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DATE: December 20, 2011

TO: EDC BOS

RE: Information relative to Agenda Item 20, Retirement Benefits

- 1) A Wall Street Journal article on Rhode Island's comprehensive pension reforms.
- 2) Fresno County's Retirement Review Task Force Findings

Fresno County is stated to have the highest and unattainable benefits in the state, and independent from CALPERS



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A Democrat Bites Union Story

Rhode Island was founded by dissidents espousing freedom of conscience, so perhaps it's fitting that the state's Democrats have bucked their labor allies and passed the most significant pension reform of the last decade. They're saving taxpayers from decades of indentured servitude to pay for public worker retirements.

The Ocean State has been running a \$7 billion unfunded pension liability, one of the largest per capita in the nation, and its annual pension bill was expected to double next year to \$600 million. While public unions wanted to keep partying like it's 1995—when its pension liability was \$1 billion—the state's left-leaning independent Governor Lincoln Chafee and Democratic treasurer Gina Raimondo took a more sober view.

Earlier this year they appointed a 12-member commission to recommend reforms that would reduce the pension bill and shore up retirement funds. Some panel members reported that the state would have to modify current worker and retiree benefits going forward to realize immediate savings. Merely tweaking benefits for new hires wouldn't save much money for another 20 to 30 years.

In contrast to President Obama's decision to ignore his own Bowles-Simpson deficit commission, the Rhode Island reformers then moved to implement these recommendations. What a concept. The reforms suspend annual 3% cost-of-living increases for retirees until the pension funds became solvent, raise the retirement age for most workers to 67 from

62, and shift all workers to a new hybrid pension plan that includes a modest annuity and defined-contribution component. They estimate their plan will lop \$3 billion off the state's unfunded liability and cut its pension bill in half next year.

These reforms are far more comprehensive than those adopted or proposed

in other states. Most have reduced future workers' benefits or required current workers to contribute more to their retirements. Only a handful have modified cost-of-living adjustments, which is where most immediate savings can be found.

A few have established mandatory hybrid or defined-contribution plans for new workers in which employees rather than taxpayers bear most of the risk. However, none have gone as far as Rhode Island and frozen benefits for current workers and shifted them to new plans. This is the most sustainable route, even if it may present legal challenges since some courts have ruled that pensions are contracts that cannot be changed. Modifying current benefits is also the hardest political sale.

Here's the stunner: Unions denounced the reforms as radical and threatened to file suit, but 77 of the state's 94 Democratic lawmakers still voted last week for the legislation with only minor amendments. Both Mr. Chafee and Ms. Raimondo deserve credit for explaining and defending the reforms to the public, which put pressure on lawmakers to go along.

Yes, America, there are courageous Democratic reformers.

In Rhode Island,
liberals take the lead
on pension reform.

WSJ 11-25-11

Submitted by Bernard Carlson
#20

at Board Hearing 1 of 439.30.11

International Trade Forum

The International Trade Forum is a leading platform for discussing global trade issues, including trade agreements, trade policy, and trade law. The forum provides a space for experts and practitioners to share their insights and experiences, and to engage in constructive dialogue. The forum is organized into several sections, including:

- Trade Policy
- Trade Law
- Trade Agreements
- Trade Disputes
- Trade and Development

The forum is a valuable resource for anyone interested in international trade, and it provides a unique opportunity for experts and practitioners to share their knowledge and expertise. The forum is organized into several sections, including:

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FRESNO COUNTY

**RETIREMENT
REVIEW**

**TASK FORCE
FINDINGS**

Presented

March 15, 2011

Fresno County Board of Supervisors

The Fresno County Retirement Review Task Force

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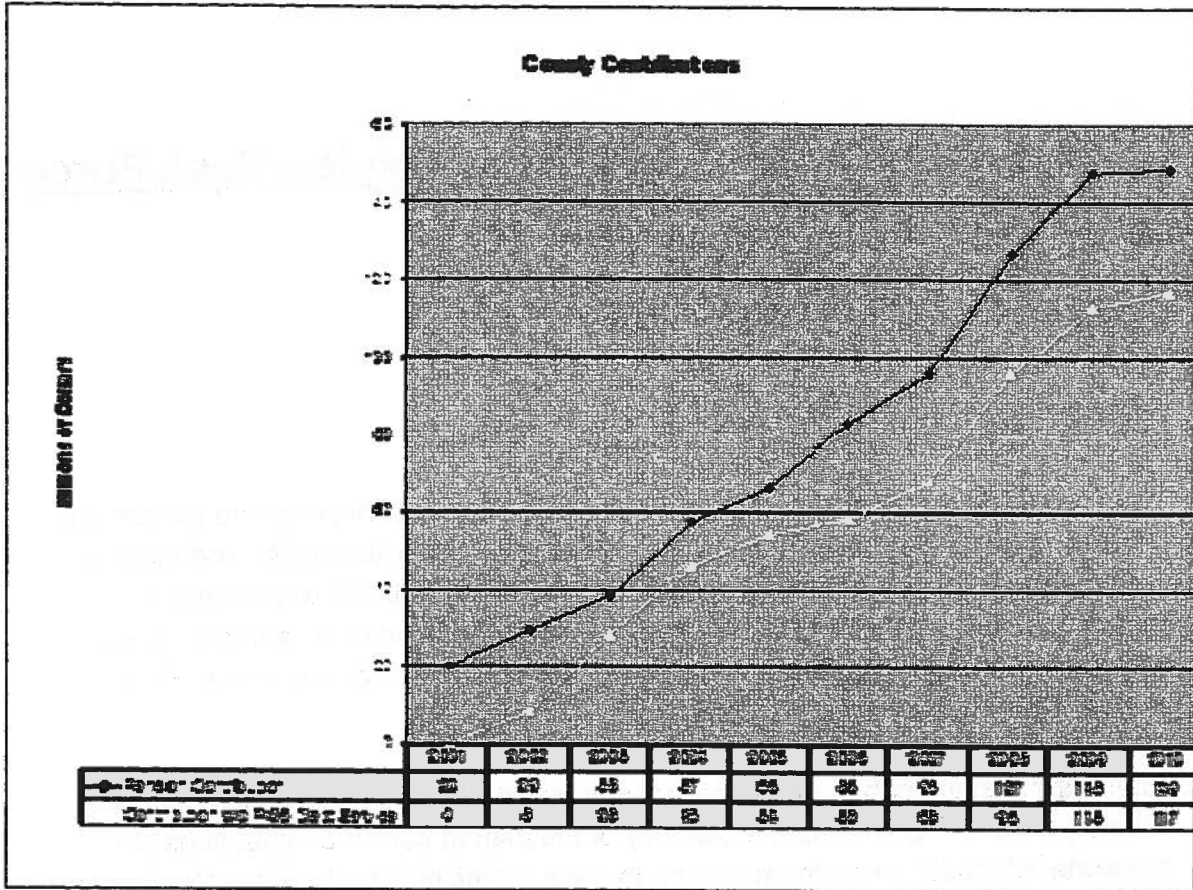
The Fresno County Retirement Review Task Force

Findings

The Fresno County Retirement Review Task Force was convened and tasked with examining the current county pension system, evaluating its viability and making recommendations for potential reforms. It has done so in full awareness of the backdrop of the nationwide municipal government pension crisis and the recent recommendations of the State of California, Little Hoover Commission's, *Public Pensions for Retirement Security Report*.

After careful examination of the current retirement plan and the study of actuarial reports, we find it is beyond the capacity of the plan to collect contributions and generate adequate investment returns to meet promised pension benefits. Between 2001 and 2010, the county's annual pension cost has increased from \$20,333,732 to \$148,756,103, an annual growth rate of over 22%. During the same time period, overall county revenues rose from \$1,055,784,614 in 2001 to \$1,384,446,596, as reported by the Auditor Controller Treasurer Tax Collector, an annual growth rate of only 2.75%. Of the increased revenue during this time, over 25% was used to absorb higher retirement costs.

The country and in particular Fresno County is feeling the effects of the worst recession since the Great Depression, leading to the layoff of county employees and a reduction in county services. Available sources of revenue have declined and are projected to be flat while pension costs continue to rise. The cost of the Fresno County retirement system is unsustainable in its current form.



Defined Benefit vs Defined Contribution Plan

The County Retirement system is a defined benefit program as provided for in California Retirement Law. A defined benefit plan guarantees, the employee will be given an agreed upon percentage of his/her salary, based upon years of service, entry and exit age, and highest final compensation level based on either a one or three year average formula. The level of pension payout is a fixed amount according to formula. The funding sources for these pension benefits are employer contributions, employee contributions, and investment returns. Market fluctuations cause the investment returns to vary widely, impacting the employer's liability while leaving the guaranteed benefit unchanged.

In contrast, a defined contribution plan provides benefits similar to 401(k) plans. It does not guarantee the amount of retirement benefit, only that annual contributions are made according to benefit plan provisions. Typically both employer and employee contribute to the plan although it could be funded either exclusively by the employer or the employee. The contributions are portable. That is, employees make investment

decisions with the funds and can take their contributions along with vested (earned) employer contribution when they leave employment with the sponsor employer. In a defined contribution plan, market fluctuations directly impact the funds available for the retiree's use; they may outlive their retirement resources.

How did we get here?

*The Fresno County Grand Jury Report of 2004 – 2005, stated that,
“Fresno County retirement benefits are the most generous in the State”.*

The Fresno County retirement plan was established as a defined benefit plan based on California state law passed in 1937 known as the 37 Act. Fresno County voters approved implementation of the 37 Act retirement provisions in 1944 and it became effective January 1, 1945. The intention was to provide retirement benefits to government employees who would be encouraged to retire at a suitable age. The retirement benefit provided by governmental agencies also was considered a counter-balance to earlier wages structures in government which, at the time, were lower compared to the private sector. The addition of a pension system had the hoped for effect and functioned efficiently. Appendix A shows a timeline of the significant changes that have impacted the pension system and brought us to where we are today.

The Fresno County Board of Supervisors decides the level of benefits which are offered to Fresno County employees as part of a comprehensive compensation package. In the past, decisions to increase long-term benefits were consistently made without sufficient timely actuarial cost analysis of the long-term results. The Board of Supervisors may elect to participate in the retirement system and top administrative staff are required to be members of the Retirement system. The potential for financial conflict of interest is inherent in the system.

Over the years, compensation negotiations have been dominated by short term budget conditions. In 1975, the county increased its annual percentage contribution to the retirement plan from 50% to 75%, in exchange for salary reductions to meet a budget shortfall. Prior to 1975, County employees shared 50% in the normal cost of the system. Once established, pension benefits are considered vested compensation and cannot be lowered. Changes to benefits for existing employees for future services are limited by state law. Only pension benefits for new hires can be changed after meet and confer with union labor representatives. It might be possible, with employee agreement

and state legislative changes, to lower the benefit for future service of current employees while keeping the benefit which has already been earned.

Due to a number of decisions and events impacting the pension system (see Appendix A for a detailed timeline) the pension plan began to accumulate a significant unfunded liability. Pension Obligation Bonds (POB's) were issued in 1998 in the amount of \$183,637,000 to cover unfunded actuarial accrued liability. Again in 2004, pension obligation bonds were issued for \$402,897,748 to pay for additional unfunded liability. This additional liability was caused by enhanced California Supreme Court Ventura Decision benefits, the Fresno County Ventura Settlement Agreement with county employees, market losses, and mandated changes to actuarial assumptions. Annual debt service on these bonds adds significantly to the county's annual pension costs even though it is not calculated into the annual plan contribution to the Fresno County Employee Retirement Association (FCERA). See Appendix B for a chart, showing the impact of the POB's on the county pension plan cost. Most recently, the record investment losses of 2008 and 2009 had a dramatic negative impact on the unfunded liability of the pension plan.

Investment earnings have not met expectations for the past decade. As reported by the investment consultant for FCERA on December 31, 2010, the ten year average annual investment return was 4.0%, net of fees. The retirement system had projected between 8.42% and 7.75% returns. The funding ratio has declined from a 98.7% in 2000 to a 72.9% in 2010 even with the County issuing \$403 million in bonds in 2004 to cover increased pension costs. If deferred losses were recognized now instead of being deferred over time, the funding ratio would be 62.1%.

Where do we go from here?

“Pension benefits promised to retirees are irrevocable, as are the promised benefits that current workers have accrued since their employment began. It also remains difficult to alter the theoretical, yet-to-be earned benefits for current workers. This situation, reinforced by decades of legal precedent, leaves little room for state and local governments to control mounting retirement costs, particularly when the only venue for change is the bargaining table.”

Little Hoover Commission 2011

Our goal is to find a way to bring the pension plan back onto a sustainable track so that it can continue to meet the promises made to our employees and retirees. At the same time, Fresno County must also continue to provide services and meet the needs of the taxpayers. Any decisions made must balance these two imperatives.

While it is likely that there will be future legislative, judicial or public initiative changes to our current government pension laws, we cannot wait for outside intervention. Our responsibility is to our current employees, retirees, and taxpayers. The current problems must be addressed within the parameters of current law. Whatever proposals are adopted or decisions made, the County Pension Plan must be continually reviewed and adjusted to meet standards going forward.

Proposed Administrative Changes:

Fresno County Employee Retirement Association (FCERA)

FCERA became independent of County operations in 2003 and represents a critical component of the pension plan system. Per the California Constitution,

- (a) The retirement board of a public pension or retirement system shall have the sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system. The retirement board shall also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.

- (b) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.

The independent operation of FCERA is essential to the ongoing health of the pension plan. The management of FCERA is vested in the Board of Retirement which is comprised of the following members:

1. County Treasurer
2. Two members elected by active general members
3. One member elected by active safety members
4. One retired member elected by the retired members
5. Four members appointed by the Board of Supervisors. These members shall be qualified electors of the county who are not connected with county government in any capacity, except one may be a County Supervisor

It is vitally important that all appointments to the FCERA board by the Board of Supervisors are free of conflict of interest. We recommend all future appointees have:

- No current or past employment history with the County or Represented Unions.
- No family member who is a participant in the system.

In addition, the Fresno County Board of Supervisors and the Board of the Fresno County Employees Retirement Association must have clear communication between them. Presentations of annual actuarial reports should be considered before a joint meeting of these two bodies. FCERA should be asked to comment on any potential changes or adjustments to the pension system by the Board of Supervisors.

We also believe that Fresno County should not take a 'pension rate' holiday when market returns are exceeding the projected rate of return. This has been done in the past when investment returns have exceeded expectations. If the pension system is fully funded, annual normal contributions along with employee contributions should continue to be invested in the system. This money should be used to pay for times when market returns do not meet expectations.

We recommend that the Fresno County Board of Supervisors suggest FCERA lower the expected investment rate of return to 7 percent to stabilize the potential for inadequate market returns compared to plan rates. We understand this change will increase unfunded assumed actuarial liability (UAAL), but we feel it better reflects a prudent investment strategy to fund a promised benefit.

Secondary to the lowering of the investment rate, we recommend that Fresno County request the board of FCERA to increase the amortization of the plan's unfunded liability from 15 years to 30. This change in amortization is allowed one time by state law to adapt to a significant pension liability. The Cheiron actuarial study shows that this is the only way Fresno County can continue to pay down the UAAL and meet their existing obligations to provide service to the taxpayers. Illustrations of the actuarial projections are at the end of this report.

Any change to the amortization period should not be taken lightly. FCERA funding policies have a profound affect on the development of the unfunded liability of the county and the required annual payment. Prior to altering the amortization period for the current unfunded liability, FCERA and the Board of Supervisors would need to have full understanding and discussion of this decision and all other changes to funding policies.

A reduction in the expected rate of return prior to altering the amortization period to a level needs to be fully analyzed and carried out. A reduction in the expected rate of return would mitigate the risk of future market driven unfunded liability. It would however also cause an increase in current unfunded liability. The trend among retirement associations is to lower these rates. Not analyzing this change and carrying out a rate of return change prior to extension of the amortization period could negate any benefit to this decision.

The graphs created by Cheiron attached (Appendix C – D) continue with the current assumptions as adopted by FCERA changing only future employee benefit levels and amortization period. Any other expected assumption changes (e.g. rate of return, inflation, salary base increases/decreases, mortality, etc.) would have differing effects on this payment curve and should be analyzed after discussion with FCERA.

Decision Makers and Key Advisors:

Concerns have been raised that the Board of Supervisors and administrative staff have a financial interest in pension decisions. An alternative retirement plan should be considered such as a defined contribution plan for designated decision makers and key advisors. The decision makers and key advisors are defined as:

The Board of Supervisors
The County Counsel Office
The Elected Auditor Controller Treasurer Tax Collector
The County Administrative Officer

Due Diligence:

In order to ensure due diligence, all future proposed retirement benefit changes must be reviewed by a Citizen's Pension Review Panel, prior to approval by the Board of Supervisors. This panel would be appointed by the Board of Supervisors from independent private citizens with experience in the area of pension plans. Past and current Fresno County employees and their family members and anyone with a financial interest in the pension plan would be prohibited from serving on this review panel. The panel would have a maximum of six months to review the proposed benefit changes and present their findings. The panel may request an actuarial study or independent legal review prior to making their report. Actuarial and legal costs would be borne by the County and the panel members would serve without compensation.

Additionally, any new retirement benefit changes should be vetted through joint discussion between FCERA and The Board of Supervisors. Both organizations should share analysis from their respective experts to ensure that any change is feasible and protects the viability of the retirement system and the County of Fresno.

Changes for New Employees:

We propose closing all existing tiers in the retirement plan to new members. We propose the adoption of a hybrid pension plan, similar to the one recently adopted in Kern County. This is a combination of a defined benefit plan with a defined contribution component. The employee's social security benefit should be included in their defined benefit plan calculation and fully integrated.

This proposal gives the employee the option of achieving a maximum retirement benefit, comparable to the existing plan, but with more flexibility. The employee could adjust their contributions to the DC part of the plan as their individual circumstances required. It would also make those DC contributions easily portable to other plans as they change jobs in the future. The county would have the flexibility to increase or decrease the matching component as part of their regular collective bargaining process going forward.

For safety employees, a return to the "Pre-Ventura" formula defined benefit formula is recommended. Within the 1937 Act there are limited options for safety employee formulas. The Act does not give the flexibility to provide a hybrid model at this time for safety employees.

According to the study performed by the actuarial firm Cheiron, the cost savings per new General employee entering into a "Kern" tier would be approximately 4% of salary. For the average tier 3 employee this amounts to approximately \$1640 per employee per year. This assumes a 6% County of Fresno match to the DB plan as is done in Kern County. The amount of County match could be negotiated between the County and its employees on an annual basis.

From the same report the cost savings on a new Safety employee would equate to 10.7% of salary. Using FCERA average compensation for a Safety Tier 2 employee, this would be a savings of approximately \$7,490 per employee per year.

Current Employees and Retirees:

If possible within current law, we would like to give existing employees the option of freezing their current pension plan, keeping the benefits they have accrued to date, and moving into the new hybrid plan for future benefits. This could be particularly attractive to those employees who do not plan to retire from Fresno County employment and those who due to personal circumstances would prefer to pay a lower pension contribution.

We recommend that Fresno County negotiate the pension plan contribution split, for the existing defined benefit tiers, to the pre-Ventura plan level of an approximately equal split between employer and employee. We recommend Fresno County retirement benefits for all future retirees are calculated on a three-year average of highest paid salary. Although some steps have already been taken, we recommend there be additional, special attention paid to the rules against salary spiking for benefit calculation purposes.

Appendix A

1944: Fresno County voters approved a defined benefit pension program for Fresno County employees.

1975: County employee salaries were reduced in exchange for changing the share of pension cost from 50% employer:50% employee to 75% employer:25% employee. This eliminated a short-term budget shortfall but no actuarial study was done to determine the future effects on county pension costs.

7/1/1996: General Accounting Standards Board (GASB) statement 25 and statement 28 were adopted by the Retirement Association as required by law. Assets were restated at fair market value instead of amortized cost value.

8/27/1996: The County implemented a merger of Valley Medical Center with Community Hospital. According to the 1998 CAFR of the Retirement Association (FCERA), this transaction provided golden handshakes in the form of additional retirement credit to terminated employees, increased the number of retirees by 10%, increased the number of deferred retirement members who were eligible for retirement benefits in the future by 49%, and decreased general active members by 21%.

8/14/1997: The California Supreme Court issued a decision in a case entitled Ventura County Deputy Sheriff's Association vs. Board of Retirement of Ventura County Employees' Retirement Association (known as the Ventura case). The Supreme Court held that a County retirement system operating under the provisions of the 1937 Act must include certain types of cash incentive payments and additional pay elements received by an employee, within the employee's "compensation earnable" and "final compensation" when calculating the employee's retirement benefits. The Fresno County Employee Retirement Association implemented the changes as of October 1, 1997. The initial actuarial report concluded that the Supreme Court decision would result in \$660,000 increase in County normal contribution for employee retirement and a \$6.4 million increase in the County's unfunded liability.

2/23/1998: Fresno County employees filed a lawsuit against Fresno County and the Fresno County Retirement Board. There were similar lawsuits filed against many of the twenty counties who had 37 Act retirement plans. This lawsuit sought additional pay categories for inclusion in the calculation of final compensation, including county paid health insurance premiums and county paid retirement contributions. Other labor

organizations joined in the lawsuit and the lawsuit became a class action suit. These lawsuits also sought retroactive application of the Ventura decision so that all retirees would benefit, not just those retiring on or after the October 1, 1997 effective date.

3/19/1998: Pension obligation bonds (POBs) were issued for \$183,637,000 in response to an unfunded assumed actuarial liability increase caused by the termination of Valley Medical Center, the remaining amortization of a higher benefit approved earlier by the County, and the new GASB 25 pronouncement to determine unfunded liability as per the minutes of the 8/8/1997 Debt Advisory Committee meeting.

6/24/1999: Fresno County employees filed a lawsuit against the Retirement Board, the Board of Supervisors, and Fresno County challenging the distribution of retirement fund surplus in 1997 and 1999. During this time, Fresno County used the earnings in excess of the assumed rate of market return to cover the employer share of cost for retirement benefits. The labor representatives charged that the County was not meeting its legal obligation to make employer contributions to the retirement fund.

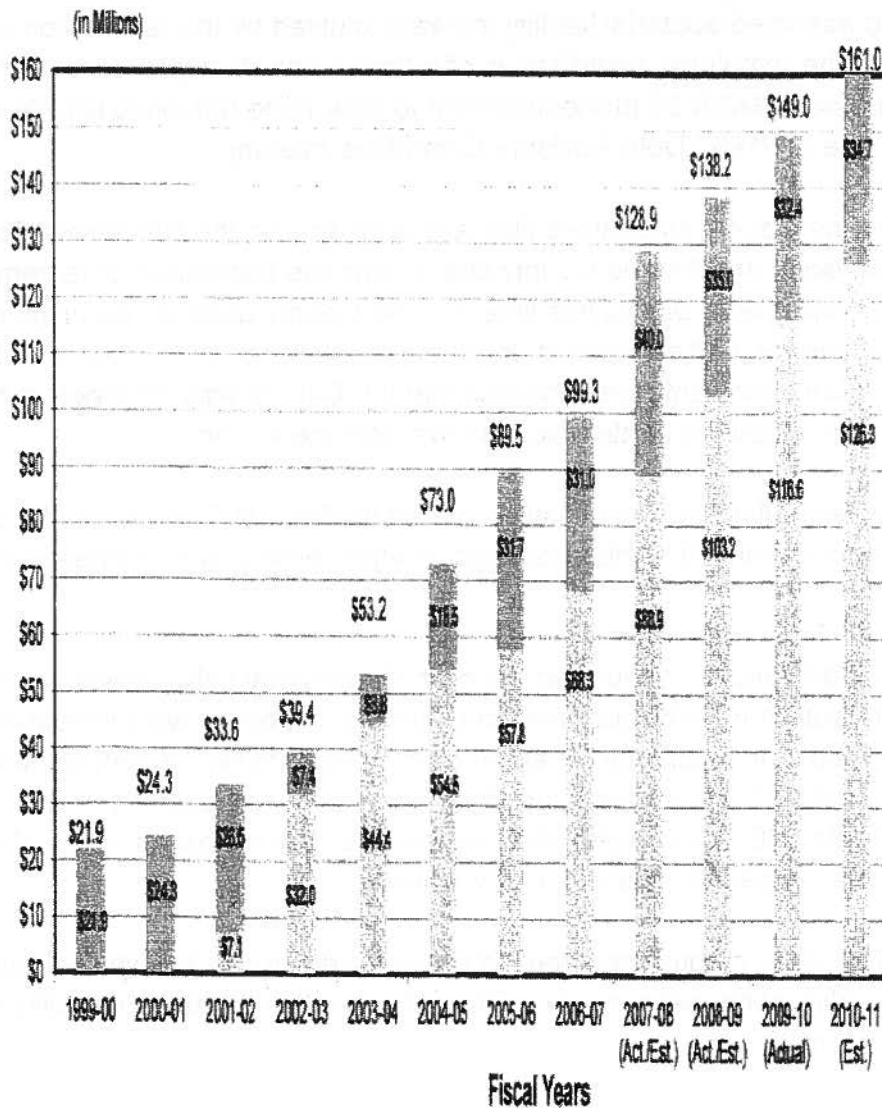
3/10/2004: Pension obligation bonds were issued for \$402,897,748 to pay for unfunded liability caused by enhanced Ventura benefits, market losses, and changes to actuarial assumptions.

6/30/2008: Actuarial report recognized the cost of additional salary steps (higher salary levels for some positions, to be achieved over time) plus cost of living increases for employees agreed to in exchange for an addition retirement tier for new employees. According to the 6/30/2008 actuarial report (p. 34), unfunded assumed actuarial liability increased \$22,384,000 due to higher than expected salary increases, and \$11,941,000 due to higher than expected liability for new retirees.

2008-2009: The stock market experienced the worst down turn in history negatively impacting the value of the pension plan. The effects of this dramatic loss will be felt for many years to come.

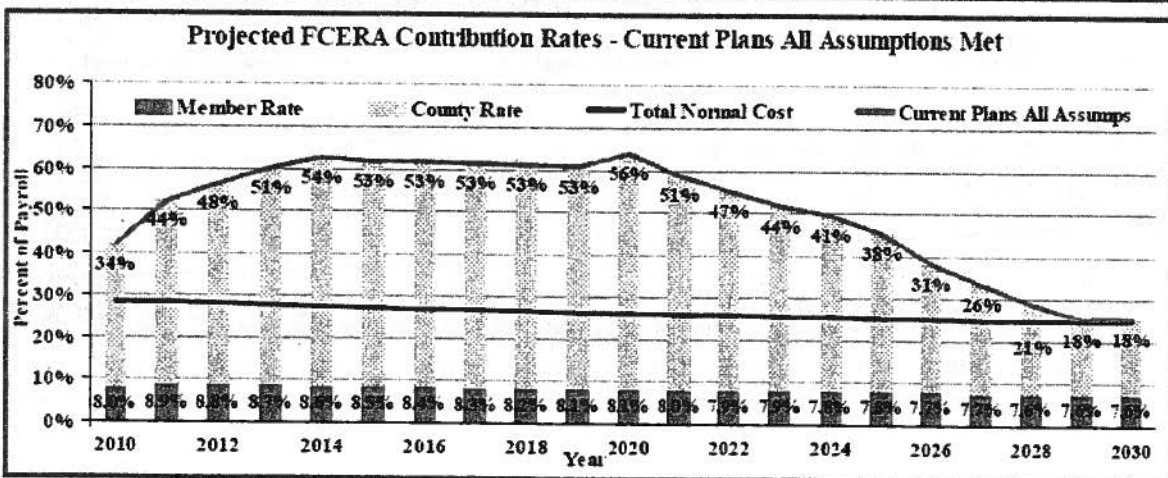
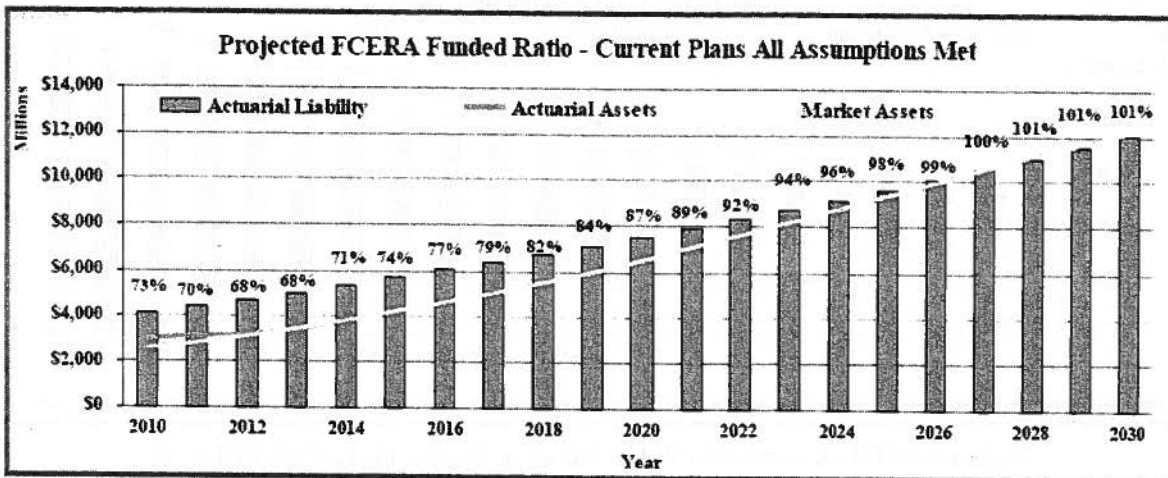
Appendix B

RETIREMENT COST TO FRESNO COUNTY



Employer Retirement Contributions to FCERA POB Debt Service

Appendix C



Appendix D

