. ("Excess" investment returns are "set aside" or "banked" to provide for future retiree cost-of-living

calculations.) As of July 1, 2010, the COLA bank continues to have a negative value. Therefore, there are no amounts subtracted from the valuation asset amount in this valuation, and there will be no COLA provided at July 1, 2011 or July 1, 2012.

Cost Impact

The table below provides a reconciliation of the change in the City's contributions, as a percentage of pay and dollar amount from FY 2011 to FY 2012.

Reason (1)	**Contribution Rate** (2)	**Contribution Amount ($ in millions)** (3)
FY 2011 Contribution	18.7%	$4.1
Actuarial Experience Loss/(Gain)	4.6%	0.8
Change in Employee Contribution Rate	-1.0%	-0.2
Change in Asset Method	-4.5%	-0.9
Change in Actuarial Assumptions	6.2%	1.2
FY 2012 Contribution	24.0%	$5.0

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The undersigned is a member of the American Academy of Actuaries and meet the Qualification Standards of the American Academy of Actuaries to render actuarial opinions about this plan. This communication shall not be construed to provide tax advice, legal advice or investment advice.

I am available to answer any questions in connection with the information provided or the results of the 2010 actuarial valuation at a time of your convenience.

Sincerely,

Joseph P. Newton, FSA, MAAA, EA
Senior Consultant

cc: Mr. Ernest M. Zmyslinski

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